

Who We Are and What We Do

The Securities and Futures Commission (SFC) is an independent statutory body established by the Securities and Futures Commission Ordinance (SFCO). The SFCO and nine other securities and futures related ordinances were consolidated into the Securities and Futures Ordinance (SFO), which came into operation on 1 April 2003.

We are responsible for administering the laws governing the securities and futures markets in Hong Kong and facilitating and encouraging the development of these markets.

Our statutory regulatory objectives as set out in the SFO are:

- >> to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;
- >> to promote understanding by the public of the operation and functioning of the securities and futures industry;
- >> to provide protection for members of the public investing in or holding financial products;
- >> to minimise crime and misconduct in the securities and futures industry;
- >> to reduce systemic risks in the securities and futures industry; and
- >> to assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry.

In carrying out our mission, we aim to ensure Hong Kong's continued success and development as an international financial centre.

The SFC is divided into four operational divisions: Corporate Finance, Intermediaries and Investment Products, Enforcement, and Supervision of Markets. The Commission is supported by the Legal Services Division and Corporate Affairs Division. Each division has distinct responsibilities.

Contents

Regulating for Better Markets 15 Years of SFC

There is an old Chinese saying: 10 years to grow a tree; 100 years to grow a man. An institution is like a tree. This cover of the Annual Report is the Chinese Banyan (*Ficus microcarpa*), commonly known as the Small-leaved Banyan, a species that can be easily found in Hong Kong. The tree can grow to a height of 20m, with a 30m wide crown spread. The cover photographs show the tree from a seedling, to seven years of age, and then to 15 years. As in the case of the Chinese Banyan, which can easily live to 500 years, 15 years is a short time for an institution like the SFC.

>> Corporate Review

2-7	Chairman's Statement
8	Whom and How We Regulate
9	How We Are Organised
10-11	Directors of the Commission
12-19	Corporate Governance and the SFC
20-21	Achievements and Work in Progress
22-23	Implementation of the Securities and Futures Ordinance
24-25	Three-year Comparisons
26-27	Significant Events 2003-2004

>> Divisional Reports

28-33	Corporate Finance
34-45	Intermediaries and Investment Products
46-55	Enforcement
56-61	Supervision of Markets
62-65	Legal Services
66-73	Corporate Affairs
74-77	Cross-Border Regulatory Co-operation

>> Financial Statements

78-95	Securities and Futures Commission Financial Statements
96-106	Investor Compensation Fund Financial Statements
107-119	Unified Exchange Compensation Fund Financial Statements
120-130	Commodity Exchange Compensation Fund Financial Statements
131-139	Committees, Panels and Tribunal
140	Consultations, Codes and Guidelines
141-144	Index

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

Chairman's Statement



»» How is the SFC going forward after 15 years?
In short, we are here to regulate so we have
better markets.

This Statement Is About

- »» The market in 2003-2004
- »» The Commission's finances
- »» 2003-2004 operational review
- »» 15 years of SFC
- »» Going forward
- »» The SFC tree

Introduction

2003 was a year of major social and economic drama and recovery. As part of the community, the Securities and Futures Commission, with its operations being so closely related to the market and the public, shared the concerns experienced by the Hong Kong people.

In the first half of 2003, the SARS epidemic took away many lives and disrupted many aspects of social and economic activities in Hong Kong and other affected places. Fortunately, Commission staff were not affected but many recognised how important it was to share as a community. Last year, we formed a volunteer service team and did our share to care for the community. You will read more of this later in the chapter on *Corporate Affairs*.

The Market in 2003-2004

After more than three years of retreat from the technology bubble of March 2000, the outbreak of SARS added pressure to the securities and futures markets in Hong Kong. The Hang Seng Index reached a 54-month low of 8,409 on 25 April 2003; market turnover shrank to as low as \$5.4 billion on 22 April. However, as the summer months approached and the epidemic receded, market confidence recovered rapidly.

In addition, the local economy received a boost on the signing of the Closer Economic Partnership Arrangement (CEPA) between the Mainland and Hong Kong. The relaxation of Mainland travel rules also benefited the retail, hotel and other tourism related sectors. The Hong Kong market essentially recovered with global markets as they benefited from historically low interest rates.

The HSI rose to an intra-year high of 13,928 on 18 February 2004. At the financial year-end, the HSI closed at 12,682, rising 47% during the year. Average daily market turnover increased to \$17.1 billion in March 2004, from \$7.3 billion in April 2003.

Last year also saw strong investor interest in H-shares and IPO activities. The H-share index surged 118% during the year, while the average daily turnover of H-shares increased to \$4.3 billion in March 2004, from \$0.8 billion a year ago.

There were 75 IPOs last year raising \$76.4 billion - the largest amount after the \$132 billion in 2000-2001 - of which 61% was for H-share companies.

As of the end of March 2004, there were 1,048 companies listed on the stock exchange with a total market capitalisation of \$5,769.5 billion (US\$740.8 billion), soaring 68% from last year. Hong Kong was the eighth largest market in the world by market capitalisation, advancing three places when compared to a year ago.

In 2003-2004, the average daily turnover on the Hong Kong market more than doubled the previous year's to \$13.8 billion. About 11% was contributed by derivative warrants. Hong Kong was the second most active derivative warrants market in the world last year by turnover. Trading of futures and options was also robust, with a total of 16.2 million contracts traded, 37% higher than the year before.

The Commission's Finances

After two years of deficit result, we turned in a surplus for 2003-2004. Improved stock market turnover, hence levy income which is our major source of revenue, lifted total revenue to \$551 million. This was an increase of 63% or \$213 million from the previous year. Nevertheless, we have not slackened in cost controls. Total operating expenditure after depreciation edged up by 7% to \$426 million, mainly because of one-off office relocation expenditure and additional staff costs for new functions. Excluding these expenditures, the increase was 2% or \$7.4 million.

The surplus contrasted with an original projected deficit of \$93 million. Reserves at the end of March 2004 stood at \$691 million.

Chairman's Statement

We have forecast an operating surplus of \$4 million for 2004-2005. This reverses a 10-year string of budgeted deficits. There are more financial details in the chapter on *Corporate Affairs*.

2003-2004 Operational Review

The single most important event that shaped the work of the Commission last year was the commencement of the Securities and Futures Ordinance (SFO) on 1 April 2003.

I am pleased to report that the primary law and the comprehensive body of subsidiary legislation underpinning it have been implemented successfully. The key achievements are set out in a special chapter in this Annual Report.

Last year, we promised to strengthen enforcement and combat corporate misconduct as a matter of priority. We had 60% more successful prosecutions of various offences, and started 10 new investigations into listed companies under extended powers of the SFO. Our efforts will continue with increasing emphasis on back-end enforcement in regulation of listing.

Moreover, the rising market and trading volume on the stock exchange improved the bottom line of intermediaries. Net profit for the 12 months to end-2003 for securities dealers and securities margin financiers jumped 3.6 times to \$6,788 million from the previous year. Total shareholders' funds rose by 23%, with return on shareholders' fund as of 31 December 2003 increasing to 10.7% from 3.6% in 2002. All categories of Stock Exchange Participants did better last year. 36 brokers left the industry in an orderly manner as part of the consolidation in the industry.

There are more details provided in the Divisional Reports. In addition, the Commission made progress in many initiatives and projects, such as:

- Move to strengthen regulation of sponsors and independent financial advisers;
- Mutual recognition with our Mainland counterpart of industry qualifications under CEPA;
- Consultation on analysts conflicts of interest;
- A new Code on Real Estate Investment Trusts and authorisation guidelines for index-tracking exchange traded funds;
- Completion of working group discussions on measures to address the risk of pooling and repledging of client securities by securities margin financiers; and
- Agreement with HKEx on the way forward for both scripless and investor participation account enhancements, including oversight of successful launch of new stock and derivatives clearing systems (CCASS/3 and DCASS) that significantly improved Hong Kong's market infrastructure.

15 Years of SFC

On 1 May 2004, the Commission would have celebrated its 15th anniversary of establishment. There is a Chinese saying that it takes 10 years to grow a tree, but 100 years to grow a man. Fifteen years are therefore a short history for an institution that was born out of a financial crisis. It has grown from strength to strength through broadly three five-year stages.

The SFC was established on 1 May 1989 based on the blueprint of the *Securities Review Committee Report*, written by the Committee chaired by Mr Ian Hay Davison, which was commissioned by the Hong Kong Government after the market crash of October 1987. The Report set out the organisation structure of a new independent market regulator and the broad regulatory framework of the securities and futures industry in Hong Kong. Mr Robert Owen led the SFC from its

provisional status to its formal establishment under the Securities and Futures Commission Ordinance, and became the first Chairman.

In the first five years (1989 - 1994), various major rules, codes and guidelines were introduced. These included those that set the standards for and governed the conduct and financial resources of industry practitioners and those that facilitated the development of products in the market (e.g. the Code on Unit Trusts and Mutual Funds). The Insider Dealing Tribunal began life in 1991 to tackle insider dealing offences. The Commission also established memoranda of understanding with the stock exchange and the central clearing body.

Under the second Chairman, Mr Robert Nottle, the Commission consolidated its position as the securities market regulator, working closely with the stock exchange, and signed the important regulatory co-operation agreement with the Mainland authorities in 1993 that marked the beginning of the H-share and red chip market.

The second stage (1994 - 1999), especially in its early part, was marked by the Commission's more active international participation and closer relationship with its counterparts in the leading markets, spurred partly by the Barings crisis.

Our third Chairman, Mr Anthony Neoh, was in 1996 appointed Chairman of the International Organization of Securities Commissions' (IOSCO) Technical Committee. He also led the initiatives in improving investor education in Hong Kong. In 1996, a consultation paper was issued on a draft composite Securities and Futures Bill, one of the core recommendations of the *Davison Report*.

1997 marked a year of booming markets, the return of Hong Kong to China, but also the beginning of the Asian financial crisis. The first half of 1998 witnessed the failure of Peregrine Holdings and C.A. Pacific, and

in August 1998, the HKSAR Government intervened in the stock market to prevent destabilisation by excessive speculative activities. The stage was set for a three-pronged reform of the securities and futures markets announced by the Government in March 1999.

I was privileged to become the fourth Chairman of the Commission in 1998 and my tasks were to implement these major reforms in the last five years (1999 - 2004). By March 2000, the stock and futures exchanges were demutualised and merged with their clearing houses to form Hong Kong Exchanges and Clearing Ltd (HKEx). Secondly, thanks to tremendous support from the Financial Services and the Treasury Bureau and the Department of Justice, as well as the input of market participants, the SFO successfully commenced operation a year ago. Thirdly, significant progress has also been made in the development of world class financial infrastructure through the implementation of fourth generation trading and clearing systems, as well as improved networks that make Hong Kong's financial infrastructure one of the most modern in major markets.

Perhaps one of the most significant changes since the launch of the GEM market in 1999, which coincided with the technology bubble, was the clarification of the role of the regulatory structure in the securities and futures markets to tackle financial and corporate misconduct. The Penny Stock Incident in 2002 led to a comprehensive and intensive public debate on the appropriate alignment of the regulatory structure in Hong Kong, against the background of major changes in the US, UK and Australia.

With the coming of the SFO, which introduced Dual Filing, and the recent announcement by the Government to give statutory backing to important listing requirements, the Commission has now a clear mandate as the statutory regulator of corporate disclosure.

Chairman's Statement

Going Forward

How is the SFC going forward after 15 years? In short, we are here to regulate so we have better markets.

The SFO has been smoothly implemented for just over a year. Through extensive soft and formal consultations with the market, we will continue to ensure that the new regulatory framework will give an appropriate level of protection to the investing public, without undue regulatory burden on market intermediaries and issuers. A review of the SFO is underway to make improvements where necessary.

It is vitally important that we must improve the quality of the market for Hong Kong to maintain its position as an international financial centre and capital raising hub of China. The responsibility for a high quality market depends on vigilance at all levels: investors, issuers, intermediaries, regulators and the media.

Information is a market fundamental. Investors must be given material, accurate, full and timely information to make investment decisions. Listed company disclosure should carry statutory liabilities with credible sanctions. In this regard, the Commission is pleased that the Government has decided on measures to improve the regulation of listing that gives statutory backing to important listing requirements.

A primary task for the Commission in the next few months is to work with the Government and HKEx to ensure that the reform can be achieved as quickly as practicable. This includes the drafting of rules under the SFO to codify certain important listing requirements, and implementation of administrative measures to improve the accountability and transparency of the listing regime.

This year, we demonstrate support for the market's effort in improving corporate governance by upgrading our own corporate governance disclosure.

Meanwhile, the SFC will continue to contribute towards IOSCO's activities in the run up to and no doubt after its

Annual Conference in 2006, which will be held for the first time in Hong Kong. I was honoured to be appointed Interim Chairman of its Technical Committee last October.

The SFC Tree

The SFC, like any institution, is like a tree. The roots, branches and leaves are its people. Their talent, energy and creativity are what make the tree grow and prosper. But the tree derives its nourishment from the ground, the community it grows in. Hence, at the 15th anniversary of its history, the SFC cannot forget the contributions of its staff, nor the community that it has responsibility to.

I would therefore like to pay tribute to the dedication and hard work of all staff, who rode out of the SARS threat stronger and more united. Their health condition and peace of mind, and their well being in the workplace, remain a top priority.

Since his arrival last May, our new Chief Operating Officer/Executive Director, Mr Peter Au-Yang, has ably helped to strengthen internal governance and administration. One of his major responsibilities is to develop training, career building and staff incentives programmes to ensure that the SFC continues to be an attractive place to retain and attract the right blend of regulatory and market expertise that delivers its services to the community efficiently and cost-effectively.

The staff strength at the end of March 2004 was 416, rising from 403 in the previous year to cope with increased workload and new functions.

We were sorry to lose two Senior Directors, Ms Stella Leung and Mr Gerald Greiner, in the past few months. Ms Leung left us to spend more time with her family abroad and Mr Greiner left to become the Deputy Chief Operating Officer of HKEx.

Two Directors on short term secondment assisted the World Bank last year on a technical assistance programme to India on capital market development. We continued to exchange staff with the China Securities Regulatory Commission in order to strengthen our ties and deepen understanding of each other's regulatory functions and work.

The Commission is pleased that our administration senior manager, Mr Patrick Cheung, was awarded the Bronze Bauhinia Star last July by the HKSAR Government for his dedicated and meritorious service in the Civil Aid Service. Mr Cheung oversaw the seamless relocation of our offices of the last 12 years to our new premises in Chater House. We would like to place on record our appreciation to all staff, contractors and our landlord for their efforts in moving with no interruption to our normal operations and services. From our staff opinion survey, staff are happy with the modern and user-friendly environment.

With respect to the Board, Dr York Liao was appointed in May as a new Non-Executive Director (NED), resulting in a Board with NEDs in majority, as required under the SFO.

Our longest serving NED, Mr Henry Fan, retired from his SFC position last November. He was succeeded by Mr Christopher Cheng. I want to pay tribute to the dedicated services of Mr Fan, who has unstintingly provided to the Commission the breadth and depth of his corporate and legal experience since 1995. Much of the achievements of the Commission is owed to the selfless wisdom of the NEDs, who have contributed to more market-oriented policies and strengthening of the institution as a whole.

We would also like to record our appreciation and thanks to the members of the Advisory Committee and all other SFC Committees, Panels, and Groups, who have contributed their experience and insights into helping the Commission achieve its regulatory goals.

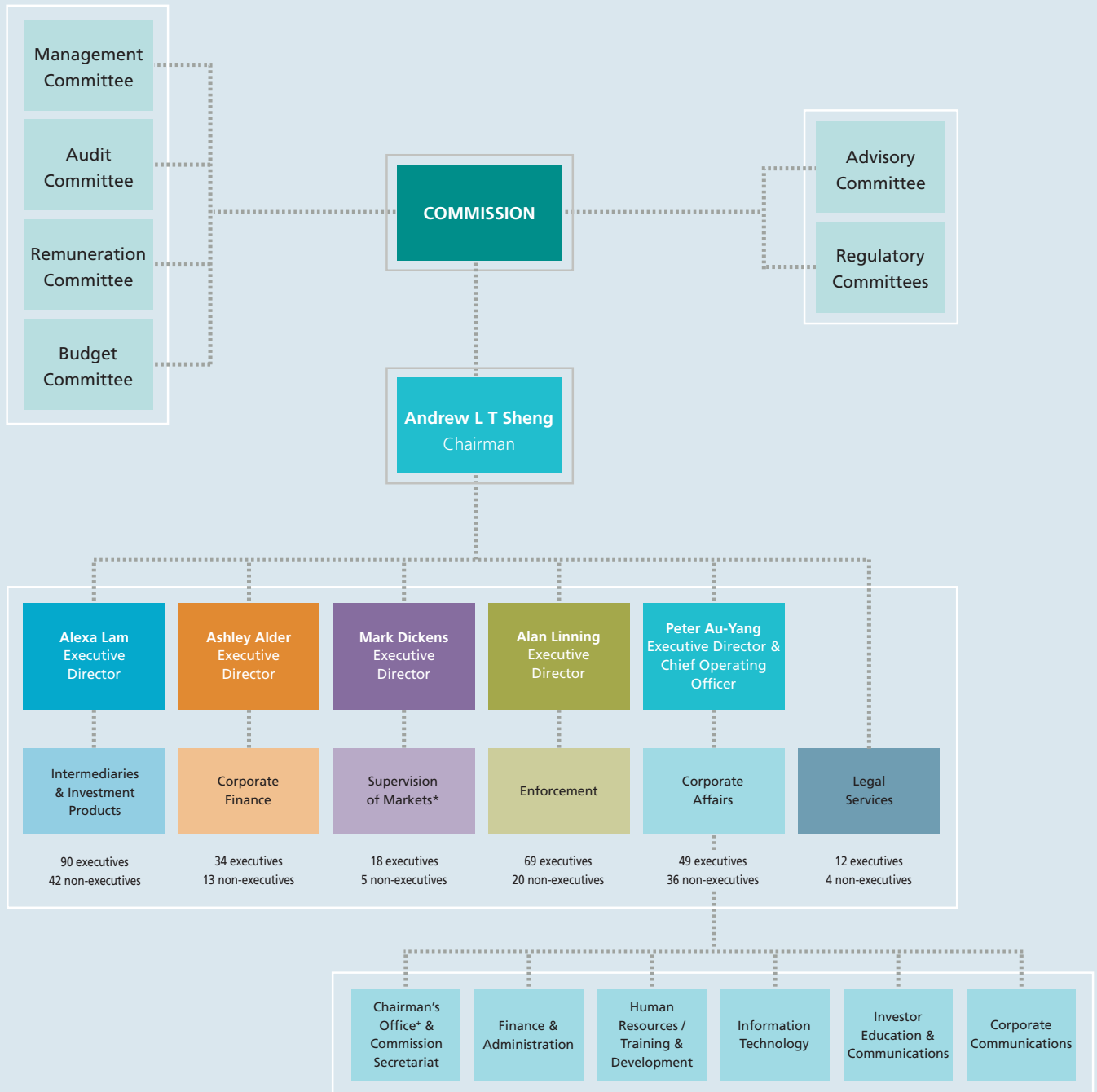
Andrew L T Sheng
Chairman

Whom and How We Regulate

Whom We Regulate	How We Do It
<p>>> Licensed corporations and individuals carrying out the following regulated activities:</p> <ul style="list-style-type: none"> ■ Dealing in securities ■ Dealing in futures contracts ■ Leveraged foreign exchange trading ■ Advising on securities ■ Advising on futures contracts ■ Advising on corporate finance ■ Providing automated trading services ■ Securities margin financing ■ Asset management 	<ul style="list-style-type: none"> ■ Set licensing standards to ensure that all practitioners are fit and proper ■ Approve licences and maintain a public register of licensees ■ Issue codes and guidelines to inform the industry of its expected standard of conduct ■ Ensure licensees' financial soundness and compliance with ordinances, codes, guidelines, rules and regulations ■ Set standards for the authorisation and operation of investment products ■ Authorise investment products and their promotion ■ Handle misconduct complaints against licensed persons ■ Investigate and take action against misconduct
<p>>> Hong Kong Exchanges and Clearing Ltd (HKEx)</p>	<ul style="list-style-type: none"> ■ Oversee the performance of its role as the frontline regulator of listing-related matters ■ Approve the creation of new markets, new products and changes to its rules and regulations ■ Monitor HKEx's own compliance with Listing Rules ■ Monitor the trading of shares, options and futures on its markets ■ Oversee its systems and technology
<p>>> Listed companies</p>	<ul style="list-style-type: none"> ■ Approve changes to the Listing Rules ■ Monitor announcements and vet listing application materials under the Dual Filing regime ■ Administer the takeovers and share repurchases codes ■ Monitor share dealings of directors and substantial shareholders ■ Monitor share buy-backs by listed companies ■ Consider exemptions of prospectus requirements ■ Investigate listed companies suspected of prejudicial or fraudulent transactions
<p>>> Approved share registrars</p>	<ul style="list-style-type: none"> ■ Approve the Federation of Share Registrars as an association whose members shall be approved share registrars ■ Require approved share registrars to comply with the requirements of the Code of Conduct for Share Registrars
<p>>> Investor Compensation Company Ltd (ICC)</p>	<ul style="list-style-type: none"> ■ Recognise the ICC as an independent compensation company ■ Approve the rules and any amendment of rules of the ICC ■ Require the ICC to prepare and regularly submit financial statements, auditors' report and other documents to the SFC
<p>>> All participants in trading activities</p>	<ul style="list-style-type: none"> ■ Monitor unusual market movements and direct trade suspension of related stocks to maintain an informed and orderly market ■ Investigate and take action against market misconduct, and other breaches of the law

How We Are Organised

>> To fulfil its functions, the SFC is divided into four operational divisions: Corporate Finance, Intermediaries and Investment Products, Enforcement, and Supervision of Markets. The Commission is supported by the Legal Services Division and Corporate Affairs Division.



Numbers of executives/non-executives refer to permanent established posts.
 * Including Research Department
 + Including China Policy team and Corporate Planning team

Directors of the Commission

➤ Under the SFO, there must be no fewer than eight members of the Commission, and the majority must be Non-Executive Directors. All Directors of the Commission are appointed by the HKSAR Chief Executive or the Financial Secretary with the delegated authority by the Chief Executive. The Commission has a number of statutory functions and also formulates overall policy and strategy.

As of 31 March 2004, the Commission consisted of 13 Directors, of whom six were Executive Directors and seven were Non-Executive Directors. Last year the Commission met on 12 occasions.

EXECUTIVE DIRECTORS



Andrew L T Sheng, SBS, JP

Chairman

(From 1 October 1998. Current appointment expires on 30 September 2005.)

Chartered Accountant; Interim Chairman, IOSCO Technical Committee (October 2003 – May 2004); Deputy Chief Executive, Hong Kong Monetary Authority (1993-1998); Central Bank of Malaysia (1976-1993 including a secondment to the World Bank, Washington, D.C. between 1989 and 1993).

Also sits on Advisory Committee, Budget Committee and Management Committee.



Mark Dickens, JP

Executive Director, Supervision of Markets Division

(From 1 April 1999. Current appointment expires on 31 March 2005.)

Director, Investor Compensation Company Ltd; Director, FinNet Ltd; SFC: Executive Director of Enforcement (1997-1999), Senior Director of Corporate Finance (1992-1996), Assistant Director of Corporate Finance (1991-1992); Australian National Companies and Securities Commission, including General Counsel and Senior Director, Market Supervision (1980-1991).

Also sits on Budget Committee, Management Committee, Futures Compensation Fund Committee, Investor Compensation Fund Committee, Securities Compensation Fund Committee, and SFC (HKEC Listing) Committee.



Alexa Lam

Executive Director, Intermediaries and Investment Products Division

(From 1 December 2001. Current appointment expires on 28 February 2005.)

SFC: Executive Director and Chief Counsel (March – November 2001), Chief Counsel (1999-2001), Senior Adviser – Chairman's Office (1998-1999); Visiting Lecturer, Faculty of Law, University of Hong Kong (1997-1998); Private law practice in Hong Kong, New York and Chicago (1981-1997).

Also sits on Advisory Committee, Management Committee, Academic and Accreditation Advisory Committee, Committee on Investment-Linked Assurance and Pooled Retirement Funds, Committee on Real Estate Investment Trusts, Committee on Unit Trusts, Futures Compensation Fund Committee, Investor Compensation Fund Committee, Investor Education Advisory Committee (to 15.06.03), Securities Compensation Fund Committee and SFC (HKEC Listing) Committee.



Ashley Alder

Executive Director, Corporate Finance Division

(From 1 October 2001. Current appointment expires on 30 September 2004.)

Partner, Herbert Smith (1984-2001); Partner (1994-2001); Solicitor admitted to practice in England and Wales in 1986 and Hong Kong in 1990.

Also sits on Advisory Committee, Management Committee and Shareholders Group.



Alan Linning

Executive Director, Enforcement Division

(From 1 November 2001. Current appointment expires on 31 October 2004.)

Partner, Dispute Resolution Practice Group, Baker and McKenzie, Hong Kong (1993-2001); Solicitor admitted to practice in Scotland in 1985 and Hong Kong in 1988; Member of Solicitors Disciplinary Tribunal.

Also sits on Management Committee and SFC (HKEC Listing) Committee.



Peter Au-Yang

Executive Director and Chief Operating Officer

(From 26 May 2003. Current appointment expires on 25 May 2006.)

Co-Head – Investment Banking, Asia Pacific, The Hongkong and Shanghai Banking Corporation Ltd (1985-2003; Co-Head (2001-2002))

Also sits on Budget Committee (from 17.11.03), Management Committee (from 26.05.03), and Investor Education Advisory Committee (from 16.06.03).

NON-EXECUTIVE DIRECTORS



Henry H L Fan, SBS, JP

(From 15 November 1995. Appointment expired on 14 November 2003.)

Managing Director, CITIC Pacific Ltd; Deputy Chairman, Cathay Pacific Airways Ltd; Member, Standing Committee on Judicial Salaries and Conditions of Service; Director, Hong Kong Science & Technology Parks Corporation; Treasurer, University of Hong Kong.

Also sits on Budget Committee (to 14.11.03), Remuneration Committee (to 14.11.03), Share Registrars' Disciplinary Committee, Takeovers and Mergers Panel, and Takeovers Appeal Committee (from 01.04.03).



Daniel R Fung, SBS, SC

(From 1 January 1999. Current appointment expires on 31 December 2004.)

Queen's Counsel (1990); Senior Counsel (1997); Former Solicitor General (1994-1998); Member, Central Policy Unit (1993-1994); Member, Basic Law Consultative Committee (1985-1990); Chairman, Broadcasting Authority; Board Member, Airport Authority (1999); Chairman, East-West Strategic Development Commission; President, China Law Council; President, International Law Association Hong Kong Branch; Vice President, Academy of Experts; Member of the World Bank International Advisory Council on Law and Justice; International Consultant to the UNDP on Corporate Governance in the PRC and on Rule of Law Programme in Cambodia and in Laos; Member, Chinese People's Political Consultative Conference.

Also sits on Remuneration Committee.



Anna H Y Wu, SBS, JP

(From 1 January 1999. Current appointment expires on 31 December 2004.)

Non-Executive Director, Mandatory Provident Fund Schemes Authority; Chairperson, University of Hong Kong Academic Board for the Postgraduate Certificate in Laws (PCLL); Adviser, Shantou University Law School; Member, Council of Lingnan University; Chairperson, Investor Compensation Company Ltd; Member, Legislative Council (1993-1995); Chairman, Consumer Council (1997-1999); Chairman, Operations Review Committee of Independent Commission Against Corruption (1997-2002); Chairperson, Equal Opportunities Commission (1999-2003).

Also sits on Audit Committee, Remuneration Committee, Committee on Investment-Linked Assurance and Pooled Retirement Funds, Committee on Unit Trusts and Investor Compensation Fund Committee.



Dr York Liao, JP

(From 26 May 2003. Current appointment expires on 25 May 2005.)

Managing Director, Winbridge Company Ltd; Chairman, Hong Kong Council for Academic Accreditation; Member, Council of Advisors on Innovation and Technology; Director, Hong Kong Science & Technology Parks Ltd, Director, Hong Kong Applied Science and Technology Research Institute Co Ltd; Member, Barristers Disciplinary Tribunal Panel; Member, Board of Trustees, California Institute of Technology; Member, Commission on Strategic Development; Member, Steering Committee on Innovation & Technology.

Also sits on Remuneration Committee (from 26.05.03).



Raymond P L Kwok

(From 1 August 1998. Current appointment expires on 31 July 2004.)

Vice Chairman and Managing Director, Sun Hung Kai Properties Ltd; Chairman and Chief Executive Officer, SUNeVision Holdings Ltd; Chairman, SmarTone Telecommunications Holdings Ltd; Director, Kowloon Motor Bus Holdings Ltd; Director, Route 3 (CPS) Company Ltd; Director, Airport Freight Forwarding Centre Company Ltd; Director, Real Estate Developers Association of Hong Kong; Member, General Committee of The Hong Kong General Chamber of Commerce; Member, Hong Kong Port Development Council; Vice Chairman, Council of The Chinese University of Hong Kong; Chairman, Management Committees of the Police Children's Education Trust and the Police Education and Welfare Trust.

Also sits on Audit Committee, Budget Committee and Remuneration Committee.



T Brian Stevenson, SBS

(From 1 January 1999. Current appointment expires on 31 December 2004.)

Chartered Accountant; Steward, Hong Kong Jockey Club; Non-Executive Director, The Hongkong and Shanghai Banking Corporation Ltd; Non-Executive Director, MTR Corporation; Member, Public Service Commission.

Also sits on Audit Committee, Remuneration Committee, Futures Compensation Fund Committee, Securities Compensation Fund Committee, Share Registrars' Disciplinary Committee, and Takeovers and Mergers Panel (from 01.04.04).



The Hon Jasper Tsang Yok Sing, GBS, JP

(From 15 November 2001. Current appointment expires on 14 November 2005.)

Member, Executive Council; Member, Legislative Council; Member, Standing Committee of Democratic Alliance for Betterment of Hong Kong; School Supervisor, Pui Kiu Middle School; Council Member, Open University of Hong Kong; Member, English Schools Foundation; Member, ICAC Complaints Committee; Member, Disaster Relief Fund Advisory Committee; Member, Chinese People's Political Consultative Conference.

Also sits on Remuneration Committee.



Christopher W C Cheng, JP

(From 15 November 2003. Current appointment expires on 14 November 2005.)

Chairman, USI Holdings Ltd; Chairman, Winsor Properties Holdings Ltd; Chairman, Standing Committee on Judicial Salaries and Conditions of Service; Director, NWS Holdings Ltd; Director, New World China Land Ltd; Director, DBS Bank (Hong Kong) Ltd; Director, PICC Property and Casualty Company Ltd; Steward, Hong Kong Jockey Club; Member, Exchange Fund Advisory Committee; Council Member, Hong Kong Trade Development Council; Member, Council of the University of Hong Kong; Charter Member, President's Council on International Activities of the Yale University; Member, INSEAD International Council; Member, Advisory Council of the One Country Two Systems Research Institute Ltd; Chairman, Hong Kong General Chamber of Commerce (2001-2003).

Also sits on Budget Committee (from 17.11.03) and Remuneration Committee (from 15.11.03).

Corporate Governance and the SFC

»» As the statutory regulator of the securities and futures markets in Hong Kong, the Commission always strives to enhance our accountability to the public and the transparency of our work by adopting and implementing corporate governance practices appropriate to best standards of public bodies.

This Chapter Is About

- »» **The composition and operations of the Commission**
- »» **Commission committees**
- »» **Internal controls**
- »» **Independent and external reviews**
- »» **Our performance pledges**

The Commission

» Composition

The constitution and proceedings of the Board of the Commission are defined by the SFO. All our Directors are appointed by the HKSAR Chief Executive and the law requires that the majority of our Directors to be independent Non-Executive Directors (NEDs).

The Commission at present comprises 13 Directors — six full-time Executive Directors (EDs) including the Chairman and seven independent NEDs. Our Directors bring to the Commission a balance of skills and experience of different disciplines and professions which benefit the Commission tremendously. The terms and conditions of offices of the Directors and their remuneration are determined by the HKSAR Chief Executive.

During the year, Mr Henry H L Fan stepped down as a NED of the Commission, and Dr York Liao and

Mr Christopher Cheng both joined the Commission as our new NEDs. Mr Peter Au-Yang, an experienced investment banker, was appointed as the Chief Operating Officer and ED with effect from 26 May 2003.

All newly appointed Directors receive briefings on the work and background of the Commission and relevant SFC publications and documents including minutes of the Commission meetings of the recent quarter and schedule of the coming Commission meetings. A copy of the Code of Conduct for Directors and Staff, which sets out the conflicts of interest guidelines and disclosure requirements on investments, is provided to every Director.

All Directors are required to disclose their investments portfolio upon appointment. The Directors and Commission staff are bound by the provisions of the SFO relating to the preservation of secrecy and avoidance of conflicts of interest.

» How the Commission Operates

The Commission meets regularly every month and holds additional meetings as necessary. All important policies and decisions are discussed and approved by the Commission. During Commission meetings, divisional staff explain policy proposals to the Directors and give regular briefings to the Directors on the progress of their work and important policy and operational issues.

The Directors have separate and independent access to the senior management and divisional staff for any additional information they require. All Directors have access to the Commission Secretary who is responsible for ensuring the procedures of the Commission are complied with, and for advising the Directors on compliance issues.

Attendance of Directors at Commission Meetings in 2003-2004		
Number of meetings	12	
Attendance of individual Directors		
Andrew L T Sheng	11	92%
Ashley Alder	12	100%
Peter Au-Yang ¹	10	100%
Mark Dickens	11	92%
Alexa Lam	10	83%
Alan Linning	12	100%
Christopher Cheng ²	4	80%
Henry H L Fan ³	6	86%
Daniel R Fung	9	75%
Raymond P L Kwok	10	83%
York Liao ¹	9	90%
T Brian Stevenson	8	67%
Jasper Tsang Yok Sing	10	83%
Anna H Y Wu	10	83%
Average attendance of meetings	87%	

¹ Mr Au-Yang and Dr Liao have become members since 26 May 2003 and there were 10 meetings during their term.

² Mr Cheng has become a member since 15 November 2003 and there were five meetings during his term.

³ Mr Fan was a member until 14 November 2003 and there were seven meetings during his term.

The Directors are also briefed on the financial positions of the Commission by way of monthly financial statements giving details of the budget, expenditure, revenue and forecasts. Our financial statements are published in the annual reports and quarterly reports to provide a balanced, clear and comprehensive assessment of the Commission's performance. Our financial statements are considered by the Audit Committee and approved by the Board before they are signed by the Chairman and one NED of the Commission. Each year, the revised and proposed budgets are submitted to the Financial Secretary for approval under the delegated authority of the HKSAR Chief Executive and laid before the LegCo after consideration by the Commission.

The Directors and the Commission committees can seek independent professional advice at the expense of the Commission as and when necessary.

The system of delegation and sub-delegation of the Commission's functions including those functions which are non-delegable are defined in the law. The Commission maintains a detailed list of all functions of

the Commission that have been delegated or sub-delegated and the Committees and post-holders to whom such functions have been delegated or sub-delegated.

Commission Committees

The Commission has established the Advisory Committee and a number of regulatory committees in performing its functions. The Advisory Committee provides an external input to the Commission on policy matters. In addition, the Commission often forms ad hoc working groups with representatives from the industry and the market in developing new policy initiatives. The composition and terms of reference of the regulatory committees are on page 131.

Our NEDs play an important role in ensuring that the Commission is accountable and transparent. They chair and participate in various Commission committees. In addition, the Chairman and the COO regularly consult the NEDs on important personnel and risk management matters.

> Audit Committee

The Audit Committee is chaired by Mr T Brian Stevenson, a Chartered Accountant and a NED of the Commission. The composition of the Audit Committee was revised in August 2002 to comprise only NEDs.

The Audit Committee convenes regular meetings at a quarterly interval and additional ones when necessary to review quarterly financial reports and the annual financial statements before their submission to the Commission for approval. It endorses the appointment of external auditors for the Commission's approval on an annual basis and plays an important role in the design of the scope of internal and external audits. It reviews audit findings set out in the external auditors' management letters and management's responses to them, and monitors the subsequent implementation of agreed improvements. For the provision of non-audit services by external auditors, the Audit Committee will critically consider each engagement on a merit basis. The external auditors are also requested to provide a

statement to ensure that the provision of such services does not impair the external auditors' independence or objectivity.

The Audit Committee also examines management procedures to monitor the effectiveness of the systems of financial and internal control. It considers and approves our annual internal control review programme and cross-divisional audit programme. At the advice of the Audit Committee to have the internal control review and annual audit conducted by separate professional accounting firms to enhance the independence and objectivity of the review and audit, the Commission appointed last year PricewaterhouseCoopers (PWC) in place of KPMG, which is our external auditors, for conducting the internal control review.

During the year, the Audit Committee also considered the revised Personnel Manual providing additional coverage on the procedures of the equal employment opportunities policy, grievance procedures, disciplinary procedures for handling performance issues and disciplinary procedures for handling conduct issues. With the establishment of the grievance procedures, the Audit Committee will deal with grievances raised by Commission staff, where applicable, about the operations of the Commission. The Commission will report on a quarterly basis to the Audit Committee regarding grievances made to the Commission and decisions taken on them.

During the year, we paid KPMG, our external auditors, \$288,300 for audit-related services and \$148,000 for non-audit related activity involving the IT security review of FinNet. We paid PWC \$151,500 for conducting the annual internal control review.

KPMG was also engaged as the external auditors of a number of funds e.g. compensation funds which are under the supervision of the Commission directly or indirectly as required by the law. In total, they paid KPMG \$237,300 for annual audits and half yearly interim reviews.

Attendance of Directors at Audit Committee Meetings in 2003-2004		
Number of meetings	5	
Attendance of individual Directors		
T Brian Stevenson	5	100%
Anna H Y Wu	5	100%
Raymond P L Kwok	4	80%
Average attendance of meetings	93%	

> Remuneration Committee

The Remuneration Committee, chaired by Mr Daniel R Fung, comprises all NEDs.

The Remuneration Committee reviews policy on the level and structure of staff remuneration and makes recommendations in this regard to the Commission. It also considers and approves results of pay surveys. The Remuneration Committee is also consulted on the re-appointment of EDs and decision on senior management.

The HKSAR Chief Executive and the Financial Secretary under the delegated authority of the former determine the remuneration packages of the SFC Chairman and EDs taking into consideration recommendations by the Remuneration Committee. Details of the Directors' remuneration packages are on page 88. The pay packages comprise an annual fixed pay and a performance-related variable pay.

The SFC Chairman consults the Remuneration Committee on the payment and amount of variable pay to individual EDs as a matter of good corporate governance practice. The decisions are reported to the Administration for information.

The remuneration of the NEDs is determined by the Financial Secretary with delegated authority by the HKSAR Chief Executive.

During the year, the Remuneration Committee discussed the market position of pay levels of the top three tiers of senior executives as well as other staff, re-appointment of EDs, discretionary performance-related variable pay, and the revised Personnel Manual.

Attendance of Directors at Remuneration Committee Meeting in 2003-2004

Number of meeting	1	
Attendance of individual Directors		
Daniel R Fung	1	100%
Henry H L Fan ¹	N/A	N/A
Anna H Y Wu ²	1	100%
Christopher Cheng ³	1	100%
Raymond P L Kwok	1	100%
York Liao ⁴	1	100%
T Brian Stevenson	1	100%
Jasper Tsang Yok Sing	1	100%
Average attendance of meeting	100%	

¹ Mr Fan was the Deputy Chairman of the Remuneration Committee until 14 November 2003 and there was no meeting during his term.

² Ms Wu has become the Deputy Chairman of the Remuneration Committee since 17 November 2003.

³ Mr Cheng has become a member since 15 November 2003.

⁴ Dr Liao has become a member since 26 May 2003.

➤ Budget Committee

The terms of reference of the Budget Committee require that the Chairman and Deputy Chairman to be NEDs; the current chairman is Mr Raymond P L Kwok. The Budget Committee examines and approves the proposed parameters and basis for annual budget compilation, including the estimates of our income and expenditure for the next financial year, which will then be submitted to the full Commission for approval.

Attendance of Directors at Budget Committee Meeting in 2003-2004

Number of meeting	1	
Attendance of individual Directors		
Henry H L Fan ¹	N/A	N/A
Raymond P L Kwok ²	1	100%
Christopher Cheng ³	1	100%
Peter Au-Yang ⁴	1	100%
Mark Dickens	0	0%
Andrew L T Sheng	1	100%
Average attendance of meeting	80%	

¹ Mr Fan was the Chairman of the Budget Committee until 14 November 2003 and there was no meeting during his term.

² Mr Kwok has become Chairman of the Budget Committee since 17 November 2003.

³ Mr Cheng has become Deputy Chairman of the Budget Committee since 17 November 2003.

⁴ Mr Au-Yang has become a member since 17 November 2003.

➤ Management Committee

The Management Committee comprises our EDs, Senior Directors and the Chief Counsel and performs administrative, financial and management functions as delegated by the Commission.

At its monthly meetings, the Committee considers funding requests from departments and divisions including requests to engage outside consultants and advisers. It also has the power to determine the remuneration, allowance and conditions of employment. Every month, it reviews the financial situation, staffing position, progress of major information technology projects and latest initiatives of the Commission.

Internal Controls

Our internal control procedures have been designed for safeguarding our assets against unauthorised use or disposition, maintaining proper accounting records and ensuring reliability and integrity of information used within the Commission or for publication. In addition, internal controls in a broad sense also include the various checks and balances that ensure us achieving our regulatory objectives and performing our regulatory functions in a fair and transparent manner and in accordance with the law and established operational procedures.

As a relatively small organisation, we do not have a full-time internal audit unit. Instead, PWC has been appointed to conduct internal control review for us annually. The annual internal control review programme, which is approved by the Audit Committee, includes reviews by both external consultants as well as our cross-divisional audit teams.

➤ PWC

PWC was appointed in July 2003 as the external consultant to carry out our internal control review programme approved by the Audit Committee. The purpose of the review is to assess whether the systems of internal control as set out in the various

Corporate Governance and the SFC

Commission's manuals are adhered to, to evaluate the adequacy of the controls in place, to safeguard assets and ensure reliability and integrity of information, and to identify enhancements to current procedures and controls to improve operating efficiency. The internal controls are designed to provide reasonable, but not absolute, assurance that errors and irregularities will not occur, and that procedures are performed in accordance with management's intentions.

During the year, PWC reviewed the fee collection procedures, application approval and revocation procedures of the Investment Products Department and the Licensing Department and procedures of appointing external professional consultants. They confirmed that the controls over these areas were generally satisfactory. Their findings and recommendations were reported to the Audit Committee.

➤ Cross Divisional Audit

The cross-divisional audit programme is designed to supplement the annual internal control review programme conducted by external consultants. During the year, the Investment Products Department looked at the fees collection procedures of the Licensing and Intermediaries Supervision Departments, and the Finance Department examined the fees collection procedures of Investment Products Department. Both audit reports were submitted to the Audit Committee for comment and approval.

➤ IT Security Review

In addition to the annual internal control review programme, we invited Mr Israel Sendrovic, an ex-Executive Vice President in charge of technology matters for the Federal Reserve Bank of New York, to carry out an IT security review on the Commission in February 2003. Based on his recommendations, the Commission has established an Information Security Unit and an IT Security Committee and started conducting periodic information security risk assessment. The enhanced information security measures have been incorporated in the Commission's

information security policy. Under the policy, all Commission staff are required to attend the information security awareness programme.

Our IT Department is subject to regular review according to ISO 9001:2000 standard for its quality management system.

Independent and External Reviews

The Commission is subject to various external checks and balances designed to ensure fairness and observance of due process. These include statutory rights of appeal, judicial review and scrutiny by independent bodies such as the Process Review Panel, the Ombudsman and the Independent Commission Against Corruption.

We publish our *Quarterly Reports* and *Annual Report* within 45 days after the end of the relevant period and submit them to the Financial Secretary and lay them before LegCo. Moreover, the Commission submits its annual estimates of income and expenditure to the HKSAR Chief Executive, who has delegated the authority for approval to the Financial Secretary. By law, the Director of Audit may examine any books, accounts, vouchers, records or documents kept by the Commission. The SFO also requires the Commission to consult the public in exercising its rule-making powers.

➤ An Independent Review Panel

The Commission's internal procedures for regulating the markets, including procedures for ensuring consistency and fairness, are reviewed on an ongoing basis by the Process Review Panel (PRP), which is an independent, non-statutory panel established by the HKSAR Chief Executive in November 2000. The PRP is tasked to review and advise the SFC upon the adequacy of the SFC's internal procedures and operational guidelines governing the action taken and operational decisions made by the SFC and its staff in the performance of its regulatory functions, including the receipt and handling of complaints, licensing and inspection of intermediaries, and disciplinary action.

The PRP currently comprises 11 members, including eight members from the financial sector, academia and the legal and accountancy professions, and three ex-officio members including the Secretary for Justice (or her representative), the Commission's Chairman and a NED of the Commission.

Over the last year, the PRP reviewed the Commission's procedures by examining various completed cases. The cases reviewed included the following: registration of intermediaries, registration of Registered Institutions, inspection of intermediaries, prudential visit of intermediaries, authorisation of collective investment schemes, handling of complaints against intermediaries, investigation and disciplinary action, processing of Dual Filing cases, approval of Approved Lending Agents, and handling of takeover and merger transactions.

The PRP met on four occasions in the calendar year of 2003, in addition to six meetings held by the Panel's two working groups - the Working Group on Corporate Finance and Enforcement and the Working Group on Licensing, Intermediaries Supervision and Investment Products. At the meetings, the PRP discussed specific topics in relation to the Commission's internal procedures and various papers containing observations and recommendations of the working groups following their case reviews.

The PRP made valuable recommendations that cover a wide range of areas relating to specific cases and procedural issues. The Commission has accepted most of these recommendations and explained why a small number of the recommendations may have difficulty in implementation. The PRP published its annual report in May in the past two years.

The reports on PRP's reviews on our internal procedures and the follow-up actions on the Panel's recommendations are submitted to the Audit Committee for consideration.

➤ **Securities and Futures Appeals Panel/Tribunal**

The independent Securities and Futures Appeals Panel (SFAP), until its replacement by a new tribunal under the SFO, heard appeals against decisions made by the SFC relating to the registration, regulation and discipline of intermediaries. The new Securities and Futures Appeals Tribunal (SFAT) consists of a chairman, who is a High Court judge, and two lay members (drawn from a panel of 22 members appointed by the HKSAR Chief Executive).

Five appeals were handled by the SFAP in 2003-2004. Of these five cases, four were in relation to disciplinary decisions made by our Enforcement Division and one licensing decision made by our Licensing Department. Three cases were concluded and decided by the SFAP: one was discontinued owing to the lack of jurisdiction; one with our decision varied; and one with our decision confirmed. Two appeal cases are still in progress before the SFAP.

Seven appeals were lodged with the new SFAT in 2003-2004. Two cases involved substantive applications for review of SFC's decisions, and the SFAT dismissed both. The other one involved application for leave to appeal out of time which was dismissed. Four pending cases are currently in progress before the SFAT. Of these seven cases, all except one are in relation to disciplinary decisions.

A wider range of SFC's decisions will now be subject to review by the SFAT.

➤ **ICAC Reviews**

The Independent Commission Against Corruption (ICAC) has conducted corruption prevention reviews on the procedures of our supporting departments and operational divisions since 1990. The last round of ICAC review was completed in 2001-2002.

Recently, the Government has recommended the Commission to invite the ICAC to study its procedures and practices for the performance of listing-related functions from the point of view of corruption prevention, and other related issues, such as building in checks and balances in the internal control system. The review will start in the second half of 2004.

➤ **Public Redress Mechanism**

Members of the public can lodge complaints against the Commission and its staff if they believe that the Commission or its staff have been guilty of maladministration in the performance of their functions.

In 2003-2004, the Ombudsman received three complaints against the Commission. The Ombudsman concluded five cases during the year including two from the year before and found all five complaints not substantiated.

In addition to having recourse to the Ombudsman, members of the public who are dissatisfied with the Commission's performance of its functions may take civil action in the Courts against the Commission, by either applying for judicial review of the Commission's decisions or by seeking remedies. There was no judicial review last year.

Our Performance Pledges

In discharging our regulatory duties, we pledge to be responsive to the general public, market participants, and intermediaries under our supervision.		% of cases meeting the pledge in 2003-2004
Investor Enquiries <ul style="list-style-type: none"> ■ Preliminary response to telephone enquiries ■ Preliminary response to written enquiries 	4 business days 2 weeks	100% 99.98% ¹
General Enquiries <ul style="list-style-type: none"> ■ Preliminary response to enquiries via enquiry@hksfc.org.hk 	4 business days	99.8% ¹
Public Complaints <ul style="list-style-type: none"> ■ Preliminary response to verbal & written complaints 	2 weeks	99.6% ²
Licensing Applications Processing of licensing applications <ul style="list-style-type: none"> ■ Representatives (provisional licence) ■ Representatives (normal licence) ■ Representatives (responsible officer) ■ Corporations ■ Change of accreditation 	7 business days 8 weeks 10 weeks 15 weeks 7 business days	84% ³ 72% ³ 89% ³ 95% ³ 87% ³
Modification/Waiver and Subordinated Loan Applications <ul style="list-style-type: none"> ■ Acknowledgement of receipt upon receiving any application 	2 business days	100%
Investment Products Authorisation <ul style="list-style-type: none"> ■ Take-up of applications upon receipt ■ Preliminary response to applicants after take-up for unit trusts, mutual funds, investment-linked assurance schemes and MPF pooled investment funds ■ Preliminary response to applicants after take-up for other schemes 	2 business days 1 week 2 weeks	100% 100% 100%

¹ Some cases failed to meet the pledge due to the exceptionally heavy workload of the responsible departments when the enquiries were received.

² Some cases failed to meet the pledge due to their complexity. More time was needed to collect information to facilitate preliminary assessment.

³ Cases that did not meet the pledge mainly consisted of those where contentious issues were involved or where there were delays in the provision of required documentation by applicants.

Achievements and Work in Progress

Corporate Finance	<p>34 executives and 13 non-executives</p> <ul style="list-style-type: none"> ■ Administer the Takeovers and Mergers Code and Share Repurchases Code ■ Oversee the SEHK's listing-related functions and responsibilities ■ Review and recommend changes to the Listing Rules, laws and regulations and facilitate the development of effective, fair and efficient capital markets ■ Administer securities and company legislation relating to listed and unlisted companies ■ Administer the Dual Filing regime to enhance the quality of corporate disclosure
Intermediaries and Investment Products	<p>90 executives and 42 non-executives</p> <ul style="list-style-type: none"> ■ Devise and administer licensing requirements for corporations and individuals engaged in regulated activities ■ Monitor and supervise the financial position and business conduct of intermediaries ■ Regulate the public marketing of investment products
Enforcement	<p>69 Executives and 20 non-executives</p> <ul style="list-style-type: none"> ■ Conduct market surveillance and enforce laws relating to the securities and futures industry, leveraged foreign exchange trading, and collective investment schemes ■ Inspect books and records of listed companies if impropriety is suspected ■ Report suspected civil market misconduct to the Financial Secretary ■ Discipline dishonest, incompetent and financially unstable regulated intermediaries ■ Co-operate with domestic and overseas regulatory bodies in investigations in Hong Kong and overseas
Supervision of Markets	<p>18 executives and 5 non-executives</p> <ul style="list-style-type: none"> ■ Facilitate the development of and encourage participation in the Hong Kong markets ■ Supervise and monitor activities of the exchange controller, exchanges and clearing houses ■ Regulate approved share registrars ■ Supervise and monitor activities of the independent Investor Compensation Company Ltd (ICC) ■ Manage Hong Kong's investor compensation funds
Legal Services and Corporate Affairs *	<p>61 executives and 40 non-executives</p> <ul style="list-style-type: none"> ■ Provide legal, finance, human resources and training, information technology, management and corporate services, strategic planning and co-ordination to the Commission ■ Educate investors on their rights and responsibilities ■ Promote effective communication with stakeholders including the media

Numbers of executives/non-executives refer to permanent established posts.

* The Corporate Affairs Division includes the Chairman's Office, Commission Secretariat, Corporate Planning, China Policy, Finance and Administration, Human Resources, Training and Development, Information Technology, Investor Education and Communications, and Corporate Communications.

Achievements in 2003-2004

- Implemented Dual Filing
- Participated in the revision of the SEHK's Listing Rules covering corporate governance matters, initial listing criteria and continuing listing obligations
- Issued a joint Consultation Paper with the SEHK on Regulation of Sponsors and Independent Financial Advisers
- Participated in the Code on Corporate Governance Practices for listed companies exposed by the SEHK
- Introduced the Companies (Amendment) Bill 2003 containing proposed amendments to the prospectus regime to the LegCo
- Participated in the Government's Consultation on Proposals to Enhance the Regulation of Listing

- Implemented the single licensing framework
- Agreed with the CSRC to mutually recognise market practitioners' professional qualifications
- Completed the Report of the Working Group on Review of the Financial Regulatory Framework for Licensed Corporations
- Approved 65 subordinated loans and 32 modifications and waivers of statutory requirements
- Stepped up supervision of hedge fund managers
- Supervised 2,414 investment products and facilitated product innovation
- Issued the Code on REITs and Guidelines for Regulating Index-tracking ETFs
- Signed a co-operation agreement with ASIC

- Concluded 990 investigations of which 910 were completed within 12 months
- Prosecuted 60 entities for breaches of various ordinances including seven entities for market manipulation
- Concluded 69 disciplinary inquiries and disciplined 78 licensees or concerned persons
- Referred 32 cases of fraud and corruption to Police and ICAC including six boiler room cases to Police

- Authorised the first group of five ATS providers
- Set up the ICC and monitored its operations
- Monitored the development and launch of advanced market infrastructure under SCEFI recommendations, including the clearing systems CCASS/3 and DCASS
- Relaxed further the short selling regulation
- Streamlined regulations on position limits and reporting requirements of futures and options contracts

- Helped ensure the smooth implementation of the SFO and formulated amendments to subsidiary legislation
- Conducted significantly more successful prosecutions for regulatory offences
- Continued stringent cost control and achieved a surplus
- Moved to new offices
- Strengthened employee relations and communication and provided more customised training
- Formed Security Committee and revised the Information Security Policy
- Strengthened communication with investors and other stakeholders
- Participated actively in community work and voluntary services

Work in Progress

- Participate in finalisation of proposals concerning the eligibility and obligations of listing sponsors and IFAs
- Conduct an overall review of existing laws and regulations relating to public offerings of shares and debentures
- Consider amendments to Takeovers Code to account for development in Hong Kong and overseas
- Work with the Government and HKEx to follow up on the Consultation Conclusions on Proposals to Enhance the Regulation of Listing

- Fine tune the licensing framework and ensure continued smooth migration of licensees
- Work on Code of Conduct amendments to address analyst conflicts of interest
- Consult on regulatory measures proposed by the Working Group on Review of the Financial Regulatory Framework for Licensed Corporations
- Analyse findings from a questionnaire on fund trading practices and develop regulatory approach towards fund manager conduct
- Review authorisation criteria for retail hedge funds
- Monitor the implementation of the new European Directive on investment funds (UCITS III) / liberalisation of the investment markets and evaluate their implications

- Target investigations on areas of corporate misgovernance, market crimes and serious misconduct by intermediaries
- Conduct more effective inspections into listed companies and continue 12 listed companies inspections
- 99 cases subject to disciplinary proceeding; 17 cases awaiting hearing in Courts and three cases currently before Insider Dealing Tribunal
- Strengthen domestic and international co-operation, especially against cross-border fraudulent activities

- Introduce an appropriate scrippless model in Hong Kong and implement other SCEFI recommendations
- Work with HKEx to facilitate the introduction of new products and services and to enhance existing ones
- Monitor HKEx's comprehensive fees review
- Monitor the launch of DCASS and the common collateral management system
- Monitor the implementation of the claims handling procedures of ICC

- Ongoing maintenance of the SFO and subsidiary legislation
- Continue refinement of subsidiary legislation under SFO
- Work on legislative initiatives to fulfil policy aims and to address market needs
- Revamp of the SFC corporate website and the eIRC
- Continue to strengthen employee relations and communication
- Provide remote access IT solution for staff off-site operational needs and contingency purpose

Implementation of the Securities and Futures Ordinance

>> The SFO (Cap.571) consolidates and modernises the 10 ordinances* previously regulating the securities and futures markets in Hong Kong. Effective on 1 April 2003, the SFO and the subsidiary legislation made under it have introduced significant changes to the regulation of the markets. One year on, we are pleased to report that the implementation of the SFO has been successful.

Improved Investor Compensation Arrangements	The independent Investor Compensation Company Ltd (ICC) has been set up to administer the Investor Compensation Fund (ICF), providing streamlined compensation arrangements and greater investor protection. ICC came into operation on 1 April 2003 with its own Board of 10 Directors. The claim procedures and documentation for submitting claims have been gazetted. The net asset size of ICF was \$962 million as of 31 March 2004.
More Transparent Market Disclosure	The new Disclosure of Interests requirements give a more complete picture of dealings by substantial shareholders and directors. To address common queries and assist compliance by the market, the SFC has issued a revised Outline of Part XV to give guidance on when and how to complete the forms to disclose interests in shares of listed companies. HKEx has also developed a search facility to provide investors with a comprehensive and user-friendly means of searching the "Disclosure of Interests" database. The SFC is now reviewing Part XV with a view to enhancing the disclosure regime.
Combating Market Misconduct	A Market Misconduct Tribunal (MMT) has been set up to handle civil cases of all forms of market misconduct. There was no referral to the MMT during the year as many investigations on post SFO events concern significant and complex matters and are still continuing. It is expected that some of these ongoing investigations will be concluded soon and will be considered for referral to the MMT.
Dual Filing to Ensure Better Corporate Disclosure	Operation of the Dual Filing arrangement has been smooth and effective. During the year, we received via the SEHK 117 new listing applications and considered it necessary to comment on fundamental issues on 54 of them. Our average response time was seven days. Dual Filing has not caused any additional compliance burden on listing applicants who have prepared adequate draft prospectuses.

<p>A New Single Licensing Regime</p>	<p>The universally applicable single licensing system, with one licence covering all regulated activities which a person is permitted to undertake, results in reduced costs for market operators without compromising investor protection. In the first year of the two-year transitional period, 65% of the intermediaries (520 corporations and 10,635 individuals) had applied to convert their old licences to new ones.</p>
<p>Improving the Regulation of Intermediaries</p>	<p>We have imposed tougher disciplinary sanctions on rule-breaking intermediaries under the SFO. During the year, we saw the first life ban of a person in the industry and the first fine. As more investigations on post SFO offences are concluded, we will use the variety of sanctions available under the new regime to punish guilty intermediaries more proportionately.</p>
<p>Enhancing SFC's Inspection and Investigatory Powers</p>	<p>The SFO has given us a wider scope to investigate listed companies and related corporations. We focused our resources on this area in 2003-2004. We continued five ongoing investigations from a year ago and conducted 10 new investigations. Five cases have been referred to the Police and we are taking legal advice on two cases about the prospects of seeking orders under Section 214 of the SFO. The section enables the Court to make a range of orders including disqualifications of directors.</p>
<p>Facilitating Market Innovation</p>	<p>The SFO provides for a flexible and pragmatic approach to the regulation of Automated Trading Services (ATS) which enable buyers and sellers to deal electronically. Authorisations were granted to five ATS providers in October 2003. Their particulars and conditions of authorisations are listed on the Register of Automated Trading Services on the SFC website.</p>
<p>Greater Accountability of the SFC</p>	<p>The Securities and Futures Appeals Tribunal (SFAT) has been established. A wide range of the SFC decisions are appealable to the Tribunal. During the year, the SFAT concluded three cases. Two cases involved substantive applications for review of SFC's decisions, and the SFAT dismissed both. The other one involved an application for a time extension to lodge an appeal outside the statutory time limit, and similarly the SFAT dismissed it.</p>

* Securities and Futures Commission Ordinance (Cap. 24)
Commodities Trading Ordinance (Cap. 250)
Securities Ordinance (Cap. 333)
Protection of Investors Ordinance (Cap. 335)
Stock Exchanges Unification Ordinance (Cap. 361)

Securities (Insider Dealing) Ordinance (Cap. 395)
Securities (Disclosure of Interests) Ordinance (Cap. 396)
Securities and Futures (Clearing Houses) Ordinance (Cap. 420)
Leveraged Foreign Exchange Trading Ordinance (Cap. 451)
Exchanges and Clearing Houses (Merger) Ordinance (Cap. 555)

Three-year Comparisons

	2003-2004	2002-2003	2001-2002
Market			
Hong Kong markets benefit from economic recovery			
MAIN BOARD			
Number of listed companies*	856 (+5%)	817 (+6%)	774
Market capitalisation (\$ billion)*	5,690.5 (+68%)	3,377.6 (-12%)	3,855.3
Average daily market turnover (\$ billion)	13.6 (+116%)	6.3 (-16%)	7.5
Funds raised through IPOs (\$ billion)	72.6 (+52%)	47.7 (+363%)	10.3
Hang Seng Index (points)*	12,682 (+47%)	8,634 (-22%)	11,033
GROWTH ENTERPRISE MARKET			
Number of listed companies*	192 (+14%)	168 (+32%)	127
Market capitalisation (\$ billion)*	79 (+54%)	51.4 (-26%)	69.1
Average daily market turnover (\$ million)	190 (+40%)	136 (-30%)	195
Funds raised through IPOs (\$ billion)	3.8 (-32%)	5.6 (+14%)	4.9
S&P/HKEx GEM Index (points)*	1,237 (+33%)	927 (-51%)	1,877
Finances and Staff			
Financial position improves with increased turnover			
Income (\$ million)	551.1 (+63%)	338.4 (-7%)	363
Expenditure increases due to office removal and new functions			
Expenses including depreciation (\$ million)	425.7 (+7%)	396.8 (-5%)	417.2
Steady permanent establishment level			
Permanent established posts*			
— excluding dual filing	374 (+4%)	361 (0%)	361
— including dual filing	392 (+5%)	373 (+3%)	361
Retention of experience and expertise			
Staff turnover (%)	7.2 (-18%)	8.8 (+19%)	7.4
Strong mix of professionals			
Number of lawyers, accountants and CFAs*	173 (+14%)	152 (-2%)	155
Better staff skills			
Number of training programmes	231 (-12%) ¹	263 (+2%)	258
Training man-day per employee	4.5 (+12%)	4 (-47%)	7.6
Corporate Finance			
More transactions handled			
Total number of transactions handled	393 (+15%)	341 (+27%)	268
Total number of major transactions (general and partial offers, whitewashes, off-market and general offer repurchases)	91 (+18%)	77 (+24%)	62
Other applications	302 (+14%)	264 (+28%)	206
Intermediaries and Investment Products			
Fewer licences under the simplified regime			
Applications for SFC licence	3,732 (-18%)	4,555 (+38%)	3,306
Applications to conduct new regulated activity ²	6,410	N/A	N/A
Total number of SFC licences*	20,510 (-22%)	26,411 (-7%)	28,395
More inspections			
Routine inspections (cases)	171 (+23%)	139 (-35%)	215
Special inspections (cases)	30 (+88%)	16 (-61%)	41
Prudential meetings	76 (-12%)	86 (-15%)	101
Breaches noted from completed inspections	810 (+59%)	510 (-8%)	553
Steady number of authorised investment products			
Authorised collective investment schemes	2,414 (-2%)	2,457 (+6%)	2,316
Investment funds increase in value			
Net asset value of authorised unit trusts and mutual funds (US\$ billion) ³	534 (+56%)	342 (+20%)	285

	2003-2004	2002-2003	2001-2002
Enforcement			
More successful prosecutions			
New investigations (cases) ⁴	1,223 (+213%)	391 (+25%)	311
Successful prosecutions ⁵	60 (+62%)	37 (-26%)	50
Unsuccessful prosecutions	0 (-100%)	7 (+40%)	5
Disciplinary inquiries conducted	167 (+2%)	163 (+14%)	143
Entities disciplined	78 (-7%)	84 (-20%)	105
Supervision of Markets			
Bigger compensation pool			
Net asset value of Unified Exchange Compensation Fund (\$ million)*	324 (-63%)⁶	872 (+12%)	780
Net asset value of Commodity Exchange Compensation Fund (\$ million)*	0.3 (-99%)⁶	129 (+11%)	116
Net asset value of Investor Compensation Fund (\$ million) ^{7*}	962	N/A	N/A
Total net asset value of all compensation funds (\$ million)*	1,286 (+28%)	1,001 (+12%)	896
Reaching Out			
Websites attract more visitors			
Corporate website's average daily hit rate (hits)	345,739 (+30%)	266,590 (+45%)	183,671
eIRC's average daily hit rate (hits)	31,434 (+21%)	25,896 (-2%)	26,367
Increased investor awareness of rights and responsibilities			
Complaints	1,252 (+31%)	959 (+33%)	721
Enquiries	5,382 (+35%)	3,982 (+30%)	3,073
More follow-up on complaints			
Complaints referred to operational divisions	708 (+23%)	576 (+28%)	449
Complaints leading to investigations	161 (-1%)	163 (+44%)	113
Press releases issued ⁸	270 (-10%)	299 (+38%)	216
Consultation and Guidelines⁹			
Consultation papers issued	6 (-70%)	20 (-20%)	25
Consultation conclusions issued	8 (-78%)	37 (+363%)	8
Codes and guidelines issued	5 (-86%)	36 (+125%)	16

* Figures as at financial year-end.

¹ The reduction in the number of training programmes is attributed to factors including the outbreak of SARS last year, our office relocation in June and reduction in SFO training for staff.

² Under the SFO, there is a universally applicable single licensing system with one licence covering all regulated activities a person is permitted to undertake. Existing licensees can apply for approval to carry out additional regulated activities under the same licence.

³ NAV as at 31 December 2003, 2002 and 2001.

⁴ Total new investigations included 775 cases of late Disclosures of Interests as a result of the more stringent reporting requirements under the SFO.

⁵ Prosecutions included cases of market manipulation, illegal short selling, unlicensed activities, breaches of Protection of Investors Ordinance and Disclosure of Interests requirements and others.

⁶ The net asset values of UECF and CECF were reduced as a result of asset transfer to the ICF.

⁷ The ICF was established on 1 April 2003 under the SFO.

⁸ Excluding press releases issued in compliance with Disclosure of Interests requirements.

⁹ The numbers in the previous two years were exceptionally high because of activities related to the SFO.

Significant Events 2003-2004

2003

1 April

The SFO came into operation, bringing Hong Kong's financial regulatory framework on a par with international standards.

1 April

Investor Compensation Company Ltd commenced operations to administer the single Investor Compensation Fund under the SFO.



13 May

The independent PRP published its second annual report, confirming that in general adequate safeguards and checks and balances were in place in the SFC's internal procedures.

14 May

The SFC published its Annual Report 2002-2003. The report was awarded two top prizes.



>> Secretary for Financial Services and the Treasury Mr Frederick Ma (left) presents Hong Kong Society of Accountants' Diamond Award to SFC COO Mr Peter Au-Yang in November.

23 May

The Companies Ordinance (Exemption of Companies and Prospectuses From Compliance with Provisions) (Amendment) Notice 2003 became effective, exempting prospectuses from those contents requirements which the SFC considers unduly burdensome or irrelevant.

26 May

Mr Peter Au-Yang was appointed as an ED of the SFC for three years, assuming the role of COO, and Dr York Liao was appointed as a NED for two years.

27 May

The FSTB and the SFC jointly consulted the public on a proposal to empower the SFC to initiate derivative actions. The proposal received limited market support.

30 May

The SFC and HKEx jointly published a Consultation Paper on the Regulation of Sponsors and Independent Financial Advisers.

26 June

The SFC signed a Declaration on Co-operation and Supervision of Cross-Border Investment Management Activity with ASIC.

30 June

The SFC moved to its new offices at Chater House.



>> The reception area of the new SFC office.

18 July

The SFC launched the *Know the SFC* video to explain its work to the public. The Cantonese language documentary drama was broadcast on Cable TV.



30 July

The SFC published the Code on REITs, broadening the choice of investment products available to the public.

1 August

Mr Raymond Kwok was re-appointed as a NED for one year.

22 August

The Court of Final Appeal (CFA) allowed the appeal by the Government against the order of Mr Justice Seagroatt for a permanent stay of the prosecution of Mr Lee Ming-tee and ordered the case to be remitted back to the Court of First Instance. The SFC intervened in the appeal on the basis that a substantial and grave injustice had been done to the SFC and its witnesses. In November 2003, the CFA ordered Mr Lee to pay costs in favour of the SFC.

25 September

IOSCO issued a Statement of Principles in addressing conflicts of interest faced by sell-side securities analysts. The SFC participated in the work on the Statement.

25 September

The SFAT, in its first review since its formation under the SFO, upheld an SFC decision to suspend Mr Wong Pui Hey Duncan for facilitating trading malpractices.

1 October

SFC Chairman Mr Andrew Sheng was re-appointed for two years.

14 - 17 October

IOSCO selected Hong Kong to host its 31st Annual Conference in 2006. SFC Chairman Mr Andrew Sheng was appointed Interim Chairman of the Technical Committee. A Multilateral MOU Concerning Consultation and Co-operation and the Exchange of Information was announced.



>> SFC Chairman Mr Andrew Sheng speaks on corporate governance at the IOSCO Annual Conference.

17 October

The SFC banned Mr Do Yu Lun for life from re-entering the securities industry for attempted theft. The prohibition order is a new disciplinary measure under the SFO.

22 October

The SFC announced that the first group of ATS providers had been authorised under the SFO.

23 October

The SFC fined Mr Richard John Patterson \$287,372 — the first fine under SFO — and publicly reprimanded him for unlicensed dealing.

15 November

Mr Christopher Cheng was appointed as a NED and the Hon Jasper Tsang was re-appointed as a NED, both for two years.

5 December

The SFC announced that the Mainland/Hong Kong Closer Economic Partnership Arrangement - Arrangements relating to Qualifications of Securities and Futures Industry Practitioners had been signed by the CSRC and the SFC.

6 December

A new SFC drama series entitled *Talk on Wise Investing* began broadcasting on Commercial Radio One.

12 December

The Securities and Futures (Price Stabilizing) (Amendment) Rules were gazetted, providing for recognition of the UK Price Stabilizing Rules.

30 December

The SFC introduced a new investor education column, Dr Wise's Column, on its website.



>>> 2004

1 March

The SFC presented the proposals of the Working Group on Review of the Financial Regulatory Framework for Licensed Corporations to the LegCo Panel on Financial Affairs. The proposals aim to address the risks arising from pooling and re-pledging of client collateral by securities margin financiers.

26 March

The Government published the Consultation Conclusions on Proposals to Enhance the Regulation of Listing, recommending giving statutory backing to the more important listing requirements and expanding Dual Filing.

31 March

The SFC published regulatory proposals to address analyst conflicts of interest for public consultation.



>> SFC Chairman Mr Andrew Sheng (right) listens to a media question during a press briefing in January on the SFC's response to the Government's consultation paper. Sitting next to him is Mr Ashley Alder, Executive Director of Corporate Finance.

Corporate Finance



A teacher in arts and design, Ms Wong Ko Pui, uses modern Chinese painting techniques to portrait a butterfly over a bloom. She outlines the objects in watermark before applying colours. The SFC seeks to raise the standards of corporate governance in the market, which will then prosper and where all participants may thrive.



Our mission is to enhance the disclosure-based regulatory regime, improve corporate governance, and promote changes to law and regulation encouraging the development of efficient markets.



Achievements

- Implemented Dual Filing
- Participated in the extensive revision of the SEHK's Listing Rules covering a number of corporate governance matters as well as initial listing criteria and continuing listing obligations
- Issued a joint consultation paper with the SEHK on regulation of sponsors and independent financial advisers
- Participated in the Code on Corporate Governance Practices for listed companies exposed by the SEHK for comments
- Played a key role in introducing prospectus-related amendments under the Companies (Amendment) Bill 2003 to the LegCo
- Participated in the Government's Consultation on Proposals to Enhance the Regulation of Listing

This Chapter Is About

- Takeovers matters
- Facilitating market development and compliance
 - Prospectus regime
- Enhancement of corporate governance
 - Revision of Listing Rules
 - Regulation of sponsors
 - Shareholders Group
- Upholding standards
 - Implementation of the Dual Filing regime
 - Enhancing the regulation of listing

WHAT WE DO

- >> **Administer the Takeovers and Mergers Code and Share Repurchases Code;**
- >> **Raise standards of investor protection and corporate governance;**
- >> **Oversee the SEHK's listing-related functions and responsibilities;**
- >> **Review and recommend changes to the Listing Rules;**
- >> **Administer securities and company legislation relating to listed and unlisted companies;**
- >> **Recommend changes to laws and regulations and facilitate the development of effective, fair and efficient capital markets;**
- >> **Review prospectuses of unlisted issuers for authorisation under companies legislation and administer the grant of exemptions for prospectuses issued by listed and unlisted issuers; and**
- >> **Administer the Dual Filing regime under the SFO to enhance the quality of disclosure by listed companies.**

WHAT WE DID

Takeovers Matters

The Takeovers Executive administers all takeovers transactions relating to public companies under the Codes on Takeovers and Mergers and Share Repurchases. The Codes are designed to ensure fair treatment for shareholders who are affected by takeovers, mergers and share repurchases. The Executive comments on takeovers announcements and documents, gives rulings and interpretations under the Codes, monitors share dealings and movements during an offer period, and is available for consultation on the

application of the Codes so that issues can be addressed and problems can be resolved at an early stage.

The Executive had another record year in terms of the numbers of general offer transactions and applications under the Codes (see Table 1 on page 32). The Executive is reviewing various provisions of the Codes with a view to consulting the public on proposed amendments later in 2004.

Major Rulings and Disciplinary Action

Takeovers Panel upheld an Executive ruling concerning on-market share repurchases by CLP Holdings Ltd

In November 2003 the Executive ruled that Rule 32 of the Takeovers Code did not enable a whitewash waiver mechanism to be used to waive general offer obligations triggered by on-market share repurchases. At that time the Kadoorie family held a 34.84% shareholding interest in CLP and a share repurchase of 11 million shares would have caused it to cross the 35% threshold and hence incur a general offer obligation. The former 35% mandatory bid threshold applied to the Kadoorie family under transitional provisions of the Takeovers Code as it had held between 30% and 35% shareholding interest in CLP in October 2001. CLP applied to the Panel for a review of the Executive's ruling. On 11 December 2003 the Panel upheld the Executive's ruling stating that it was clear from the wording of Rule 32 that it did not provide for whitewash waivers triggered by on-market share repurchases. The Panel also decided that the particular circumstances in this case did not justify the exercise of any discretion which the Takeovers Panel may have to modify or relax the application of Rule 32.

Takeovers Executive sanctioned Hui Chuen Kin, Daniel and Lui Bing Kin, Michael, executive directors of International Capital Network Holdings Ltd (ICN)

On 24 April 2003 the Executive publicly censured Mr Hui Chuen Kin, Daniel and Mr Lui Bing Kin, Michael and imposed a 24-month "cold shoulder order" denying them direct or indirect access to the securities markets. Hui surrendered his licence with the SFC as a deemed licensed representative for the same period. The sanctions concerned a voluntary offer for ICN by Koffman Securities Ltd that was announced in early September 2002. On 17 September 2002 ICN issued an announcement advising shareholders not to take any action in response to the offer until they had received advice from ICN's board and its financial advisers. In the same announcement ICN informed shareholders that its cash reserve of some \$40 million was being kept under the control of a wholly owned subsidiary of ICN. In the months that followed ICN refused to issue a document in response to the offer despite rulings of the Executive and the Panel for it to do so. On 19 November 2002 ICN announced for the first time that its cash reserve had been reduced to \$3.6 million, mainly as a result of two transactions. The offer lapsed on 9 December 2002. ICN did not issue a response document throughout the offer period. The Executive considered that Hui and Lui had breached the Takeovers Code in connection with the two transactions. The Executive also found that Hui and Lui had breached the Takeovers Code and a ruling of the Panel in failing to ensure that ICN issued a response document during the offer period.

Facilitating Market Development and Compliance

➤ Prospectus Regime

The first phase of a market development project focused initially on retail bonds and other debt-related products and involved the issue of three sets of SFC guidelines under the prospectus regime to facilitate the conduct of public offerings of securities and two class exemptions in relation to prospectuses for debenture offerings. With completion of the first phase in May 2003, the second phase continued with the introduction of the Companies (Amendment) Bill 2003 to the LegCo in the following month.

The part of the Bill dealing with the prospectus regime seeks to level the playing field between different types of offers and/or issuers and put the SFC guidelines mentioned above on a statutory footing. Scrutiny of the relevant provisions by the Bills Committee was largely completed in January 2004. It is hoped that the part of the Bill dealing with the prospectus regime will be enacted in the summer of 2004.

The third phase involves an overall review of existing provisions of the Companies Ordinance relating to public offers of shares and debentures, including a study of equivalent legislation in leading overseas jurisdictions. Work is now under way to formulate proposals to modernise Hong Kong's public offering regime. It is expected that a consultation paper setting out our recommendations for reform will be issued in the third quarter of 2004.

Enhancement of Corporate Governance

➤ Revision of Listing Rules

We worked closely with the Listing Division of the Stock Exchange of Hong Kong (SEHK) in the extensive revision of Listing Rules announced in January 2004. These changes covered a number of corporate governance matters and the SEHK's minimum criteria for companies seeking an initial listing.

The SEHK also exposed for comments a Code on Corporate Governance Practices and proposed Corporate Governance Report. It is intended that the major part of this Code will apply to issuers' financial years beginning 1 January 2005. The Commission

believes that the Code will represent a significant enhancement of corporate governance standard among Hong Kong listed companies.

➤ Regulation of Sponsors

In May 2003 we issued a joint consultation paper with the SEHK on the regulation of sponsors and Independent Financial Advisers (IFAs). The paper proposed that the SEHK would maintain a list of acceptable sponsors and IFAs, as well as standard of conduct to be adhered to by them — in particular due diligence work to be carried out by sponsors in IPOs.

The consultation responses indicate that the market believes strongly that decisions on whether a firm licensed under the SFO may be allowed to engage in a particular type of business should be determined by the SFC alone, to avoid "double regulation". The SFC is now considering changes to the existing regulatory regime for licensed and registered persons under the SFO to cater specifically for sponsors and IFAs. It is also reviewing measures that would help strengthen regulatory oversight over these intermediaries. In doing so, the SFC is mindful that any regulatory regime must be effective and pragmatic.

Separately, in light of comments received from the market, HKEx is preparing amendments to the Listing Rules to clarify HKEx's expectation of sponsors and IFAs, in particular a sponsor's role in advising applicants for listing and in conducting due diligence.

Shareholders Group

The Shareholders Group is a standing committee under Section 8 of the SFO to engage investors and harness their views on issues relating to shareholders' rights and interests. The Group consists of 13 members from different constituencies including retail and institutional investors, professionals, academics, market commentators, advocates of investors' rights, and a Consumer Council representative.

During the year, seven meetings were held where members discussed various issues and advised on regulatory proposals. Their views have assisted the Corporate Finance and other divisions of the SFC in performing their functions more effectively. Topics discussed included:

Corporate Finance

- Consultation Paper on the Regulation of Sponsors and IFAs;
- Straight-Through-Processing for Investor Participant Accounts;
- Revised Code of Best Practices and Proposed Corporate Governance Report;
- Disclosure-based Securities Regulation;
- Review on Tick Size Reduction by HKEx;
- Consultation Paper on Proposals to Enhance the Regulation of Listing; and
- Exposure Draft of the Code of Corporate Governance Practices and Corporate Governance Report.

Upholding Standards

➤ Implementation of the Dual Filing Regime

Under the Dual Filing regime, listing application materials as well as listed company disclosure are now required to be filed with both the SFC and the SEHK. Since its implementation on 1 April 2003, the regime has been operating smoothly and effectively and has been well received by the market.

In May 2003, we appointed nine members to the Dual Filing Advisory Group, which advises on treatment of cases under the regime and the relevant regulatory provisions, as well as on related policy issues. In 2003-2004, the Group met three times.

The SFC's emphasis is on the quality of corporate disclosure. We identify major disclosure issues at the beginning of the listing process and provide comments. This approach has been endorsed by the Group as the right way to administer disclosure-based regulation.

To ensure transparency, the SFC gives quarterly detailed updates on the implementation of Dual Filing. Our average response time was seven working days. In 2003-2004, we received 117 new listing applications. We have commented on 54 of them. Dual Filing has not caused any additional compliance burden on listing applicants who have prepared adequate draft prospectuses. Going forward, we will continue to work in full co-operation with the SEHK to ensure that the Dual Filing arrangement is market-friendly and the interest of investors is sufficiently protected.

Matters handled by Corporate Finance		Table 1	
Codes on Takeovers and Mergers and Share Repurchases	2003-2004	2002-2003	
General and partial offers under Takeovers Code	43	29	
Privatisations	7	9	
Whitewash waiver applications	34	31	
Other applications under Takeovers Code	301	255	
Off-market and general offer repurchases	7	8	
Other applications under Share Repurchases Code	1	9	
Total	393	341	
Disciplinary cases dealt with by the Executive	0	2	
Takeovers and Mergers Panel			
Reviews of Executive rulings by Panel	1	2	
Referral by the Executive	0	1	
Disciplinary hearings	0	1	
Special meetings for review of the Takeovers and Share Repurchases Codes	0	0	
Total number of Panel meeting days	1	4	
Companies Ordinance (CO) and Securities and Futures Ordinance (SFO)			
Applications for exemption under Section 309 of the SFO (in 2002-2003: Securities (Disclosure of Interests) Ordinance)	460 ¹	290	
Authorisation under Section 105 of the SFO (in 2002-2003: Section 42(g) of the Protection of Investors Ordinance)	5	10	
Unlisted companies' prospectuses authorised for registration by the Registrar of Companies	49	14	
Certificates of Exemption under Sections 38A and 342A of CO	69 ²	27 ²	
Applications for listing of shares on the Stock Exchange	117	N/A ³	

¹ With 1,007 warrants listed, 7 equity-linked instruments, 2 debt instruments and 2 shares issued.

² Each certificate issued can include more than one CO exemption.

³ The SFC began to review listing applications under the Dual Filing regime from 1 April 2003.

➤ Enhancing the Regulation of Listing

Following the release of the Expert Group Report in March 2003, the Government issued a Consultation Paper on Proposals to Enhance the Regulation of Listing in October 2003.

On 29 January 2004, the SFC submitted its views on the consultation paper. We fully agree with the Government that we must continue to upgrade our market quality by improving the listing regime, and in doing so consider market development needs and local circumstances. The SFC's approach is to advocate pragmatic, feasible, technical solutions that will ensure that Hong Kong's system of listing regulation matches international financial centre standards.

On 26 March 2004, the Government issued its consultation conclusions paper. The main proposals involve a phased and focused approach to give statutory backing to the more important listing requirements which will be made and enforced by the SFC under the SFO. In Phase I, rules will be prepared by the SFC under Section 36 of the SFO dealing with:

- financial reporting and other periodic disclosure (e.g. annual and interim reports) by listed companies;
- disclosure of price sensitive information by listed companies; and
- shareholders' approval for certain notifiable transactions.

Phase I will involve exposure of draft Section 36 rules for public consultation before an SFO Amendment Bill is introduced to the LegCo, targeted for the first quarter of 2005. The Amendment Bill seeks to establish a three-pronged regime to deal with breaches of the new statutorily backed rules involving direct civil sanctions by the SFC — namely reprimands and disqualification orders imposed on issuers, directors and corporate officers and/or referral to the Secretary of Justice for possible criminal prosecution or civil proceedings before the Market Misconduct Tribunal (MMT). Expansion of the new rules to cover other important aspects of the Listing Rules will be dealt with in Phase II.

To enhance the transparency of the listing regulatory process, and as one of the Government's recommendations in its consultation conclusions, we will prepare audit reports on HKEx's performance for publication.

These reforms represent a major step forward in effort to enhance the regulation of listed companies and the Commission is committed to ensuring that they will be effective and in the interest of issuers and investors, and for the continued development of Hong Kong as an international financial centre.

Intermediaries & Investment Products



Madam Leung is renowned for her exquisite handiwork in making Chinese silk fabric buttons. She skillfully coils the insider patterns, frames them and sews them up. Like the buttonhole and the knot, the SFC and the industry work together to create a better market.



Our mission is to work in partnership with the industry to safeguard investor interests, facilitate market development and encourage high standards of professionalism.



Achievements

- Implemented the single licensing framework and achieved good progress in the migration of intermediaries to the regime
- Agreed with the CSRC to mutually recognise market practitioners' professional qualifications for licensing purpose
- Established a new fidelity insurance scheme for Stock Exchange Participants
- Completed the Report of the Working Group on Review of the Financial Regulatory Framework for Licensed Corporations
- Approved 65 subordinated loans and 32 modifications and waivers of statutory requirements to facilitate brokers' operations
- Stepped up supervision of hedge fund managers
- Supervised 2,414 investment products and facilitated the growth of alternative investment products
- Issued the Code on REITs and the Guidelines for Regulating Index-tracking ETFs
- Signed a Declaration on Co-operation and Supervision of Cross-Border Investment Management Activity with ASIC

This Chapter Is About

>> Licensing Department

- Implementing the new licensing regime
- Upkeeping market standards
- Facilitating market development

>> Intermediaries Supervision Department

- Monitoring intermediaries' financial soundness
- Conduct supervision

- Review of financial regulatory framework
- Flexible regulation and ongoing dialogue with intermediaries

>> Investment Products Department

- Product authorisation
- Facilitating product and market development
- Strengthening regulatory co-operation on fund management activities
- Stepping up communication with the fund industry

LICENSING DEPARTMENT

WHAT WE DO

>> **Act as the gatekeeper of the industry, ensuring that only fit and proper individuals and organisations are allowed to deal with investors and other market participants.**

WHAT WE DID

Implementing the New Licensing Regime

The Department continued to undertake various initiatives to ensure a successful switch-over by the industry to the new licensing regime under the SFO. Apart from devoting significant resources to conducting seminars and training sessions for various segments of the industry, we also:

- published the Licensing Information Booklet and posted on the SFC website sample completed licensing forms and Frequently Asked Questions and Answers;
- oversaw the roll-out of revamped licensing examinations for securities, futures, and leveraged foreign exchange trading intermediaries to align with the new licensing structure; and
- guided intermediaries on the new regime by issuing various circulars and guidelines.

The migration of licensees to the new regime has progressed smoothly and orderly. During the two-year transitional period provided under the SFO, all intermediaries previously registered under the former regime and intending to continue business are required to apply for a licence under the SFO. In the first year of the transitional period, 65% of the intermediaries (i.e. 520 corporations and 10,635 individuals) had applied to convert their old licences to new ones.

Upkeeping Market Standards

We continued to be vigilant in our gatekeeping duty. During the year, 144 applications were withdrawn because they failed to meet the licensing requirements. We also imposed licensing conditions on 1,839 new licensees as a means to limit their scope of activities, and revoked the licence of 115 bankrupt licensees to ensure that only fit and proper individuals are allowed to deal with investors.

To maintain the high standards of intermediaries and to protect investors, we:

- consulted the market on a policy proposal to address the analyst conflicts of interest issue. This followed the findings from our Securities Firm Survey and Investor Survey on Investment Research Activities conducted in 2003, where both the industry and investors had called for clearer and more specific regulations to address the issue.

Premised on the existing regulatory framework and the IOSCO principles as well as taking into account the local environment, the proposed guidelines aim to reduce analyst conflicts and mandate better management of conflicts by the firms and individuals (e.g. through disclosure). The SFC has also taken into account measures adopted in other leading markets in formulating these proposed guidelines.

We are mindful that the proposed measures should not constraint the free flow of market information or affect the quality of investment research. We will also step up investor education to enhance investor awareness of the issue; and

- worked with an industry group to appoint a new insurance broker to arrange and administer a more economical fidelity insurance scheme for securities brokers. The overall premium paid by Stock Exchange Participants has been substantially reduced by 35%. To further enhance investor protection, and market integrity and stability, we have also arranged for the futures brokers to subscribe to similar fidelity insurance in 2004-2005.

Facilitating Market Development

Pursuant to the CEPA commitments, the SFC worked with the CSRC to mutually recognise each other's market practitioners' qualifications for licensing purpose. In December 2003, the CSRC and the SFC signed the Arrangements relating to Qualifications of Securities and Futures Industry Practitioners, which offers a simplified alternative route for securities and futures professionals of both jurisdictions to work across the border.

Hong Kong professionals having passed the examination on relevant Mainland laws and regulations may be granted industry qualifications by Mainland's Securities Association of China (SAC) or China Futures Association. Mainland professionals may be deemed by the SFC as having satisfied the requirements for industry qualifications in Hong Kong. Such arrangement has helped facilitate the flow of qualified personnel and expertise between the two jurisdictions, contributing to the further development of both markets.

In the first examination on Mainland securities regulations conducted by the SAC in Shenzhen on 20 March 2004, 348 Hong Kong professionals took part and 169 (about 50%) of the candidates passed.

To dispense with the licensing examination for former practitioners to re-enter the industry while not compromising intermediary standards and investor protection, we relaxed the re-entry competence requirements.

Former licensees who had left the industry for three to eight years would not need to sit for the competence examination but would be required to complete five Continuous Professional Training hours for each year of absence from the industry, or attend a specialised course to be provided by the Hong Kong Securities Institute in respect of securities and futures or the Vocational Training Council in respect of leveraged foreign exchange. Former practitioners who had left the industry for less than three years are exempt from the examination requirement.

During the year, we:

- granted 13 modifications or waivers in respect of statutory requirements to 21 licensed persons and applicants under circumstances where investor protection would not be compromised;
- pledged faster processing of licensing applications. New performance pledges for the processing of provisional licence and change of accreditation applications (seven business days) were introduced. We also pledged to process normal representative licence and responsible officer (formerly dealing director and supervisory director) applications faster (Please see details in *Our Performance Pledges* section);
- worked with HKEx to dispense with its requirements for sales representative registration and simplify its procedures for dealing director applications; and
- encouraged new product development. In collaboration with the Investment Products Department, we published the licensing guidelines for specialised fund managers of REITs, ETFs, and financial intermediaries of the Capital Investment Entrant Scheme.

Licensing Statistics

Under the new single licence regime, the number of applicants for licences decreased by 18% to 3,732 (Table 1). This might be because applicants no longer need to apply for several licences to carry out different regulated activities. Instead, there was a 40% surge in the number of applications for approval to carry out additional regulated activities. Similar to the previous years, applications for dealing in securities remained the most significant, followed by advising on securities.

Intermediaries & Investment Products

Applications for Licence / Regulated Activity								Table 1
1 April 2003 to 31 March 2004								
Applications	Businesses		Individuals				Total	
	Corporations		Representatives		Responsible Officers		Licence	Regulated Activity
	Licence	Regulated Activity	Licence	Regulated Activity	Licence	Regulated Activity		
Received	61	118	3,396*	5,673	275	619	3,732	6,410
Approved	46	90	2,962	4,995	243	512	3,251	5,597
Refused	0	0	0	0	0	0	0	0
Withdrawn	11	32	117	218	16	33	144	283

* 1,511 applicants also applied for provisional licence.

The number of licensees (both businesses and individuals) decreased by 22% during the year, from 26,411 as of 31 March 2003 to 20,510 as of 31 March 2004 (Table 2). There were 97 registered institutions at

year-end. The decline in the number of licensees might be attributed to business consolidation under a single licence, as intermediaries could reduce their compliance costs.

Number of Licences					Table 2
as at 31 March 2004					
	Corporations	Representatives	Responsible Officers	Total	
By Licensee					
SEHK Participants	448	7,390	1,130	8,968	
HKFE Participants	122	404	45	571	
SEHK and HKFE Participants	5	217	24	246	
Non-Participants	723	8,750	1,252	10,725	
Total	1,298	16,761	2,451	20,510	
By Regulated Activity					
Type 1 — Dealing in Securities	668	12,126	1,461	14,255	
Type 2 — Dealing in Futures Contracts	153	3,733	340	4,226	
Type 3 — Leveraged Foreign Exchange Trading	16	975	45	1,036	
Type 4 — Advising on Securities	980	9,574	1,532	12,086	
Type 5 — Advising on Futures Contracts	217	1,472	306	1,995	
Type 6 — Advising on Corporate Finance	839	7,651	1,200	9,690	
Type 7 — Providing Automated Trading Services	76	1,222	130	1,428	
Type 8 — Securities Margin Financing	8	22	13	43	
Type 9 — Asset Management	973	7,676	1,321	9,970	
Total	3,930	44,451	6,348	54,729	

INTERMEDIARIES SUPERVISION DEPARTMENT

WHAT WE DO

- Continuously monitor the financial positions of intermediaries and supervise their conduct;
- Raise the standards of control and risk management of intermediaries; and
- Carry out policy reforms to enhance investor protection and foster market development.

WHAT WE DID

Monitoring Intermediaries' Financial Soundness

➤ Financial Positions of Intermediaries

Hong Kong's financial market made a significant rebound as the local economy began to recover in the latter part of 2003. Fuelled by the rising market and increased trading volume on the SEHK, licensed intermediaries' reported financial positions improved substantially when compared to the previous year. Table 3 summarises the securities market's statistical information and financial highlights for 2003.

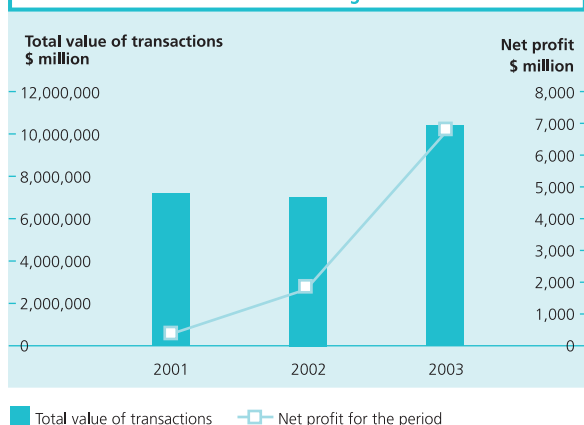
As a whole, the Hong Kong securities industry had a very strong year. Although there was a slight decrease in the number of intermediaries, their financial positions were solid. Net commission income from securities dealing rose (by 32% from a year ago) with the increase in other income such as proprietary trading and income from other financial activities. With the firms continuing to exercise tight controls over their expenditure, the securities industry's net profit more than tripled that in the previous year. The changes in total transaction values and net profit of securities dealers and securities margin financiers from 2001 to 2003 are shown in Chart 4.

Statistical Information on Securities Market ¹ Table 3

	As at 31/12/2003	As at 31/12/2002
Total number of securities dealers and securities margin financiers	673	696
Total number of active cash clients (up 22%)	687,802	565,585
Total number of active margin clients (up 25%)	71,240	56,787
Balance Sheet	(\$ million)	(\$ million)
Cash in hand and at bank ²	88,209	56,998
Amounts receivable from margin clients ³	15,327	12,242
Amounts receivable from clients and other dealers arising from dealing in securities	63,261	24,986
Other assets	105,003	34,511
Total assets (up 111%)	271,800	128,737
Amounts payable to clients and other dealers arising from dealing in securities	109,517	50,055
Total borrowings from financial institutions	36,786	5,380
Other liabilities	62,066	21,690
Total shareholders' fund ⁴	63,431	51,612
Total liabilities and shareholders' fund (up 111%)	271,800	128,737
	12 months to 31/12/2003 (\$ million)	12 months to 31/12/2002 (\$ million)
Profit and loss		
Total value of transactions ⁵	10,456,801	7,066,624
Net commission income from securities dealing	13,329	10,109
Gross interest income	2,034	2,139
Other income ⁶	20,369	15,691
Total overheads and interest expense	-28,944	-26,075
Net profit for the period (up 264%)	6,788	1,864

- The above data were extracted from the monthly FRR returns submitted by securities dealers and securities margin financiers.
- Cash in hand and at bank includes trust monies held on behalf of clients amounting to \$41,126 million (2002: \$20,647 million).
- 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).
As at 31/12/03: 4.2
As at 31/12/02: 3.4
- The value of shareholders' fund includes value of redeemable shares.
- The value of transactions includes trading in equities and bonds both in Hong Kong and overseas.
- Other income mainly comprises corporate finance income, fund management income, net profit/loss on proprietary trading, intercompany charges and others.

Total Transaction Values and Net Profit of Securities Dealers and Securities Margin Financiers¹ Chart 4



- The value of transactions includes trading in equities and bonds both in Hong Kong and overseas.

Financial Performance of Stock Exchange Participants ^{1,2}							Table 5	
(\$ million)								
	Category A		Category B		Category C		All Exchange Participants	
	2003	2002	2003	2002	2003	2002	2003	2002
TOTAL								
Total value of transactions	2,605,007	1,995,041	2,173,651	1,387,553	1,137,154	730,540	5,915,812	4,113,134
Total operating income	7,310	7,437	5,536	3,574	3,280	2,658	16,126	13,669
Total overheads and interest expense	5,709	6,163	3,475	3,474	2,784	3,189	11,968	12,826
Net profit for the year	1,601	1,274	2,061	100	496	-531	4,158	843

1. The above data were extracted from the monthly FRR returns submitted by securities dealers.

2. Categories A, B and C Participants are identified on a monthly basis, based on their turnover on the SEHK. Category A Participants refer to the top 14 brokers by market turnover, whilst Category B Participants refer to those ranked 15 - 65 and the remainders are grouped under Category C. The categories of Stock Exchange Participants listed in Table 5 are classified based on the December 2002 and 2003 turnover data.

Table 5 shows the increase in market turnover/value of transactions benefited all Stock Exchange Participants whose main source of income derives from the trading of local equities. In addition, Stock Exchange Participants continued to control their costs effectively, which resulted in better profitability.

All categories of the Stock Exchange Participants did better in 2003 in terms of turnover and net profit. In particular, the turnover of Category B Participants increased by more than 50% in 2003, while their expenditure remained at 2002 level. Likewise, Category C Participants as a whole were able to return to profitability after a loss-making 2002.

➤ Additional Regulatory Measures

The SFO has standardised the regulatory capital framework for all licensed intermediaries in the form of a liquid capital requirement to strengthen prudential regulation over advisers and asset managers. Advisers and asset managers are now required to regularly submit their financial returns to the SFC. In addition, to obtain information about their business operation and risk management measures, all licensed corporations and associated entities are required to submit annually a Business and Risk Management Questionnaire with their audited accounts.

During the year, we continued to take proactive actions to manage down targeted risky intermediaries with weak internal controls and risk management, including ring-fencing their business activities, in order to protect investors' assets and minimise systemic risk.

Conduct Supervision

➤ Assessing Intermediaries' Compliance with Rules and Regulations

Inspection of intermediaries is another major function performed by the Department to protect the interests of the investing public. The Department inspected 201 intermediaries and made prudential visits to 76 intermediaries, an overall increase of 15% from the previous year. There were more inspections, resulting in the identification of more breaches, in particular those of conduct regulation. A summary of breaches by intermediaries identified during our inspections is listed in the Table 6.

Breaches by Licensed Corporations Noted During SFC Inspections			Table 6	
Nature of Breaches	Total Number of Breaches			
	2003-2004	2002-2003		
Failure to comply with FRR	38	41		
Failure to safekeep clients' securities	34	44		
Failure to maintain proper books and records	21	24		
Failure to safekeep clients' money	33	32		
Unlicensed dealing and other registration issues	14	19		
Breach of licensing condition	3	5		
Breach of requirements of contract notes / statements of account / receipts	72	20		
Failure to make filing / notification	3	16		
Breach of margin requirements	8	8		
Marketing malpractices	4	1		
Illegal short selling of securities	2	3		
Breach of Code of Conduct	253	104		
Breach of Code on Unit Trust and Mutual Funds	0	5		
Breach of Corporate Finance Adviser Code of Conduct	2	0		
Breach of Fund Manager Code of Conduct	18	15		
Non-compliance with anti-money laundering guidelines	30	10		
Breach of other rules and regulations of the Exchanges	5	9		
Internal control weaknesses	226	153		
Others	44	1		
Total	810	510		

➤ **Stepping up Regulation of Hedge Fund Managers**

In light of the growing popularity of hedge funds in Hong Kong, we carried out special inspections to examine whether hedge fund managers adhere to the relevant regulations. Special attention was paid to their internal due diligence procedures and risk management policies.

Review of Financial Regulatory Framework

In May 2002, a Working Group on Review of the Financial Regulatory Framework for Licensed Corporations was formed to develop a robust risk-focused financial regulatory framework for licensed corporations. The Working Group comprising representatives from the industry, academia and the Consumer Council had held 14 meetings since its inception.

The Working Group's recommendations were presented to the LegCo Panel on Financial Affairs in March 2004. The proposals aim to address the risks arising from pooling and re-pledging of client collateral by securities margin financiers. The principal measures proposed include introducing a cap on the amount of client collateral that a firm can re-pledge as security for its borrowings at a percentage of the aggregate amount of all its margin loans outstanding at the time; and increasing the haircut ratios prescribed under the Financial Resources Rules (FRR). These measures are supplemented by additional disclosure requirements under the Code of Conduct. A public consultation paper on the proposals is expected to be issued in the second quarter of 2004.

Flexible Regulation and Ongoing Dialogue with Intermediaries

The SFC understands the need to facilitate the market and be flexible in enforcing its regulations, codes and guidelines. The following two cases illustrate our commitment to helping our intermediaries comply with our requirements without compromising investor protection:

Approval of Subordinated Loans

As the Hong Kong stock market rose and turnover increased towards the end of 2003, intermediaries' business volume expanded rapidly. In order to ensure that they had sufficient working capital to keep up with the pace of business growth, many intermediaries applied to the SFC for the approval of subordinated loans to meet the capital requirements under the FRR.

During the year, the Department approved 65 applications for subordinated loans, amounting to \$8,564 million. Only 29 applications were approved in the previous year. The processing time of subordinated loans for the purpose of IPO financing was as short as two business days.

Modifications and Waivers of Regulatory Requirements

During the year, we received an application for modification of FRR requirements from a licensed corporation principally engaged in proprietary trading of equity and equity derivatives. Given its unique business scope, the intermediary was granted modification allowing it to apply an alternative model to calculate its market risk capital requirement of proprietary positions in its trading book in lieu of haircuts and financial adjustments under the FRR.

Including the above modification, the Department granted a total of 32 modifications and waivers of regulatory requirements to intermediaries, an increase of 68% over the 19 cases in the previous year.

INVESTMENT PRODUCTS DEPARTMENT

WHAT WE DO

- >> Authorise investment products for sale to the Hong Kong public and their advertisements in accordance with product codes and industry standards;
- >> Monitor disclosures and ongoing compliance;
- >> Formulate policies for the development of new products;
- >> Strengthen international regulatory co-operation in relation to collective investment schemes and their operators; and
- >> Conduct annual survey on the fund management activities in Hong Kong.

WHAT WE DID

Product Authorisation

As at 31 March 2004, the total number of authorised products stood at 2,414, comparable to last year's 2,457 (Table 7). During the year, 277 products were authorised and 320 products were withdrawn. We witnessed continuous fund restructuring and amalgamation by the fund sponsors and managers as part of their efforts to improve existing product ranges to better meet investors' needs.

	As at 31/03/2004	As at 31/03/2003
Unit trusts and mutual funds	1,872	1,965
Investment-linked assurance schemes	160	129
Pooled retirement funds	37	37
MPF master trust schemes	46	47
MPF pooled investment funds*	255	241
Others [#]	44	38
Total	2,414	2,457

* 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.

[#] Other schemes comprise 38 equity-linked deposits and 6 paper gold schemes.

Table 8 shows that standard bond and equity funds still comprised the bulk of the funds population. Specialised investment products had become increasingly popular, with guaranteed funds and hedge funds experiencing the largest growth. As at 31 March 2004, there were 244 guaranteed funds and 10 hedge funds, compared to 181 guaranteed funds and four hedge funds a year ago. Innovative product concepts such as guaranteed funds linked to hedge funds or a hedge fund index also emerged during the year.

The market for both investment-linked assurance schemes and MPF pooled investment funds also expanded during the year. The revival of interest in common stocks also gave rise to renewed focus on equity-linked products. There were 38 authorised equity-linked deposits in 2003-2004, representing a 36% increase from 2002-2003 and continuing the growth trend.

On the back of the recovery of the global markets, the aggregate net asset value of all authorised unit trusts and mutual funds as at 31 December 2003 amounted to US\$534 billion, a rise of 56% compared to last year (Table 8). Funds authorised in Hong Kong continued to show a strong international flavour (Table 9).

	Total		NAV*	
	Number	%	(US\$ million)	%
Bond	294	17	112,048.3	21.0
Equity	891	52	270,581.5	50.6
Diversified	110	7	41,094.6	7.7
Money Market	58	3	81,471.8	15.3
Fund of Funds	76	5	3,863.3	0.7
Index	22	1	8,139.4	1.5
Guaranteed	244	14	15,998.9	3.0
Hedge	10	1	404.9	0.1
Other specialised [#]	6	0	685.4	0.1
	1,711	100	534,288.1	100.0
Umbrella structures	161			
No of Authorised Funds	1,872			

* Net Asset Value as at 31 December 2003

[#] Includes: Futures & Options Funds & Leveraged Funds

Origin/Net Asset Value of Authorised Unit Trusts and Mutual Funds **Table 9**

as at 31 March 2004				Total			
	Umbrella Number	Sub- funds Number	Single Funds Number	Number	%	NAV* (US\$ million)	%
Hong Kong	15	50	34	99	5	6,792.5	1.3
Luxembourg	55	838	11	904	48	305,463.8	57.2
Ireland	40	285	15	340	18	151,561.6	28.4
Guernsey	4	40	1	45	2	2,470.2	0.4
United Kingdom	2	39	13	54	3	28,098.9	5.3
Other Europe	1	4	13	18	1	10,337.3	1.9
Bermuda	2	22	7	31	2	2,237.6	0.4
British Virgin Islands	4	8	9	21	1	1,614.3	0.3
Cayman Islands	37	261	53	351	19	24,073.9	4.5
Others	1	1	7	9	1	1,638.0	0.3
No of Authorised Funds	161	1,548	163	1,872	100	534,288.1	100

* Net Asset Value as at 31 December 2003 (excluding "umbrella funds")

Facilitating Product and Market Development

The SFC facilitated the development of a wide range of investment products, as part of our continuous efforts to reinforce Hong Kong's position as a premier regional fund centre. The guidelines on guaranteed funds, hedge funds, index funds, index-tracking ETFs, as well as the Code on REITs have laid the regulatory foundation for the development of specialised investment funds in Hong Kong.

- After extensive industry consultation, we released the Code on REITs in August 2003, which sets out the regulatory requirements for the authorisation of real estate investment trusts for sale to the public.

The introduction of REITs is part of the SFC's continuous efforts to broaden the choice of investment products available to the public. 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 SFC appreciates the importance of diversification into overseas properties for the longer-term development of REITs. Hence, we have set up a Task Force on Overseas Real Estate Investment by REITs to conduct research on overseas regulatory framework and perform case studies on overseas investments by REITs in foreign countries. Upon completion of its research, the Task Force will make recommendations on the minimum benchmarks that REITs should set for themselves if and when they invest in overseas properties. The market will be consulted on the Task Force's recommendations.

- We also worked with the SEHK in streamlining the listing process for authorised collective investment schemes and amending the related rules under Chapter 20 of the Main Board Listing Rules. This new Chapter 20 came into effect on 1 September 2003.
- In October 2003, we released the Guidelines for Regulating Index-tracking ETFs. The first ETF under the new guidelines was authorised in November 2003. This fund was also the first ETF authorised for listing pursuant to the streamlined listing regime as mentioned above.
- The SFC also assisted the Government in the implementation of the new Capital Investment Entrant Scheme (CIES). Based on the investment criteria released by the Department of Immigration, 16 authorised funds managed by our licensees were included as permissible investment under the scheme as of the end of March 2004.

Strengthening Regulatory Co-operation on Fund Management Activities

The SFC signed a Declaration on Co-operation and Supervision of Cross-Border Investment Management Activity with ASIC in June 2003. There are now seven overseas jurisdictions officially recognised as acceptable inspection regimes under the Code on Unit Trusts and Mutual Funds. Five of them are also officially recognised as acceptable inspection regimes under the Code on

Intermediaries & Investment Products

REITs. Under the terms of the various MOUs, the SFC and the overseas regulators would be able to exchange information with and offer assistance to each other concerning activities of fund managers licensed in their own jurisdictions.

Stepping Up Communication with the Fund Industry

In our ongoing effort to enhance regulatory transparency, we published Frequently Asked Questions and Answers on our website to help the market understand the requirements of REITs and the investment related aspects of funds that seek to qualify for the CIES. A REITs application checklist was also published to assist preparation of supporting documents.

We conducted seminars for industry participants and a majority of these engagements concerned the new Code on REITs, our authorisation process, hedge funds requirements and issues arising from hedge funds applications.

Furthermore, we have been monitoring closely the international development on mutual fund trading malpractices including market timing and late trading. We are in dialogue with overseas regulators in this respect.

In order to gather information about the current fund industry trading practices in Hong Kong, the Department and the Intermediaries Supervision Department conducted a market-wide survey in early February 2004 with 176 licensed fund management or advisory companies. The survey aims to collect information about the fund managers' internal controls to prevent market timing and late trading. Such information will be used to facilitate our formulation of regulatory approach towards the conduct of fund managers and the operations of investment funds.

Facilitating Market Development

To sum up, the following are initiatives of the Intermediaries and Investment Products Division to facilitate market development and their results:

>> Cost Savings for the Market

- Industry saved \$4.6 million in SFC's lower licensing fees.
- Stockbrokers save \$14 million in fidelity insurance premium for 2004-2005 - a 35% reduction from last year.

>> Launching New Services and Products

- We worked closely with the market to facilitate new investment products such as hedge funds, REITs and index-tracking ETFs so intermediaries can offer diversified products and services to customers.
- Private data survey sources suggested that Hong Kong is the largest centre in Asia (ex-Japan) in terms of assets under management by Asian-focused hedge funds. Moreover, Hong Kong attracted the most money in the Asian region for new hedge funds start-ups in 2003.

>> Faster Handling of Applications

- We have pledged to process licensing applications faster - for representatives and responsible officers the processing time is substantially reduced to eight weeks (previously 10 weeks) and 10 weeks (15 weeks) respectively. Provisional licence and change of accreditation may be approved in seven business days.

>> Continuous Industry Dialogue

- We meet regularly with the five brokers associations. Moreover, we met with various industry groups 23 times during the year to exchange views on policy issues, such as CEPA, analysts' conflicts of interest, brokers' fidelity insurance scheme, and risks arising from securities margin financing.
- We issued 64 circulars to intermediaries and provided 13 training and briefing sessions, covering operational areas. More than 300 FAQs were posted on the SFC website to help the market better understand our regulation.

Enforcement



Ms Sally Shin Sheung Mei, an amateur Chinese calligrapher, writes the Chinese character “正”, which means fairness and impartiality, in clear and purposeful strokes. We enforce the law without fear or favour.



Our mission is to protect investors and improve the quality of Hong Kong's markets by detecting and deterring unlawful or unethical activities and behaviour through effective enforcement.



Achievements

- Concluded 990 investigations of which 910 were completed within 12 months
- Successfully prosecuted 60 entities for breaches of various ordinances including seven entities for market manipulation
- Concluded 69 disciplinary inquiries and disciplined 78 licensees or concerned persons
- Referred 32 cases of fraud and corruption to Police and ICAC including six boiler room cases to Police

This Chapter Is About

>> Surveillance

- Inquiries into unusual price movements and trading
- Disclosure of Interests

>> Investigations

- Listed companies
- Market misconduct including market manipulation and insider dealing

- Disclosure of Interests
- Unlicensed activities
- FRR breaches
- Obstruction of SFC investigations
- Other investigations

>> Disciplinary actions and appeals

- >> Co-operation with other law enforcement agencies and overseas regulators

Enforcement

WHAT WE DO

- >> **Enforce laws relating to the securities and futures industry, leveraged foreign exchange trading, and collective investment schemes;**
- >> **Inspect books and records of listed companies if impropriety is suspected;**
- >> **Report suspected civil market misconduct to the Financial Secretary;**
- >> **Enforce disclosure of interests of substantial shareholders, directors and chief executives of listed companies;**
- >> **Suppress illegal or improper practices in trading, collective investment schemes and the provision of advice or other financial services;**
- >> **Discipline dishonest, incompetent and financially unstable regulated intermediaries; and**
- >> **Co-operate with domestic and overseas regulatory bodies in investigations in Hong Kong and overseas.**

WHAT WE DID

This was another rewarding year. The number of cases handled rose significantly due to the stricter Disclosure of Interests reporting requirements embodied in the SFO. Our efforts to streamline work processes and to target priorities helped us investigate cases faster without compromising quality.

We continued 313 ongoing investigations from 2002-2003. Another 1,223 cases were opened during the year as a result of information provided by the public, foreign regulators, law enforcement agencies in Hong Kong, HKEx and internal referrals. Out of these 1,536 cases, 990 were concluded, with the remaining 546 subject to ongoing investigations, hearings or prosecutions.

To ensure our markets are ethical and transparent, our priorities in 2003-2004 were to fight corporate misgovernance, market misconduct and intermediaries who are dishonest or put clients at risk. Our focus on corporate governance resulted in a larger number of listed company inspections. More market manipulators and dishonest intermediaries were successfully prosecuted. Also, we disciplined intermediaries for poor internal controls in their businesses and for failing to protect their clients' assets.

During the year, the majority of investigations related to events that predated the implementation of the SFO. These cases continued to be investigated under the old legislation. There were also new inquiries relating to post SFO events or offences and some of them concerned significant and complex matters. Investigations of these cases are resource intensive and take time. There will be some lead time before the results of our enforcement efforts become apparent. Yet, we expect to conclude some cases in the near future, resulting in sanctions under the SFO.

On the disciplinary front, we have already imposed tougher sanctions under the SFO. For example, we saw the first life ban of a person from re-entering the industry and the first fine. As more investigations on post SFO offences are concluded, we will use the variety of SFO sanctions to punish intermediaries more proportionately.

Surveillance

> **Inquiries into Unusual Price Movements and Trading**

Our Surveillance Department is responsible for monitoring day-to-day trading in the stock and derivative markets in Hong Kong. Using sophisticated computer systems, we identify and make preliminary assessments of unusual price and turnover movements. Suspicious activities are reported to the Investigation Department.

In cases of suspected market manipulation, insider dealing or dissemination of false or misleading information, we obtain trading details from brokers, conduct preliminary inquiries and refer cases for full investigation.

Our daily surveillance programme actively monitors the media for reports of improper activities. We also surf the Internet to detect possible unlicensed dealing, unauthorised advertising of investment services, or other abnormal activities.

During the year, we concluded 153 inquiries into untoward share price and volume movements necessitating the obtaining of trading records from brokers. On many occasions our early inquiries either explained the untoward movements or put a stop to the potentially improper trading activities, hence removing the need for further inquiries. However, 24 cases were referred to the Investigation Department for full investigation.

There were 314 trading suspensions in listed securities due to unusual price or volume movements. In all but four cases, the suspensions were requested by the companies concerned following inquiries by HKEx or the SFC. These suspensions were usually lifted on the day after the concerned company released news which might have an impact on its stock, or statements that it was unaware of the reason for the unusual movements. Three suspensions were directed by HKEx because the management could not be contacted for clarification of potentially price sensitive matters and on one occasion we directed the suspension of trading. These cases are subject to further investigation.

Last year we commenced investigations into trading activities during the pre-opening sessions before the listing debuts of PICC Property and Casualty Company Ltd and Great Wall Automobile Holding Company Ltd, to determine if there was market manipulation or other misconduct.

We found that bid orders at levels substantially higher than the IPO subscription price were placed and cancelled within a very short period of time during the pre-opening sessions. Although ultimately these orders did not affect the opening prices because they were cancelled, the SFC considers that these actions distorted the price discovery process during the pre-opening sessions and gave a misleading impression to the public that the stocks would be traded at substantially higher prices than they were reasonably expected to.

We discovered that the majority of these orders belonged to accounts controlled by licensed persons. Although the majority of such cases were concluded with the issue of warning letters to brokers and licensed persons, some are still being actively pursued.

➤ **Disclosure of Interests**

The SFO has set a tighter threshold for disclosure (a shareholder owning 5%, down from 10%, must disclose) and has prescribed more timely notification (three business days as compared to five days previously) and more notifiable items. The aim is to ensure that investors are provided with complete, timely and better quality information so they can make informed investment decisions.

With the new stringent reporting requirements we saw an upsurge in the number of late filings referred by HKEx. Altogether 775 cases of late disclosures were opened. Given the market's concern about the complexity of the new reporting regime, we exercised considerable discretion in determining whether cases warranted further investigation. For the first three months of the new regime, we adopted a more tolerant attitude towards delays. Thereafter, wherever possible, we chose to warn instead of prosecute offenders. Altogether 185 warning letters were issued. However, the filing delays in 36 cases were sufficiently long to justify further investigation.

Investigations

With the introduction of the Dual Filing regime, we have been taking a more proactive approach to company disclosure. We opened three cases involving false and misleading disclosure and in the course of conducting company inspections discovered a further five instances of misleading disclosure.

➤ **Listed Companies**

The SFO has empowered us to investigate listed companies and related corporations more effectively. During the year we focused our resources on this area. We continued five ongoing investigations from a year ago and conducted 10 new investigations. Two cases were concluded with no further action. Five cases were

Enforcement

referred to the Police for further investigation, although in four of these cases our own investigations are continuing. We are taking legal advice on two cases about the prospects of seeking orders under Section 214 of the SFO. The section enables the Courts to make a range of orders including disqualification of directors. Investigations into the remaining cases are continuing.

In addition to targeting delinquent corporations and their associates, we will also take action against the sponsors of newly listed companies whose work falls short of the standards required of them and damages investors.

➤ Market Misconduct

Our enforcement programme continued to focus on the fundamentals of maintaining a fair and open market by fighting serious market misconduct.

■ Market Manipulation

Market manipulation continued to be a priority. We are encouraged to see the successful prosecution of seven people in the Courts for manipulating the shares of Pioneer Global Group Ltd (Case 1 in Table 1), Yeebo (International Holdings) Ltd (Case 2), China Development Corporation Ltd (Case 3), Climax International Company Ltd (Case 4), Victory Group Ltd (Case 5), SEEC Media Group Ltd (formerly known as Sino Infotech Holdings Ltd) (Case 6), Daido Group Ltd, Perennial International Ltd and Chinney Alliance Group Ltd (Case 7). This was a marked improvement over the four convictions last year. We are confident this trend will continue because we have three cases awaiting trial and another seven awaiting legal advice and clearance to prosecute. One of these cases relates to attempted manipulation of the pre-opening price of index futures.

The Courts passing the sentences have commented that market manipulation is a serious offence that involves dishonesty and deception, and the public should be protected from misleading pictures of both the price and supply and demand for shares. As a reflection of this tougher judicial stance, suspended terms of imprisonment appeared to be the standard tariff under

the Securities Ordinance. Under the SFO, misconduct offences carry a maximum jail sentence of 10 years and fines of up to \$10 million. As such, increased penalties are anticipated in the future.

Successful Prosecutions — Market Manipulation						Table 1
1 April 2003 to 31 March 2004						
Case	Defendants	Date of Conviction	No of Summonses Involved	Fine(\$)/ Penalty	Costs of Investigation Awarded(\$)	
1)	Poon Lak To Joseph	20.05.03	1	\$50,000 fine	12,945	
2)	Wong Chi Kit	20.05.03	1	4 months' imprisonment suspended for 2 years	27,757	
3)	Chan Yuk Fei	20.05.03	7	3 months' imprisonment suspended for 18 months	8,257	
4)	Choi Kam Tui	10.06.03	1	4 months' imprisonment suspended for 2 years	13,574	
5)	Wong On Ching Johnny	22.07.03	1	\$15,000 fine and 3 months' imprisonment suspended for 1 year	44,550	
6)	Wang Changhua	29.07.03	1	\$5,000 fine and 2 months' imprisonment suspended for 1 year	18,217	
7)	Lam Yat Wa	05.09.03	3	\$30,000 fine and 6 months' imprisonment suspended for 1 year	37,006	
Total: 7 entities			15	100,000	162,306	

■ Insider Dealing

In 2003-2004, there was a notable decline in market activities that gave rise to suspicions of insider dealing. The SFC investigated four cases carried forward from a year ago and six new cases. We concluded two cases with no further action and investigations continued in the remaining eight cases.

During the year, the Insider Dealing Tribunal (IDT) completed its hearing relating to Siu Fung Ceramics Holdings Ltd. The company's former chairman and four other parties were found to have engaged in insider dealing. A hearing in May 2004 will determine the penalties. The inquiry on Firststone International Holdings Ltd was also heard and four people were found to have engaged in insider dealing. The IDT started an inquiry

on HKCB Bank Holdings Company Ltd/Lippo China Resources Ltd/Lippo Ltd and the hearings continue. Another inquiry concerning Chinney Alliance Group Ltd started in April 2004. There are seven more inquiries with the IDT waiting to be heard.

➤ Disclosure of Interests

Eleven people and two companies (compared to 15 people and six companies in the previous year) were prosecuted for material Disclosure of Interests related breaches (Table 2). The numbers declined because we exercised discretion whether to prosecute, considering the fact that shareholders might experience difficulties in complying with the new SFO requirements.

Successful Prosecutions — Disclosure of Interests						Table 2
1 April 2003 to 31 March 2004						
Case Defendants	Date of Conviction	No of Summonses Involved	Fine(\$)		Costs of Investigation Awarded(\$)	
1) Wong Lin Chooi	27.05.03	1	5,000		5,000	
2) Chau King Nui Helen	03.06.03	12	18,000		3,414	
3) Lai Ping Keung	24.06.03	8	20,000		15,183	
4) Tung Fai	08.07.03	2	10,000		7,990	
Wisdom Latch Ltd		2	10,000		7,990	
5) Chiu Kwong Chi	15.07.03	1	3,000		15,000	
Wong Wai Ying		1	3,000		15,000	
6) Cheung Kee Wee Anthony	18.11.03	6	15,000		4,685	
Cheung Lin Wee		6	15,000		4,685	
Cheung Ying Wai Eric		6	15,000		4,685	
7) Ho Shu Wah	03.03.04	2	5,000		4,071	
Hotung Eric Edward		2	5,000		4,071	
Hotung Enterprise Ltd		4	10,000		4,071	
Total: 13 entities		53	134,000		95,845	

➤ Unlicensed Activities

The down trend of unlicensed dealing was reversed during the year. In 2003-2004, 14 people and two companies were prosecuted for different types of unlicensed activities (Table 3), including aiding or abetting.

➤ FRR Breaches

During the year, two people and two companies were prosecuted for providing false and misleading information to the SFC. All of them related to submission of monthly financial returns. Four people and two companies were prosecuted for other FRR related breaches (Table 4).

Successful Prosecutions — Unlicensed Activities						Table 3
1 April 2003 to 31 March 2004						
Case Defendants	Date of Conviction	No of Summonses Involved	Fine(\$)/ Penalty		Costs of Investigation Awarded(\$)	
Unlicensed Dealing in Securities						
1) Chan Kin Hung	21.10.03	2	10,000		5,000	
Lam Ka Yuk		2	10,000		5,000	
2) Ma Chun Wah	18.11.03	1	3,500		2,500	
President Securities (Hong Kong) Ltd		1	3,500		2,500	
Wong Lai Sze		1	3,500			
3) Chan Siu Tung	04.02.04	1	2,500		1,000	
6 entities		8	33,000		16,000	
Unlicensed Dealing in Commodities						
1) Ng Man Wai	03.06.03	1	7,500		2,962	
1 entity		1	7,500		2,962	
Unlicensed Investment Advising						
1) Wong Wai Kuen	09.09.03	1	3,500		5,000	
Chan Pui Sing Thomas	16.09.03	1	3,500		5,000	
Moy Kwok Chiu Theodore	04.12.03	1	1,000		3,000	
3 entities		3	8,000		13,000	
Unlicensed Forex Trading						
1) Chew Chun Ming Anthony	01.04.03	1	10,000		14,128	
2) Wong Chi Ho	31.10.03	2	13,000		19,814	
3) Lee Kam Wa Patrick	29.12.03	1	80 hours' community service			
4) Lam Hon Wing	27.02.04	1	10,000		10,000	
5) Yu Wai Fong	15.03.04	3	60,000		37,957	
Hong Kong Forex Investment Ltd	16.03.04	1	30,000		9,489	
6 entities		9	123,000		91,388	
Total: 16 entities		21	171,500		123,350	

Successful Prosecutions — Financial Resources Rules Related Breaches						Table 4
1 April 2003 to 31 March 2004						
Case Defendants	Date of Conviction	No of Summonses Involved	Fine (\$)		Costs of Investigation Awarded(\$)	
Provision of False / Misleading Information						
1) Ho Yan Lock Salex	01.04.03	2	90,000		18,215	
2) Prosperous Securities Ltd	29.07.03	1	10,000			
3) Kwok Wood Yan Tiffit Securities (Hong Kong) Ltd	18.08.03	11	22,000		14,743	
		11	22,000		14,743	
4 entities		25	144,000		47,701	
Breach of Financial Resources Rules						
1) Lim Boon Kick Tartan Securities (Asia) Ltd	27.05.03	4	35,000		28,332	
		4	35,000		28,333	
2) Chan Man Ching	29.07.03	1	5,000		22,934	
Lee Po Wing		1	5,000		9,828	
Prosperous Securities Ltd		1	5,000			
3) Lam Kwong Tim Spencer	30.03.04	1	7,000		18,660	
6 entities		12	92,000		108,087	
Total: 9 entities		37	236,000		155,788	

Enforcement

➤ Obstruction of SFC Investigations

We welcomed the Courts' decision to sentence four people convicted of failing to co-operate with SFC investigations to imprisonment and to community service work (Table 5). In passing the sentences the Courts commented that this was not a minor offence as it carried a maximum penalty of \$100,000 and six months' imprisonment.

Failing to co-operate in investigations undermines the SFC's effort to curb illicit activities that threaten Hong Kong's markets. The SFC will not hesitate to prosecute. Licensees will also face disciplinary action.

Successful Prosecutions — Obstruction of SFC Investigations					Table 5
1 April 2003 to 31 March 2004					
Case Defendants	Date of Conviction	No of Summonses Involved	Fine(\$)/ Penalty	Costs of Investigation Awarded(\$)	
1) Chan Kim Wing	30.09.03	2	20,000		
Tang Kin Lok Eddie		2	20,000		
2) Cheung Wai Kei	13.01.04	1	10,000	17,699	
Ken					
3) Cheuk Yik Cheung	10.02.04	2	80 hours' community service	500	
4) Tang Kin Lok Eddie	10.02.04	2	2 weeks' imprisonment	2,248	
Total: 4 entities		9	50,000	20,447	

➤ Other Investigations

We noted a decline in unauthorised investment promotion and illegal short selling prosecutions. Four people and one company were prosecuted for unauthorised investment promotion and one person for short selling. There were also four people prosecuted for hawking of futures contracts. One person was prosecuted for disposition of securities without authority and another one was prosecuted for breaches relating to the keeping of trust accounts (Table 6).

During the year, the SFC successfully prosecuted 60 entities. There were no acquittals.

Successful Prosecutions — Others					Table 6
1 April 2003 to 31 March 2004					
Case Defendants	Date of Conviction	No of Summonses Involved	Fine (\$)	Costs of Investigation Awarded(\$)	
Breach of Protection of Investors Ordinance					
1) Brunner Piers Daniel	08.04.03	4	24,000	9,474	
Carlyle					
Colliers International Agency Ltd		7	70,000	9,474	
Lam Kar Yan Rosaline		4	20,000	9,474	
2) Chan Kwok Ho	03.06.03	2	6,000	9,477	
Raymond					
Ng Man Wai		2	10,000	5,923	
5 entities		19	130,000	43,822	
Short Selling					
1) Sang Yee Pan Rondy	25.07.03	2	5,000	19,667	
1 entity		2	5,000	19,667	
Hawking of Futures Contracts					
1) Li Man Hin	16.12.03	1	4,000	2,500	
Lui Kim Ho		1	2,500	2,500	
Yau Oi Yi		1	2,500	2,500	
2) Lung Chai Yu	17.03.04	1	2,000	12,996	
4 entities		4	11,000	20,496	
Disposition of Securities without Authority					
1) Tong On Jimmy	05.02.04	3	60,000	26,181	
1 entity		3	60,000	26,181	
Failure to Maintain Trust Accounts					
1) Fong Shik Yee	18.08.03	7	7,000	7,371	
1 entity		7	7,000	7,371	
Total: 12 entities		35	213,000	117,537	

Disciplinary Actions and Appeals

➤ Disciplinary Inquiries

Honest and effective intermediaries help Hong Kong remain an international financial centre. To protect investors and market confidence, it is essential that we take tough disciplinary actions against those who put their clients' interests and the integrity of the market at risk.

In June 2003, we stated that we would refocus our disciplinary resources on the areas of corporate finance, fund managers and investment advisers, and banks. A tougher stance would be taken on three key failings - dishonesty, conflicts of interests and control-supervision failures that put investors at risk. We expect to conclude some of these cases in 2004-2005. A significant increase in penalties should become evident this year.

In 2003-2004, we conducted 167 disciplinary inquiries. Of these we concluded 69 cases resulting in discipline of 78 entities, with a broader range of sanctions. The penalties were heavier and more precisely tailored to the misconduct involved.

We also took disciplinary actions against 18 licensees which were eventually concluded with no formal sanction imposed. Disciplinary proceedings were commenced and discontinued against a further eight deemed licensees who left their firms before the conclusion of the actions.

One difficulty during the year was that, under the SFO transitional provisions, we lost jurisdiction to discipline if, after we started proceedings, a licensee left his employer and only held a transitional deemed licence. There were also cases in which we lost disciplinary jurisdiction when a licensee left the industry before we commenced any disciplinary proceedings. We referred all these cases to our Licensing Department for possible refusal if they ever re-applied for a licence.

Significant Disciplinary Actions			Table 7
1 April 2003 to 31 March 2004			
Registrants	Date of Action	Misconduct	Disciplinary Action
1) Chu Yuet Wah	05.04.03	SFC allegations of facilitating market manipulation	Mutual agreement that she would surrender her licence and not re-apply for 2 years and not be involved in running the business of her securities dealer firm
2) Yeung Tsz Chung	07.04.03	Misappropriation of stocks to the value of some \$21 million over a period of more than 10 years	Revocation
3) Kwok Wai Keung	06.05.03	Front running	12 months' suspension
4) Leung Tak Shing Raymond	10.09.03	Improperly destroying documents, failing to issue account statements and contract notes and creating a conflict of interest	14 months' suspension
5) Li Hon Kay	02.10.03	Improperly sold a client's shares and misappropriated the sale proceeds	Revocation
6) Do Yu Lun	17.10.03	Attempted theft	Life ban
7) Fan Yee Wai Richard	17.10.03	Giving false and misleading information to SFC and deceiving his employer and other breaches	12 months' suspension
8) Richard John Patterson	23.10.03	Carried out dealings in securities prior to approval of his license application	\$287,372 fine and public reprimand
9) Tam Siu Ki Simon	30.10.03	Rat trading and other trading malpractices	Revocation

During the year, we disciplined nine licensees for serious misconduct (Table 7). Of these, we:

- Imposed one prohibition order for life under the SFO on a licensee for misappropriation. We revoked the licences of three licensees for misappropriation of stocks, rat trading and other trading malpractice.
- Suspended the licences of three persons for 12 to 14 months for:
 - front running
 - improperly destroying documents, failing to issue statements of account and contract notes, and creating a conflict of interest
 - giving misleading information to the SFC, deceiving his employer and other breaches
- Agreed with one licensee that she would surrender her licences and not re-apply for two years and not be involved in running the business of her securities dealer firm for the same period on the basis of SFC allegations that she had facilitated market manipulation.
- Fined a licensee \$287,372 — the first fine under the SFO — and publicly reprimanded him for dealing in securities prior to getting a licence.

We also:

- Suspended the licences of 20 licensees from one week to six months for:
 - breaches of the Code of Conduct
 - poor internal controls
 - trading malpractice
 - misconduct relating to handling client accounts
 - facilitating potentially improper or illegal client trades
 - facilitating unlicensed dealing activities
 - providing misleading information in SFC interviews
 - falsely holding out an unlicensed firm as an investment adviser

Enforcement

- Publicly reprimanded 44 licensees for:
 - circumventing HKEx's rules, breaches of FRR and the Code of Conduct
 - poor internal controls and inadequate staff supervision to conduct business properly
 - selective disclosure of price sensitive information
 - improper conduct relating to handling of client accounts
 - providing misleading information and other breaches

We also issued 39 warning letters in less serious cases.

We disciplined a total of 29 licensees for internal control and supervision failures in 2003-2004 as compared to seven in the previous year. Such failures allow individual and corporate misconduct to occur. They also expose investors to actual or possible loss and damage market integrity. We will continue to focus on this area in the coming year.

Lessons to Learn

In November 2002, we started publishing a monthly digest of enforcement actions, the *SFC Enforcement Reporter*. It aims to provide the industry and the public with information on our disciplinary and prosecution actions to reinforce regulatory messages. We continued to receive positive feedback from the market. The following are important messages worthy of intermediaries' attention:

Case 1. Do Yu Lun

We banned Mr Do Yu Lun for life from re-entering the industry for attempted theft of \$12,000 from a client. Do's employer sacked him when it discovered his attempted theft and thwarted it. Under the SFO, we were able to impose the prohibition order on him even after he had left his employer.

The prohibition order is one of the new disciplinary measures available to the SFC under the SFO. This case illustrates that the SFC will only allow persons whose honesty and integrity are unquestioned to work in the industry. Licensees who steal or attempt to steal from their clients will have their licences revoked and will not be allowed back into the industry.

Case 2. Richard John Patterson

We reprimanded and fined Mr Richard John Patterson \$287,372 for unlicensed dealing before the approval of his licence.

Unlicensed dealing is both a crime and a ground for discipline. Since the SFC may impose harsher sanctions with its new power to fine, it may choose to pursue licensed persons through discipline alone. It may also choose to pursue both routes. There is no double jeopardy. Although circumstances of individual cases differ, the level of fine imposed indicates the relative severity with which the SFC will treat each case. Fines will enable the SFC to deal far more flexibly with disciplinary cases.

Case 3. Chu Yuet Wah

Ms Chu Yuet Wah voluntarily surrendered her licences and undertook not to apply for new licences for two years. She also agreed with the SFC not to have any involvement in or influence over the day-to-day running of her firm, Kingston Securities Ltd, during that period. The SFC alleged that she had either actively assisted or turned a blind eye to the manipulative activities of two former employees of Merrill Lynch (Asia Pacific) Ltd in derivative warrants for a six-month period. We settled on a no finding/no admission basis to achieve a firm but pragmatic regulatory result in the interests of the market and investors.

Case 4. Ting Chuk Kwan

We reprimanded Ms Ting Chuk Kwan for selectively disclosing non-public price sensitive information which she received from the management of New World Development Ltd prior to the company's release of interim results. She disclosed the information to the sales and trading staff of her firm, Goldman Sach (Asia) LLC, in an internal broadcast before the information became public.

It is important for analysts not to disclose non-public price sensitive information at all. The only acceptable disclosure is for the listed company concerned to disclose the information to the investing public as a whole in accordance with the Listing Rules. If an analyst has published a research report and the report is rendered inaccurate by the new information, he should withdraw the report without comment.

We view this case as a warning, and are pleased that it seems to have prompted reforms in industry practice. We will punish future similar acts more harshly. On 31 March 2004, the SFC issued guidance to analysts on how to handle non-public price sensitive information.

➤ Disciplinary Appeals

The Enforcement Division handles appeals cases stemming from its own disciplinary decisions before the appeals bodies.

In 2003-2004, three appeal cases were decided by the Securities and Futures Appeals Panel (SFAP) established under the old laws. One decision was upheld in our favour, one was discontinued due to lack of jurisdiction, and in the remaining case, the SFAP reduced the SFC's penalty. The SFAP will continue to hear appeals lodged before 1 April 2003, and two appeal cases are still before it. A decision in one is expected shortly and the hearing of the other is set for early May 2004. Appeals to SFAP are only public if, at the end, a public sanction is imposed.

Applications for review lodged after 1 April 2003 are heard by the Securities and Futures Appeals Tribunal (SFAT), a new body established under the SFO to replace the SFAP. The SFAT consists of a chairman, who is a High Court judge, and two lay members (drawn

from a panel of 22 members appointed by the HKSAR Chief Executive). All SFAT hearings are held in public unless in the interests of justice the Tribunal determines otherwise.

During the year, the SFAT concluded three cases. This is encouraging and faster than the SFAP. Two cases involved substantive applications for review of SFC's decisions, and the SFAT dismissed both. The other one involved an application for a time extension to lodge an appeal outside the time limit, and similarly the SFAT dismissed it. Four cases are pending before the SFAT. Review hearings on one matter will take place in April 2004 and on two matters in early June 2004. The review hearing on another matter is delayed as the applicant has applied to judicially review the SFC's decision. A hearing of that judicial review application is scheduled for early September 2004.

The SFAT made a number of guiding statements in its decisions. It made it clear that it would be reluctant to interfere with the SFC's decision unless the applicant could demonstrate that a clear error had been made by the SFC and good and cogent reason existed for varying the SFC's decision. In another case, the Tribunal stated that, for the sake of certainty, it would not allow appeals outside the statutory 21-day time limit, unless the appellant could prove "good cause". The SFAT decided that the appellant's delay in instructing lawyers because of her concern about legal costs and antagonising the SFC, and her spending time to discuss the matter with friends were not "good cause". In a third case, the appellants applied for the review hearing to be held in private, on the ground that any public hearing would adversely affect their reputation. The SFAT rejected the application, and decided that private hearings should only be confined to cases which are of their nature unusual and highly sensitive. The SFAT considered that it would be essential that the regulation of the financial market is conducted with a high degree of transparency, and private hearings, by their very nature, do not help.

Co-operation with Other Law Enforcement Agencies and Overseas Regulators

To fight financial crime and misconduct effectively, we maintain close contacts with domestic enforcement agencies and our counterparts in other jurisdictions.

We continued our co-operation with the CSRC in the investigation of corporate misconduct involving the

activities of Hong Kong listed companies in the Mainland. We worked closely with the Hong Kong Police (in particular the Commercial Crime Bureau) and the Independent Commission Against Corruption (ICAC) on matters ranging from corporate fraud and misappropriation by brokerage staff to boiler room fraud and market manipulation. We assisted their investigations by providing expert evidence and other support as required. We also co-operated with the Hong Kong Monetary Authority (HKMA) in cases involving misconduct and trading malpractice by staff of registered institutions.

During the year we referred 32 cases to the Police and ICAC for further investigation and action. To enhance the understanding of each other's work, an officer from the ICAC was seconded to the SFC's Enforcement Division for two months to exchange expertise and experience. Similar secondment will take place in the coming year.

We continued our efforts to enhance international regulatory co-operation, information sharing and cross-border investigation. The SFC currently has 33 bilateral or tri-lateral co-operative arrangements with regulatory bodies around the world. We are discussing arrangements with five other jurisdictions. We are also one of the signatories of the IOSCO Multilateral Memorandum of Understanding, which greatly enhances regulatory co-operation among all signatories (Please see further details in *Cross-Border Regulatory Co-operation* chapter).

Boiler Rooms

We received 43 complaints about boiler room operations, compared with 68 in 2002-2003.

"Boiler room" operators are salespersons who cold call potential investors and use high pressure sales tactics to promote real or bogus investments. Very often, they are located in one country and approach investors in another by telephone, email, fax or post. As both the operators and the purported investments are based overseas, their legitimacy is often difficult to verify and their operations are difficult to trace. Often they disappear after receiving investors' money.

Since November 2000, we have set up an Alert List on our website to warn investors of unlicensed overseas companies that have come to our attention. We are aware that some companies solicit Hong Kong investors and we have put a remark beside those companies on the Alert List.

In 2003-2004, we referred six complaints to the Joint Financial Intelligence Unit, the Hong Kong anti-money laundering body jointly run by the Police and the Customs & Excise Department. All these boiler rooms maintained bank accounts in Hong Kong.

Supervision of Markets



Mr Yorkling Chow, despite his 30 years of carpentry experience, does not take the production of a Chinese window frame lightly because the structure calls for sophisticated craftsmanship. Step by step carefully, he carves and polishes the frame to remove any remaining flaws. The SFC works with the market to build an efficient and robust financial infrastructure.



Our mission is to ensure that the regulation and development of Hong Kong's securities and futures markets meet international standards.



Achievements

- Authorised the first group of five Automated Trading Services (ATS) providers
- Set up the Investor Compensation Company Ltd (ICC) and monitored its operations
- Monitored the development and launch of advanced market infrastructure under SCEFI recommendations, including the clearing systems CCASS/3 and DCASS
- Relaxed further the short selling regulation
- Streamlined regulations on position limits and reporting requirements of futures and options contracts

This Chapter Is About

>> Facilitating market development

- Encouraging product innovation and enhancement
- Relaxation of regulations
- Authorisation of ATS providers
- Review of HKEx's fees

>> Strengthening financial infrastructure

- Upgrade of CCASS/3
- Review of HKEx's systems

- Rollout of derivatives trading and clearing systems
- Implementation of SCEFI initiatives

>> Investor compensation

- Processing investor compensation claims
- Investor Compensation Company Ltd

>> Market research

WHAT WE DO

- >> **Facilitate the development of and encourage participation in the Hong Kong markets;**
- >> **Strengthen market infrastructure;**
- >> **Supervise and monitor activities of the exchange controller, exchanges and clearing houses;**
- >> **Regulate approved share registrars;**
- >> **Supervise and monitor activities of the independent Investor Compensation Company Ltd; and**
- >> **Manage Hong Kong's investor compensation funds.**

WHAT WE DID

Facilitating Market Development

> Encouraging Product Innovation and Enhancement

The SFC encouraged HKEx to widen its product range, enhance its markets and streamline the regulatory requirements for various products:

- On 8 December 2003, Hong Kong Futures Exchange (HKFE) introduced the Hang Seng China Enterprises Index Futures contract. The underlying Hang Seng China Enterprises Index (also known as the H-shares Index) is a popular stock price index to track the performance of the H-shares market. Immediately after the launch the contract received favourable support from market participants and the average daily turnover exceeded 5,000 contracts in a few months' time. A new futures contract is exempt from the SFC levy during the first six months of trading.

- On 1 September 2003, HKEx enhanced its block trade facility for futures and options contracts for a trial period of six months. Block trades comprise privately negotiated large buy and sell orders. The minimum threshold of stock options block trades was increased from 100 contracts to 500 contracts and the block trade restriction imposed on expiring contracts during the last two trading days was removed. At the end of the trial period, the SFC approved the changes on a permanent basis.
- The first ETF authorised under new SFC guidelines was listed on SEHK in November 2003 under the streamlined arrangements in Chapter 20 of the Listing Rules. We had worked closely with HKEx to ensure that the necessary market infrastructure was in place for the trading of this ETF, including the HKSCC rule amendments to facilitate scripless creation and redemption of ETFs and short selling with tick rule exemption.

> Relaxation of Regulations

To maintain the competitiveness of our markets and to reduce the compliance burden of market participants, the SFC has been working closely with the industry, HKEx and the Government on measures to streamline the short selling regime. Following the legislative changes in 2002 to relax short selling regulation, on 26 May 2003, the SFC approved HKSCC rule changes to facilitate the introduction of buy-in exemption for settlement failures resulting from a delay in the recall of loaned securities.

With the exemption, a stock lender unable to settle its short positions on T+2 due to a failure to recall loaned securities will be exempted from the compulsory buy-in. But as in the case of other buy-in exemptions, these outstanding positions must be settled in full by T+3.

The exemption allows a lender to maintain fewer buffers in the lending pool. As more securities are available for lending, the liquidity of the stock market is enhanced. The exemption came into operation on 6 June 2003 for a six-month trial period. Subsequently the SFC approved the exemption on a permanent basis.

On 17 September 2003, the SFC issued a consultation document on the draft Securities and Futures (Contracts Limits and Reportable Positions) (Amendment) Rules 2003.

The Amendment Rules allow any person, including a non-Exchange Participant, who holds or controls futures or stock options to apply the reporting requirements and the prescribed limits separately to his own account and to each of the other persons except where the person has discretion in respect of the futures or stock options contracts which he holds for the other persons. This helps provide a level playing field for Exchange Participants and non-Exchange Participants.

Following negative vetting by the LegCo, the Amendment Rules came into force on 30 April 2004. A revised Guidance Note on Position Limits and Large Open Position Reporting Requirements has been issued to reflect the changes.

➤ **Authorisation of ATS Providers**

We authorised in October 2003 five ATS providers, including four overseas exchanges and one local subsidiary of an international information provider. Particulars of the authorised entities and the authorisation conditions are listed on the Register of Automated Trading Services, available on the SFC website.

As of March 2004, the SFC was processing three applications (including two from overseas exchanges and one from a local company) to provide ATS in Hong Kong.



An on-line register on the SFC website gives details of ATS providers.

➤ **Review of HKEx's Fees**

Fees charged by HKEx in its capacity as a recognised exchange controller, SEHK and HKFE in their capacities as a recognised exchange company and by the clearing houses in their capacity as a recognised clearing house must be specified in rules and approved in writing by

the Commission. With demutualisation, the Government eliminated the portion of the statutory levy going to SEHK from 1 September 2001 and SEHK sought approval from the SFC to replace the lost revenue with a trading fee of 0.005% of the value of transactions recorded on the SEHK, subject to review after 12 months. The Commission granted approval on condition that HKEx complete a comprehensive review of all its fees within a year of the trading fee taking effect.

The comprehensive fees review has not been completed by HKEx and extensions of time have been approved by the Commission. Now that a number of issues that delayed the review have been resolved, HKEx and the SFC are holding discussions on the way forward to complete the fees review.

Strengthening Financial Infrastructure

➤ **Upgrade of CCASS/3**

The third stage of the new Central Clearing and Settlement System (CCASS/3) was successfully introduced in May 2003 after a series of internal tests and market rehearsals. The new generation of CCASS/3 is equipped with an open architecture, accessibility through the secured network FinNet, common collateral management functions, upgraded security features and direct access to participant supplied systems through open gateway systems. It provides a robust and convenient settlement platform to the clearing participants.

The SFC monitored the project management process, testing procedures, rollout procedures and contingency planning during the implementation and rollout.

➤ **Review of HKEx's Systems**

In view of several HKEx glitches in 2002, the SFC requested HKEx to conduct a series of comprehensive reviews on the technical architecture of its critical systems, the operational procedures and the overall IT quality management framework so as to strengthen the reliability and stability of the systems. In 2003, HKEx invited independent consultants to conduct the various

Supervision of Markets

reviews and make recommendations. During the year, no critical market-wide system problems were reported. The SFC continues to monitor HKEx's implementation of the recommended measures.

➤ Rollout of Derivatives Trading and Clearing Systems

A new derivatives trading system was launched in October 2003 and no critical problems occurred during the two-week stabilisation period. The new system provides a more reliable trading platform and is able to interface with a new derivatives clearing system, known as Derivatives Clearing and Settlement System (DCASS).

In order to minimise the operational risk of the integrated trading and clearing systems, the SFC monitored the independent reviews conducted by HKEx on the project planning and implementation process, testing procedures, rollout procedures, contingency and fallback plans of DCASS. Moreover, we requested HKEx to provide adequate training to clearing participants to ensure market readiness before the rollout. The internal tests and market rehearsals for DCASS were successfully completed in early 2004. DCASS was launched in April.

➤ Implementation of SCEFI Initiatives

■ Work Towards a Scripless Model

On 30 September 2003, the SFC published the consultation conclusions on proposals of a scripless securities market. Overall, the market was supportive of the proposals. On 24 October, HKEx published its own independent consultation paper entitled Proposed Operational Model for a Scripless Securities Market, which explained HKEx's proposed operational details of a Split Register Model. In response to market comments, HKEx has revised its proposal to be a Single Register Model, under which the registrars need not issue scrips and instead will keep electronic records of such shares. CCASS will dematerialise most of the jumbo certificates in its vaults but investors or brokers may continue to withdraw physical share certificates from CCASS. Depending on market demand, HKEx may provide further enhancements.

In the meantime, the SFC continues to work with the FSTB and Law Draftsman on redrafting the legislation to reflect the changes in the new model.

■ Strengthening Interoperability

Several initiatives to enhance market interoperability proceeded satisfactorily during the year. They help facilitate straight-through-processing and reduce the need for manual efforts in the settlement process.

The high level requirements for system enhancements to facilitate central pre-matching of settlement instructions in CCASS were agreed and finalised between HKEx and the industry. Work on system enhancements has commenced and is targeted for implementation in the fourth quarter of 2004.

The Commission is co-ordinating with share registrars and selected market participants to conduct trial runs to provide IPO allotment results in useable data format. If the trial is successful, the initiative will be offered to all market participants in the second quarter of 2004.

The Commission is also working with HKEx and custodians to explore the feasibility of building a centralised Corporate Actions Database with standardised corporate action information. The initiative would save efforts of market participants in manually extracting corporate announcements from newspapers.

Major custodians have agreed on a best practice guide based on the SWIFT message standards, to standardise the use of client reference number in settlement instructions. SWIFT Hong Kong has undertaken to publish the industry recommended best practice.

■ Enhancement of Investor Participant (IP) Accounts Service

The Commission has been working with HKEx to improve the IP Accounts service. HKEx has proposed a number of short-term measures including extending the hours for on-line access to nearly 24 hours a day, allowing the use of user ID and password for Internet access, providing SMS message to alert IPs on activities requiring their actions, allowing IPs to submit electronic request for demand poll voting, allowing Free of Payment IP settlement instructions without affirmation and offering of on-request statement services. The target launch date of these measures is the third quarter of 2004.

The SFC continues to work with HKEx on the implementation of other SCEFI initiatives, taking into account market demands.

Investor Compensation

› Processing Investor Compensation Claims

As at 31 March 2004, the net asset values of the Unified Exchange Compensation Fund (UECF) and the Commodity Exchange Compensation Fund (CECF) were \$323.8 million and \$0.3 million respectively. During the year, compensation payments totalling \$14.5 million were made from the UECF to 258 claimants in respect of the default of C.A. Pacific Securities Ltd (CAPS), Lawsons Securities Company, Ying Kit Company Ltd and Teil Stock Investment Co. Claimants have received, or will receive, the amount allowed by the SEHK up to \$150,000 per claimant under the agreed compensation arrangement. No payments were made from the CECF during the year.

The SFC has made additional payments totalling \$172,700 and \$2.6 million to four clients of Chark Fung Securities Co Ltd and eight clients of Win Successful Securities Ltd respectively under the \$8 million entitlement per Exchange Participant of UECF.

During the year, the SFC worked with the liquidators of CAPS and HKEx on the asset distribution to the claimants of CAPS. In May 2003, a Court order was made to the last group of appellants on the classification of the cash and margin clients. As there was no further appeal during the 28-day appeal period, the liquidators started the share distribution from 30 June until 28 October 2003. The claimants who had received compensation payment could opt to receive all the allocated shares from the liquidators if they paid back the entire compensation amount to UECF. About 300 claimants returned \$31.8 million to the UECF. The SFC has also collected allocated shares from liquidators under its subrogation rights.

› Investor Compensation Company Ltd

Under the SFO, the independent ICC has been set up to administer and manage the Investor Compensation

Fund (ICF), which replaces the UECF and the CECF. The compensation arrangement has been streamlined and there is greater protection to investors. Coverage has been extended to all investors transacting through licensed intermediaries dealing in HKEx's products, including securities and futures dealers, registered institutions under the Banking Ordinance and margin financiers.

ICC came into operation on 1 April 2003 with its own Board of Directors. The Commission has established an Investor Compensation Fund Committee to monitor and regulate the ICF and ICC. We have assisted the ICC in setting up its operational procedures, claim handling process, corporate policy and technical infrastructure.

During the year, ICC received three claims. One of them was rejected and the other two were being processed as of 31 March 2004.

UECF and CECF have transferred assets of \$700 million and \$108 million respectively to ICF. Including the ongoing transaction levy and investment income, the net asset size of ICF was \$962 million as of 31 March 2004.

Market Research

The Division extensively researches developments in the securities and futures markets of Hong Kong and other major markets. We also work with other divisions and regulators to monitor market and industry performance. Apart from providing support to the Commission to achieve our regulatory objectives by analysing information and identifying the latest trends, we give information to the Government and IOSCO.

To better communicate with market participants and investors and to provide them with timely information, we enhanced the research paper series and the Statistics section on our website. During the year, we issued 10 research papers covering various aspects of the securities and futures markets and widened our coverage of market and industry statistics. The SFC worked with other regulators and academia on the publication of the research-based *SFC Quarterly Bulletin*.

Legal Services

Achievements

- Helped ensure the smooth implementation of the SFO and over 40 items of subsidiary legislation made under it
- Formulated amendments to subsidiary legislation to address market developments
- Revised the Outline of Part XV of the SFO to provide further guidance to the market on the new Disclosure of Interests regime
- Advised on possible breaches of the old ordinances and the new SFO regime
- Conducted significantly more successful prosecutions for regulatory offences
- Published a summary explaining the SFC's consultation procedures

This Chapter Is About

- >> **The Securities and Futures Ordinance**
- >> **Prosecutions and appeals**
- >> **Legal support for the Commission's work**
- >> **Legal advice and assistance in policy initiatives**

WHAT WE DO

- **Assist with reform of the laws governing the securities and futures markets;**
- **Conduct prosecutions in the Magistrates' Courts for a wide range of regulatory offences;**
- **Advise the operational divisions on possible breaches of the securities laws;**
- **Advise the Commission in relation to suspected insider dealing;**
- **Handle civil litigation matters involving the SFC and appeals;**
- **Provide general in-house legal advice and support;**
- **Handle policy initiatives with a significant legal content and participate in major cross-divisional policy initiatives.**

WHAT WE DID

The Securities and Futures Ordinance

In the lead-up to and following commencement of the SFO on 1 April 2003, the Division was actively involved in the implementation process to help ensure a smooth transition to the new regime for the market. We assisted the operational divisions in responding to questions from the industry and the public about the application of various provisions of the SFO or items of subsidiary legislation. The Division also provided advice to the operational divisions about the new law.

At the beginning of the transitional period, we responded to a great number of queries from both practitioners and the public about the operation of the new Disclosure of Interests regime. We revised the Outline of Part XV of the SFO, which gives guidance on when and how to complete the forms to disclose interests in shares of listed companies, to address many of the common queries and to assist the market to comply with the requirements.

One of the advantages of the SFO regime is that many of the detailed and technical regulatory requirements are prescribed in subsidiary legislation which can be amended relatively quickly, thus providing the SFO with the flexibility to address changing market and global conditions. Shortly after the legislative drafting team had completed the major tasks of drafting and gazetting of the considerable body of subsidiary legislation, we, together with the operational divisions, started to consider and formulate amendments to some of the items of subsidiary legislation to address market developments.

In late 2003 the Securities and Futures (Price Stabilizing) (Amendment) Rules were gazetted. The amendment includes the UK as a recognised jurisdiction under the Hong Kong Price Stabilizing Rules to facilitate offerings in both jurisdictions. More recently, we gazetted the Securities and Futures (Contracts Limits and Reportable Positions) (Amendment) Rules.

Six months into the new regime, the SFC began the task of the ongoing maintenance of the SFO. The objectives are to examine if the existing provisions are effective in meeting the SFC's policy objectives and to consider if any provisions need to be updated in view of market developments. The maintenance exercise will result in an Amendment Bill and various amendment rules which will be released for public consultation.

Following the Government's publication on 26 March 2004 of the Consultation Conclusions on Proposals to Enhance the Regulation of Listing, the legislative drafting team has commenced work on the new statutory rules to be made by the SFC under Section 36 of the SFO, which will contain the important listing requirements to be given statutory backing. The plan is to include amendments to the primary legislation required for the new statutory framework in the Amendment Bill.



The new Disclosure of Interests requirements give a more complete picture of dealings by substantial shareholders and directors.

Prosecutions and Appeals

The Commission prosecuted a wide range of offences in the Magistrates' Courts pursuant to its powers under Section 62 of the now repealed Securities and Futures Commission Ordinance (SFCO) and Section 388 of the SFO.

With the commencement of the SFO, the Division has been advising on various offences both under the former regime of 10 ordinances and the SFO. The Division also continued to advise on evidence and to prosecute cases under the old ordinances, including market manipulation, unregistered dealing, breach of disclosure requirements, promotion of unauthorised investment arrangements, failures to comply with requirements to attend interviews and failure to give full assistance with an SFC investigation.

Over the year, there has been a significant increase in cases handled by the prosecution team which comprises one third of the Division staff (four out of 12 lawyers). There was also an increasing trend for persons prosecuted by the Commission to enter pleas of not guilty which resulted in more than twice as many cases proceeding to trial as in the previous year.

For the first time, the SFC successfully prosecuted a licensed leveraged foreign exchange trader (Hong Kong Forex) for failing to ensure that a person (Ms Yu Wai Fong) who was actively engaged in leveraged forex trading was licensed. Hong Kong Forex was convicted after trial and was fined \$30,000 and ordered to pay the SFC's investigation costs.

Yu was convicted of unlicensed forex trading under the Leveraged Foreign Exchange Trading Ordinance. In addition, she was convicted of making unsolicited calls to induce a person to enter into a leveraged forex trading contract.

Also for the first time, we successfully prosecuted a number of people for hawking futures contracts under the Commodities Trading Ordinance and three people for failing to comply with the requirement to attend an interview with the SFC in relation to an investigation in breach of Section 33(12)(c) of the SFCO and Section 184(1)(c) of the SFO.

Court of Final Appeal Allows Appeal Against Stay of Proceedings Against Mr Lee Ming-tee and Orders Payment of SFC's Costs

From late June to early July 2003, the Court of Final Appeal (CFA) heard the appeal by the Government against the order of Mr Justice Seagroatt for a stay of the prosecution of Mr Lee Ming-tee on charges of conspiracy to defraud and publishing a false statement. The SFC had intervened, with leave of the Court, in the appeal on the basis that a substantial and grave injustice had been done to the SFC and its witnesses by the Judge's mistaken adverse factual findings and conclusions when he ordered a permanent stay of Mr Lee's trial. The Judge's main finding against the SFC was that certain senior SFC officers had deliberately and improperly terminated a disciplinary investigation into the conduct of Mr Meocre Li (the prosecution's expert witness in Mr Lee's trial) with regard to a share placement in order to avoid the need to make disclosure to the prosecution, which might have compromised Mr Li's standing as an expert witness in the trial.

Judgment was handed down by the CFA on 22 August 2003. The Court unanimously allowed the appeal by the Government against the order of Mr Justice Seagroatt and ordered the case to be remitted back to the Court of First Instance for Mr Lee to stand trial.

The CFA found that the Judge's view of the evidence was mistaken in several respects and that his findings of facts, and certain inferences which he had drawn, could not be sustained. The CFA further found that when due weight was given to the seriousness of the conduct alleged against the SFC, the explanations offered on behalf of the SFC and the strong possibility that any errors of judgement on the part of the SFC were innocent, the Court could not be satisfied that the alleged ulterior intention or purpose had been made out or that the inferences sought to be drawn by the respondent were compelling. The CFA stated that the Judge's finding that the SFC terminated its inquiry into Mr Li in order to protect his status and standing as a witness could not be sustained and could not support the grant of a permanent stay.

The CFA also found that, in the particular circumstances of this case, the SFC and Mr Li should have made disclosure of the SFC's disciplinary investigation to the prosecution because the SFC should have realised that the information in its possession arising out of the investigation was potentially damaging to Mr Li's integrity and standing as an expert witness in Mr Lee's trial. However, the CFA found that this failure to disclose could not justify a stay of the prosecution.

In November 2003, the CFA ordered Mr Lee to pay the SFC's costs for the High Court proceedings and the appeal.

Legal Support for the Commission's Work

➤ Civil Actions

The Division is preparing for judicial review proceedings which have been instituted in respect of a disciplinary decision made by the Commission in 2003. We are also reviewing two cases with a view to instituting proceedings under Section 214 or other relevant Sections of Part X of the SFO in the interests of investor protection.

➤ Takeovers and Mergers Panel

The Division provided a legal adviser to assist the Takeovers and Mergers Panel in considering an application for a review of an Executive ruling by CLP Holdings Ltd (Please see details in *Corporate Finance* chapter).

➤ Appeals Against SFC Decisions

The Division represented the Commission in respect of two review applications against the SFC decisions to revoke the applicants' registrations as dealers' representatives following the making of bankruptcy orders against them. The first case was before the SFAP in September 2003. The other was one of the first cases to be heard by the newly established SFAT. Both appeals were dismissed by the appeals bodies.

Legal Advice and Assistance in Policy Initiatives

One of the main functions of the Division is to provide legal advice to the SFC's operational and support divisions. During the year, we advised on matters including:

- the interpretation of securities laws, both under the old regime and the SFO (and subsidiary legislation);
- the provisions of other legislation affecting the Commission such as the Companies Ordinance, the Personal Data (Privacy) Ordinance, the Copyright Ordinance, the Gambling Ordinance and the Employment Ordinance;
- all aspects of the SFC's decision making process: the exercise of our investigative, disciplinary and intervention powers; and
- the SFC's procedures, to ensure procedural fairness in the exercise of our powers.

We also participate in cross-divisional policy initiatives, sometimes in a leading role where the project has major legal content and often assisting with policy initiatives led by other divisions. During the year, we assisted in the formulation of the legislative proposals for a scripless market and worked closely with the Corporate Finance Division in the early formulation of the SFC's policy on regulation of listing. We also assisted in revising our personnel policies and procedures.

In addition, we published a summary of the SFC's consultation procedures in October 2003, explaining why we consult, what we are required to do, what we do and the stages of a typical consultation. This aims to enhance the public's understanding of how the SFC conducts its consultations. Public views improve our decision making process and help ensure that our proposals meet the needs of the market and investors.

The Division also provides general legal support to the Commission in relation to employment matters, insurance and commercial contracts and agreements.

Corporate Affairs

Achievements

- Continued stringent cost control and achieved a surplus after two years of deficit
- Moved to new offices
- Strengthened employee relations and communication
- Provided more customised training to staff
- Formed Security Committee and revised the Information Security Policy to strengthen protection of information assets
- Reached out to more investors with new education initiatives
- Strengthened communication with investors and other stakeholders
- Participated actively in community work and voluntary services

This Chapter Is About

- >> The SFC's finances and administration
- >> Human resources matters
- >> Technology advancement
- >> Investor education and communications
- >> Reaching out to stakeholders
- >> Ensuring smooth transition to the SFO regime
- >> Care for the community

WHAT WE DO

- >> Provide finance, human resources, training, information technology, management and corporate services to the Commission;
- >> Provide strategic planning and corporate co-ordination on the Commission's work;
- >> Educate investors on their rights and responsibilities; and
- >> Promote effective communications with stakeholders including the media.

This chapter covers the work of the Chairman's Office, Commission Secretariat, Corporate Planning, Finance and Administration, Human Resources, Training and Development, Information Technology, Investor Education and Communications, and Corporate Communications.

WHAT WE DID

Finances and Administration

> Financial Highlights

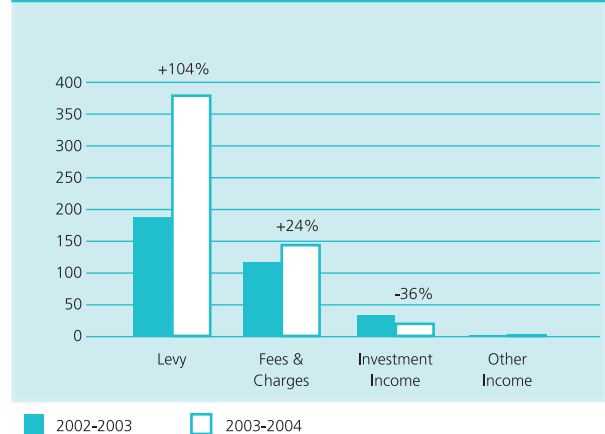
Benefiting from the revival of market activities since the second quarter of the financial year, the SFC's total revenue for 2003-2004 increased by 63% or \$213 million from the previous year to \$551 million. Yet, the increases in both levy income and fees and charges income were partially offset by the drop in investment income.

Levy income, our major source of revenue, increased by 104% or \$194 million to \$380 million (2002-2003: \$186 million) as the average daily market turnover surged to \$14.6 billion (\$7 billion). For income purpose, the turnover figure includes the amount of new fund raisings, which also attract transaction levy.

Fees and charges income rose by 24% or \$28 million to \$145 million (\$117 million). Investment income fell

36% or \$12 million to \$21 million (\$33 million) due to the continuous softening of interest rate, despite the increase in funds available for investment.

Breakdown of SFC Revenue (\$ million)



During the year, we continued to exercise stringent cost control with measures which we have adopted since the second half of 2001. We froze fixed salary and exercised tight control on staff number. We also kept recruitment expenses and expenditure for staff activities to a minimum, and the provision of training activities at a modest level.

Total expenditure was \$426 million (\$397 million), \$7 million below the approved budget. Compared to a year ago, expenditure was 7% or \$29 million higher. The increase was mainly attributable to the one-off office relocation expenditure and new expenses for discharging the Dual Filing function. Should these expenditures be excluded, the increase was 2% or \$7.4 million.

As a result, the SFC achieved a surplus of \$125 million for the year 2003-2004 as compared with the projected deficit of \$93 million for 2003-2004 and the \$58 million actual deficit recorded in 2002-2003. Our reserves at the end of March 2004 stood at \$691 million, equivalent to 1.6 times of estimated expenditure (including depreciation) of \$443 million for 2004-2005.

Corporate Affairs

Our budget for 2004-2005 forecasts an operating surplus of \$4 million. In March 2004, the Financial Secretary under the delegated authority from the Chief Executive approved the budget.

> Office Relocation

In June 2003, 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 adopted a modest fitting standard and reused old furniture as far as possible. Our new offices became fully operational on 30 June 2003.

Our computer centre was also relocated as part of the office relocation in July 2003. Normal computer services were maintained during the relocation process without additional investment in transitional hardware and any service interruption.

Human Resources Matters

> Staffing and Remuneration

The Commission considers its staff the greatest asset. Its remuneration policy is to ensure that the SFC pay levels are competitive and effective in attracting, retaining and motivating competent staff.

There were 392 permanent established posts (including 18 permanent established posts created for the additional work under Dual Filing) and eight temporary established posts. Separately, provision was made for 19 temporary staff and 14 Executive Trainees.

As at 31 March 2004, there were 416 staff (including 17 staff for Dual Filing), comprising 382 regular staff filling the permanent established posts and 34 temporary staff. Total staff number was 403 a year ago.

A total of 173 SFC staff, representing 42% of all staff, held professional qualifications. During the year, overall staff turnover decreased from 8.8% to 7.2%.

In accordance with the recommendations of the Hay Report issued in June 2002, the remuneration information of the top three tiers of our senior executives is disclosed as follows:

- All Executive Directors are not entitled to any other benefits except for retirement benefits, medical and life insurance, and annual leave. A six-month "sanitisation" period is applicable to all Executive Directors upon them leaving the Commission which is not treated as garden leave with pay, and no compensation will be made.
- In his last employment contract up to 30 September 2003, the Chairman's annual remuneration was up to \$7,875,000, comprising a fixed pay of \$7,500,000 and a performance-related variable pay of up to \$375,000. Since 1 October 2001, the Chairman had voluntarily reduced his fixed pay from the contractual sum of \$7,500,000 to \$6,750,000 per annum. He had also voluntarily offered to forego all of his variable pay. In his new employment contract effective 1 October 2003, the Chairman's annual remuneration package comprises a fixed pay of \$6,750,000 and a performance-related variable pay of up to \$337,500. The fixed pay is constant throughout the contract period and the variable pay is awarded annually on performance basis. His total emoluments (including retirement benefits) during the year amounted to \$6,800,000.
- The average of the total emoluments (including retirement benefits) of the other five Executive Directors during the year amounted to \$4,077,000.
- The average of the total emoluments (including retirement benefits) of the seven serving Senior Directorate Grade Staff during the year amounted to \$2,773,000.

> Human Resources Policies and Staff Opinion Survey

To continuously enhance its internal operations, the SFC revised its Personnel Manual to include the Equal Employment Opportunities Policy, Grievance Procedures and Disciplinary Procedures. The revised Personnel Manual is effective from 1 April 2004.

To better understand what staff think of their work and the Commission, staff were invited to take part in an opinion survey conducted by an international human resources consulting firm in late 2003. The survey attracted a satisfactory response rate of 58% among staff. The survey results will be released after consideration by the Board.

› Training and Development

The training budget was kept to a minimum in the first half of the year as part of the overall cost saving strategy. During this period, the Commission relied heavily on internal expertise and market participants for training. In the second half when the market picked up, the Commission was quick in allocating additional resources for customised training. Tailor-made in-house courses were provided to promote staff competence and effectiveness. During the year, 231 customised training programmes covering topics on industry, management, language and information technology were held in-house. These included workshops on interpersonal and communication skills, presentation skills, supervisory management and Putonghua.

Staff also shared experience among themselves and presented their areas of responsibility in briefings. These included training sessions on SFO and new initiatives such as Dual Filing and new rules on listing and corporate governance. Senior executives including the Chairman and other Executive Directors also spoke on topical issues.

Local and overseas external speakers were also invited to provide updates on market issues and overseas regulatory experience. Prominent speakers included Mr Noel Hinton, Deputy Director General of the London Takeover Panel and Mr James Clarkson, Director of Regional Office Operations of the US SEC. In March 2004, we joined the Hong Kong Securities Institute and the Hong Kong Association of Banks to organise a luncheon seminar on self-regulation in securities market, presented by Sir Howard Davies, Director of the London School of Economics and former Chairman of the UK FSA.



Sir Howard Davies receives a souvenir from Mr Andrew Sheng after the luncheon seminar.

To broaden staff's exposure and experience, we continued to operate a secondment programme with the CSRC and send staff to essential overseas training. During the year, three staff were seconded to the CSRC for four weeks each while we received three CSRC secondees for three weeks to six months. One staff was seconded to ASIC for four weeks while two staff members attended training in the UK and the Asia Pacific region.

Staff Welfare and Employee Relations

We stepped up efforts to enhance employee relationship and communication in 2003-2004. A number of in-house lunches and a barbeque were organised. Subsidies were also disbursed to departments to enable them to organise staff functions and recreational activities to promote team spirit.

We also organised health talks for staff and sought to ensure that the Commission's office environment and equipment comply with the Occupational Safety and Health Ordinance.



SFC Basketball Team and supporters pose with senior representatives of various financial regulators after winning the Supervisory Cup Basketball Competition 2003 last August.

Last year also saw the formation of an SFC basketball team. Other recreational activities like inter-divisional table tennis matches and Chinese chess competitions were organised. We had friendly sports games and matches in badminton, basketball, table tennis and soccer, etc. with other regulators and organisations including the HKMA, MPFA and HKEx.

Technology Advancement

During the year, a placee database was established to track placee information and capture shares placement activities information from HKEx for analysis and investigation.

Corporate Affairs

A video-conferencing facility was installed in November 2003. It serves as an alternative channel to communicate with other organisations and our overseas counterparts, and would be particularly useful during contingencies.

A secure remote access IT solution is being developed to enable staff to access SFC systems when they are away from the office. A Storage Area Network System Project aimed to improve system efficiency, availability and recovery capability is being developed and scheduled for completion in June 2004.

As a follow-up to the Information Security Review in February 2003, a Security Committee chaired by the Chief Operating Officer was formed in September 2003. The Security Committee advises on Commission-wide security policies and procedures, serves as a forum for discussion on security best practices, and reports to the Management Committee on the implementation of measures.

Our Information Security Policy was revised in December 2003. This new policy aims to protect the SFC's information assets more effectively and to provide all staff members with a common understanding of this important subject. To enhance system security, a project to implement dual-factor authentication and single sign-on for system logon is underway and due to be completed by July 2004.

> FinNet

FinNet is a private data network to support the financial communities in Hong Kong in conducting secure electronic transactions, information delivery and peer-to-peer communication, etc. It provides an open, robust, secure, scalable and high performance network based on open standard technology. Through a single network connection to FinNet, licensees can access multiple services offered by application / information providers and regulatory bodies.

In addition to dial-up, ISDN and frame relay access, a low cost private broadband service was introduced to FinNet in June 2003. At present, major users include HKMA, HKEx, MPFA, the SFC, local banks, brokerage firms and securities and derivative intermediaries. The

member base is being actively expanded to other market participants, making more financial application services available to the FinNet community.

Investor Education and Communications

> New Endeavours

Educating and empowering investors to protect themselves remains a top priority.

The SFC in December 2003 started a monthly on-line column written by a fictitious character, Dr Wise. Dr Wise represents the institutional wisdom of the SFC. He talks to investors about the key principles of investing. The column is posted on the SFC website on the last Tuesday of each month.

For the first time, the SFC produced a Cantonese documentary video drama, *Know the SFC*, to explain its work to the public. It also highlights some significant improvements of the regulatory framework under the SFO. An abridged version was aired on Cable TV in July and August 2003, and the full version is available on VCD for free distribution to the public.

Canto-pop singers and artistes also helped educate the investors during the year. They played some of the characters in a radio drama series entitled *Talk on Wise Investing* on Commercial Radio One. The 15-episode programme comprised short radio dramas followed by explanations by market professionals and SFC representatives of the do's and don'ts of investing.

SFC Smart Investor Award

In view of the increasing incidence of financial scams, in particular on-line fraud, the SFC launched a Smart Investor Award in February 2004 to raise public awareness.

Members of the public may report to the SFC any suspicious scam websites or boiler rooms that target Hong Kong investors. Persons making a valid report may receive the Smart Investor Award and an SFC corporate gift. Three investors have won the awards for reporting information to us leading to the publication of the names of four unlicensed entities on our Alert List.

The Alert List on the SFC website publishes names of unlicensed overseas companies or suspected boiler rooms/scam websites that investors should avoid. During the year, we posted 65 entities on the Alert List.

In addition, we also created sample scam websites to illustrate typical boiler room and scam websites.

➤ Retail Investor Survey

We conducted the Retail Investor Survey 2003 in October and November 2003 to look into the investment behaviour of retail investors, what deterred them from investing and factors that might prompt them to invest in the future.

According to the survey, there was increased investment participation compared to 2001 when we conducted the last survey. Investors were discerning with respect to their investment decisions and a majority of them considered different attributes of a listed company before buying the stock. About three-quarters of retail investors found our investor education initiatives helpful.

➤ Other Initiatives

We published focused education materials on new products, pooling risks, portfolio planning and IPO investing. We also educated investors on how to ask the right questions when investing in stocks. These publications were supplemented by on-line feature articles. Over 100 articles were also published in newspapers and magazines.



Some of the leaflets published by the SFC to educate investors.

In addition, we conducted 31 seminars, reaching over 5,300 investors. For instance, we partnered with the Open University of Hong Kong and HKEx on a series of five investor education lectures for the public in August 2003. The response was overwhelming with over 700 participants. Workshops for secondary school teachers conducted in the fourth quarter of 2003 attracted over 500 enrolments. We were also invited to talk to 1,000 secondary school students on the market basics and the proper attitude of investing.

➤ Investor Enquiries and Complaints Handling

During the year, we handled 5,382 investor enquiries compared to 3,982 a year earlier. We also handled 1,252 complaints, against 959 in 2003. The increases were attributable to the increased market and IPO activities in the second half of 2003-2004.

Every public complaint received is tabled at the Complaints Control Committee, which meets every week to conduct preliminary assessment of complaints and determines whether further action is necessary. The Committee is chaired by an Executive Director and comprises senior executives of various departments. During the year, 708 cases were referred to our operational divisions for further evaluation and 161 were investigated by the Enforcement Division.

Statistics of Public Complaints

Nature of complaints	2003-2004	2002-2003
Conduct of licensed intermediaries (including registered institutions from 1 April 2003 onwards)	380 (+25%)	305
Listing related matters & disclosure of interests	436 (+35%)	323
Market misconduct	211 (+73%)	122
Financial products	28 (-13%)	32
Other financial activities	175 (+18%)	148
Miscellaneous	22 (-24%)	29
Total	1,252 (+31%)	959

Reaching Out to Stakeholders

The Commission actively engages stakeholders in the development of its regulatory policies and keeps the market and the public informed of its latest news and activities.

We see the mass media as an important partner in communicating the SFC's work and policies to our stakeholders including the general public. During the year, we issued 270 press releases and our senior executives gave 32 interviews to local, Mainland and international media. A total of 11 press conferences and briefings were held to announce new policies and discuss the Commission's work. We also handled 1,486 media enquiries during the year.

Corporate Affairs

The SFC's corporate website at www.hksfc.org.hk is a valuable source of information for market practitioners and the investing public. To keep the market fully informed of our enforcement actions, in December 2003 we started providing fortnightly updates on our website of current SFC prosecutions in the Magistrates' Courts for breaches of securities and futures law. Our website achieved an average of 345,739 hits per day during the year, compared to 266,590 hits per day in 2002-2003. Its increasing popularity is demonstrated by the average of 437,103 hits per day in March 2004.

We received 1,278 public enquiries (non-investors) via email, nearly 30% more than a year ago. We also handled 2,551 public enquiries via phone or in writing.

For the first time, the SFC was given two top annual report awards in Hong Kong. The *Annual Report 2002-2003* was the winner of the Diamond Award in the Hong Kong Society of Accountants' Best Corporate Governance Disclosure Awards 2003 (Public Sector/Not-for-Profit Organisations category) and the Gold Prize in the 2003 Hong Kong Management Association's Best Annual Reports Awards (Non-profit Making and Charitable Organisations category). This was the first time the SFC took the Diamond Award and the fourth consecutive year it was awarded the Gold Prize.

We continued to issue regular corporate publications to inform the market and the public. The monthly *SFC Enforcement Reporter* and the bi-monthly newsletter *SFC Alert* keep the market abreast of our enforcement actions and work in general respectively. In February 2004, we revamped the *SFC Alert* with enhanced contents and a more reader-friendly layout. The *SFC Quarterly Report*, published within 45 days after quarter-end, also provide regular updates on the SFC's financial position and regulatory work. The research-based *SFC Quarterly Bulletin* and its more detailed on-line version include useful statistics and in-depth analysis into topical market issues. All these publications are available free on the SFC website.

Throughout the year, we continued to receive visitors from local and overseas regulators and financial institutions who want to learn more about the SFC in general or to discuss specific subjects.

Internally, we introduced an electronic news clipping service to provide timely and comprehensive news updates to staff. It also helps ensure that the Commission complies with the Copyright Ordinance.



The *SFC Alert* is expanded to six pages with more useful features.

Ensuring Smooth Transition to the SFO Regime

The dedicated SFO section on the SFC website was continuously updated during the year. It provides a one-stop-shop for interested parties to conveniently locate all relevant materials in relation to the SFO, including rules, regulations and guidelines.

In addition, we set up a dedicated email box to answer public enquires. Various divisions handled 1,044 enquiries during the year. Most of the enquiries were related to the new single licensing regime, regulations of intermediaries and disclosure of interests.

We also organised or took part in 44 SFO training seminars during the year, attracting more than 4,300 participants.

SFO Training Sessions Given by the SFC		
1 April 2003 to 31 March 2004		
Target audience	Number of seminars conducted	Total number of participants
Exchange Participants	3	470
Accountants & legal practitioners	11	970
Investment advisers, exempt dealers and exempt investment advisers	1	280
All registered persons and interested market practitioners	21	477
Members of the Hong Kong Securities Institute and the public	8	2,120
Total	44	4,317

Care for the Community

Lastly, the Commission and its staff continued to support community and charitable activities enthusiastically, doing our part as a responsible and caring corporate citizen.

Staff participated in and donated to events such as Community Chest Green Day, Dress Casual Day, Operation Santa Claus, Project Shield for SARS by SCMP, Campaign for Helping the Vulnerable and the Needy To Prevent Atypical Pneumonia by Hong Kong Red Cross, We Care Education Fund, Business Community Relief Fund for Victims of SARS and We Care Foundation. In addition, with voluntary donations from staff, our staff visited an old age home and a special school for children with disabilities to show our care and concern for the less privileged. Staff enjoyed the time spent with the elderly and the children and fully appreciated that it is more blessed to give than to receive.



Visits to an old age home and a special school for children with disabilities.

An SFC volunteers team was formed to co-ordinate efforts in planning and organising community services work. The Chairman and the Chief Operating Officer serve as honorary team leader and honorary adviser respectively.

It is also worth noting that many Commission staff also generously give their own time to voluntary community services such as Civil Aid Service, Oxfam and other organisations.



HKSAR Chief Executive Mr Tung Chee Hwa confers the Bronze Bauhinia Star on SFC senior manager of administration Mr Patrick Cheung for his service in the Civil Aid Service.

Cross-Border Regulatory Co-operation

This Chapter Is About

- >> SFC's involvement in IOSCO
- >> Partnership with other regulators
- >> Combating money laundering
- >> Co-operation with Mainland China

WHAT WE DO

- >> Work with overseas regulators under co-operative arrangements;
- >> Participate actively in international securities regulators forum; and
- >> Develop and strengthen ties with Mainland authorities.

The SFC has developed a successful partnership with the international community and always seeks to contribute to the global efforts to enhance the quality and effectiveness of market regulation. We continue to strengthen regulatory co-operation, information sharing and cross-border investigation with our counterparts in other jurisdictions.

At present, the SFC has 33 bilateral or tri-lateral co-operative arrangements with overseas regulatory bodies. We are discussing arrangements with five other jurisdictions.

During the year, the SFC signed a co-operation agreement with ASIC to strengthen supervision of fund managers (Please see details in *Intermediaries and Investment Products* chapter).

IOSCO

In May 2002, IOSCO adopted the Multilateral Memorandum of Understanding (MMOU), the first multilateral international arrangement of its type among financial market regulators. The SFC was among the first signatories to have signed the MMOU in February 2003, which helps the SFC establish MOU relationship with nine jurisdictions with which it did not already have a co-operative arrangement in place. Regulators from major markets including the US, UK, Germany, France and Canada are also signatories. To date, 25 jurisdictions have signed the MMOU, while another two jurisdictions have indicated a willingness to undertake the necessary reforms to do so.

This arrangement greatly enhances regulatory co-operation among all signatories, allowing regulators worldwide to assist each other in combating cross-border securities fraud, market misconduct, terrorist financing and other financial crimes.

Hong Kong actively participates in the work of IOSCO through committees and projects. Represented by SFC Chairman Mr Andrew Sheng, Hong Kong is a member of the IOSCO Technical Committee, which consists of 15 securities regulators from the world's developed markets.

We are also members of the five Standing Committees of the Technical Committee that deal with different aspects of securities and intermediaries regulation.

At the IOSCO Annual Conference held in Seoul in October 2003, Mr Sheng was appointed Interim Chairman of the Technical Committee until the end of the next Annual Conference to be held in May 2004.



SFC Chairman Mr Andrew Sheng (second from left), joins Mr Dongan Cansizlar (first from left), Chairman of Emerging Markets Committee; Mr Kap Soo Oh (third), Chairman of Presidents' Committee; and Mr Fernando Teixeira Dos Santos, Chairman of Executive Committee, at the closing press briefing of the IOSCO Annual Conference 2003.

Hong Kong was also selected to host the 31st Annual Conference in 2006. This will be the first time that Hong Kong hosts an IOSCO Annual Conference.

In February 2004, the Technical Committee set up a Chairmen's Task Force to deal with the challenges posed by Parmalat, the Italian food company alleged of fraudulent accounting. As a priority, the Task Force will identify potential new issues arising from recent cases (including concerns about transparency in the bond markets, the role of unregulated entities, the role of complex group structures, and appropriate levels of sanctions) and review implementation of existing standards. It will suggest responses aimed at producing appropriate regulatory incentives, such as improving risk identification and assessment by regulators and giving attention to fostering better co-operation among regulators in the exchange of information. The US SEC and Italian CONSOB are co-chairing this Task Force and target to report to the Technical Committee in May 2004.

The Technical Committee had similarly acted quickly to establish Chairs' Committees in the aftermath of the collapse of Enron in December 2001. Three sets of IOSCO principles were issued in October 2002 to strengthen ongoing disclosure and material developments reporting by listed entities, auditor independence and auditor oversight. These high-level principles as well as two other sets issued in September 2003, regarding the activities of credit rating agencies and sell-side analyst conflicts of interest, were well received by the market and the Financial Stability Forum.

➤ **Standing Committees**

The Corporate Finance Division participates in the Standing Committee on Multinational Disclosure and Accounting (SC1). SC1 monitors and comments on international developments in accounting and auditing standards and drafts IOSCO standards relating to disclosure matters. During the year, our staff continued to play an active role in SC1's Audit Task Force, and reviewed and prepared comments on International Standards on Auditing issued by the International Audit and Assurance Standards Board. We also participated in

the IOSCO's work with other international regulators to help the International Federation of Accountants establish its Public Interest Oversight Board.

The Supervision of Markets Division participates in the Standing Committee on the Regulation of Secondary Markets (SC2). During the year, we responded to survey questionnaires on transparency in the trading of corporate bonds and led the consolidation of the survey results and participated in the drafting of the report. We also provided inputs to the final report on stock repurchase programmes.

During the year, the joint task force of IOSCO and the Committee on Payment and Settlement Systems (CPSS) began a review of risk management of central counterparties. We participated in the task force and joined the drafting teams on three recommendations. A report containing 14 recommendations was released for public consultation on 8 March 2004.

The Intermediaries Supervision Department participates in the Standing Committee on the Regulation of Market Intermediaries (SC3). During the year, SC3 published the survey results on regulation of market intermediaries in a cross-border environment, discussed the Basel II Accord on banks' capital adequacy framework and identified issues with high impact to securities firms for discussion with the Basel Committee on Banking Supervision. We were particularly interested in the new outsourcing mandate and commented on the draft outsourcing principles with reference to the experience in Hong Kong.

The Enforcement Division participates in the Standing Committee on Enforcement and Exchange of Information (SC4), which promotes mutual assistance to combat cross-border crimes and misconduct. During the year, SC4 continued to assess applications for membership of the IOSCO MMOU, consider issues of legal and practical difficulties encountered in co-operation between regulators and work on a set of principles for the securities industry on Client Identification and Beneficial Ownership.

Cross-Border Regulatory Co-operation

We are taking an active part in a new SC4 project to look at regulators' needs and ability to preserve and repatriate assets for the victims of fraud. It is anticipated that the project will help identify the issues involved and aim to remove the financial incentive for fraudsters to engage in cross-border crimes and misconduct.

The Investment Products Department participates in the Standing Committee on Investment Management (SC5). During the year, the SC5 considered regulatory issues arising from fund mergers and schemes of amalgamations, money laundering safeguards in the asset management industry, and independent review of collective investment schemes key elements. The SC5 issued two consultation papers in respect of regulatory standards on fees and expenses of investment funds, and best practices on performance presentation standards of investment funds.

Partnership with Other Regulators

During the year, the SFC worked with various overseas securities regulators on joint initiatives to strengthen international co-operation and exchange of ideas on market regulation. In September 2003, SFC staff went to New York to perform a joint inspection with regulators from Australia, UK, and the US at the headquarters of an international fund manager. In March 2004, with the assistance of Taiwan Securities and Futures Commission, we visited the Taiwan branches operated by selected Hong Kong intermediaries to understand their operations.

In addition, we were invited by the Thailand Securities and Exchange Commission and the CSRC to provide training at their local offices on the regulation of futures dealers in November 2003 and January 2004 respectively. Both training sessions were very well received.

During the year, the Enforcement Division received 46 requests for enforcement-related assistance: 11 were requests for investigatory assistance involving the SFC in the exercise of its statutory powers; and 35 were

requests for non-public information. On the other hand, we made six requests to overseas regulators and, of these, four were requests for investigatory assistance and two were for non-public information.

In respect of licensing-related matters, the SFC received 103 requests from overseas regulatory authorities and made 383 requests.

		2003-2004		2002-2003		2001-2002	
		In	Out	In	Out	In	Out
Enforcement-related requests for investigatory assistance		11	4	13	14	13	15
Enforcement-related requests for information		35	2	28	6	36	6
Licensing-related requests for information		103	383	200	451	224	474
Total		149	389	241	471	273	495

Combating Money Laundering

In a worldwide effort to combat money laundering and terrorist financing, the Intermediaries Supervision Department, as part of the Hong Kong delegation, attended the Annual Meeting of the Asia Pacific Group on Money Laundering in Macao in September 2003. The Department also took part in the Financial Action Task Force on Money Laundering's (FATF) revision of the FATF 40 recommendations to address problems associated with money laundering and terrorist financing. The revised FATF 40 recommendations were finalised and released in August 2003.



More than 100 delegates participate in the Asia Pacific Group on Money Laundering 2003 Annual Meeting in Macao.

Co-operation with Mainland China

The Commission and the CSRC continued to work closely during the year. We attended the 31st Memorandum of Regulatory Co-operation (MORC) meetings in November 2003 in Beijing organised by the CSRC. Executives from the CSRC, the SFC, HKEx, the Shanghai Stock Exchange and Shenzhen Stock Exchange exchanged views on policy initiatives and concerns about regulation of securities markets.

As part of the MORC, the Enforcement Division met with their counterparts at CSRC to discuss market surveillance, enforcement and other cross-border issues on market development.

Under the CEPA commitments, the SFC also worked with the CSRC to recognise each other's market practitioners' qualification for licensing purpose (Please see details in *Intermediaries & Investment Products* chapter).

Securities and Futures Commission

Auditors' Report

To The Securities And Futures Commission (the SFC)

(Established in Hong Kong under the Securities and Futures Commission Ordinance)

We have audited the financial statements on pages 79 to 95 which have been prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

Respective responsibilities of directors and auditors

The Hong Kong Securities and Futures Ordinance requires the directors to prepare financial statements which 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 judgements and 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 solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

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 judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the SFC's and the group's circumstances, consistently applied and 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 misstatements. 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 SFC and of the group as at 31 March 2004 and of the group's surplus and cash flows for the year then ended, and have been properly prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

KPMG

Certified Public Accountants

Hong Kong

4 May 2004

Consolidated Income and Expenditure Account

For the year ended 31 March 2004

(Expressed in Hong Kong dollars)

	Note	2004 \$'000	2003 \$'000
Income			
Levies		380,336	186,166
Fees and charges		144,591	116,915
Investment income	5	21,310	32,773
Recoveries from Investor Compensation Fund		3,162	1,273
Other income	6	1,749	1,319
		551,148	338,446
Expenses			
Staff costs	7	328,818	302,398
Premises			
rent		18,561	20,010
other		14,151	11,267
Other expenses	8	37,001	39,489
		398,531	373,164
Depreciation		27,206	23,662
		425,737	396,826
		125,411	(58,380)
Surplus/(deficit) for the year			
Accumulated surplus brought forward		522,773	581,153
Accumulated surplus carried forward		648,184	522,773

We have not prepared a separate statement of changes in equity as the surplus/(deficit) for the year would be the only component of such a statement.

The notes on pages 83 to 95 form part of these financial statements.

Securities and Futures Commission Financial Statements

Consolidated Balance Sheet

At 31 March 2004

(Expressed in Hong Kong dollars)

	Note	2004 \$'000	2003 \$'000
Non-current assets			
Fixed assets	9(a)	34,037	30,976
Held-to-maturity debt securities	10	66,329	388,794
Current assets			
Held-to-maturity debt securities	10	579,802	39,036
Bank deposits		75,781	178,371
Debtors, deposits and prepayments	12	58,101	25,764
Cash at bank and in hand		2,182	421
		715,866	243,592
Current liabilities			
Fees received in advance		34,788	31,557
Creditors and accrued charges		22,198	17,212
		56,986	48,769
Net current assets			
		658,880	194,823
Total assets less current liabilities			
		759,246	614,593
Non-current liabilities			
	13	68,222	48,980
Net assets			
		691,024	565,613
Funding and reserves			
Initial funding by Government			
	15	42,840	42,840
Income and expenditure account			
		648,184	522,773
		691,024	565,613

Approved and authorised for issue by the Commission on 4 May 2004 and signed on its behalf by

Andrew L T Sheng
Chairman

T Brian Stevenson
Non-executive Director

The notes on pages 83 to 95 form part of these financial statements.

Balance Sheet

At 31 March 2004

(Expressed in Hong Kong dollars)

	Note	2004 \$'000	2003 \$'000
Non-current assets			
Fixed assets	9(b)	33,597	30,976
Held-to-maturity debt securities	10	66,329	388,794
Current assets			
Held-to-maturity debt securities	10	579,802	39,036
Bank deposits		75,781	178,371
Debtors, deposits and prepayments	12	57,877	25,749
Cash at bank and in hand		962	421
		714,422	243,577
Current liabilities			
Fees received in advance		34,788	31,557
Creditors and accrued charges		20,366	17,197
		55,154	48,754
Net current assets		659,268	194,823
Total assets less current liabilities		759,194	614,593
Non-current liabilities	13	68,170	48,980
Net assets		691,024	565,613
Funding and reserves			
Initial funding by Government	15	42,840	42,840
Income and expenditure account		648,184	522,773
		691,024	565,613

Approved and authorised for issue by the Commission on 4 May 2004 and signed on its behalf by

Andrew L T Sheng
Chairman

T Brian Stevenson
Non-executive Director

The notes on pages 83 to 95 form part of these financial statements.

Consolidated Cash Flow Statement

For the year ended 31 March 2004

(Expressed in Hong Kong dollars)

	2004 \$'000	2003 \$'000
Cash flows from operating activities		
Surplus / (deficit) for the year	125,411	(58,380)
Adjustments for :		
Depreciation	27,206	23,662
Investment income	(21,310)	(32,773)
Loss / (profit) on sale of fixed assets	60	(6)
	131,367	(67,497)
Increase in debtors, deposits and prepayments	(28,515)	(350)
Increase / (decrease) in fees received in advance	3,231	(1,744)
Increase / (decrease) in creditors and accrued charges	3,628	(10,415)
Increase in non-current liabilities	19,242	45,194
Cash generated from / (used in) operations	128,953	(34,812)
Payment to the Unified Exchange Compensation Fund	–	(30,000)
<i>Net cash generated from / (used in) operating activities</i>	128,953	(64,812)
Cash flows from investing activities		
Interest received	24,908	33,103
Held-to-maturity debt securities bought	(264,721)	(132,002)
Held-to-maturity debt securities redeemed	39,000	319,700
Fixed assets bought	(28,978)	(17,095)
Fixed assets sold	9	7
<i>Net cash (used in) / generated from investing activities</i>	(229,782)	203,713
Net (decrease) / increase in cash and cash equivalents	(100,829)	138,901
Cash and cash equivalents at beginning of the year	178,792	39,891
Cash and cash equivalents at end of the year	77,963	178,792

Analysis of the balance of cash and cash equivalents:

	2004 \$'000	2003 \$'000
Bank deposits	75,781	178,371
Cash at bank and in hand	2,182	421
	77,963	178,792

Notes to the Consolidated Financial Statements

For the year ended 31 March 2004
(Expressed in Hong Kong dollars)

1. Status and principal activities

The SFC is governed by Part II of the Hong Kong Securities and Futures Ordinance (the SFO). Under the SFO, the SFC has the duty to ensure an efficient, fair and transparent market and, to promote public confidence and investor awareness in Hong Kong's securities, futures and related financial markets. In performing its duty, the SFC is required to act in the interest of the public and ensure that improper and illegal market activities are properly investigated.

2. Income

Details of the funding of the SFC are set out in Section 14 and Sections 394 to 396 of the SFO. Major sources of funding include:

- (a) a share of the levies collected by The Stock Exchange of Hong Kong Limited and Hong Kong Futures Exchange Limited on transactions recorded on the Exchanges at rates specified by the Chief Executive in Council; and
- (b) fees and charges in relation to its functions and services according to the provision of subsidiary legislation.

In each financial year, the SFC is eligible to receive an appropriation from the Government. Since the financial year ended 31 March 1994, the SFC has requested the Government not to make appropriations to it.

3. Significant accounting policies

The SFC prepares its consolidated financial statements, which comprise the SFC and its subsidiary (together referred to as the "Group"), in accordance with International Financial Reporting Standards (including applicable International Accounting Standards and Interpretations) promulgated by the International Accounting Standards Board. We set out below a summary of our significant accounting policies.

Basis of preparation

We have prepared these financial statements using the historical cost basis. The accounting policies have been applied consistently by Group enterprises.

Basis of consolidation

Subsidiaries are those enterprises controlled by the SFC. Control exists when the SFC has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. Except for a subsidiary that has not commenced operation during the year, we include the financial statements of the other subsidiary in the consolidated financial statements from the date that control commences until the date that control ceases. We eliminate all material intragroup balances and transactions in preparing the consolidated financial statements.

3. Significant accounting policies (cont'd)

Recognition of income

Levies We record levies from The Stock Exchange of Hong Kong Limited and Hong Kong Futures Exchange Limited as income on an accrual basis.

Fees and charges We record annual fees as income on a straight-line basis over the periods to which they relate. We record other fees and charges as income when they are receivable.

Investment Income We record investment income on an accrual basis. It comprises (a) interest earned on bank deposits and held-to-maturity debt securities; and (b) the amortisation of premium or discount on purchases of held-to-maturity debt securities on a straight-line basis over the periods to redemption.

Operating leases

We treat the rent payable under operating leases as an expense on a straight-line basis over the life of the lease. We recognise lease incentives received in the income and expenditure account as an integral part of the total lease expense.

Retirement benefits

We recognise obligations for contributions to defined contribution schemes as an expense in the income and expenditure account when they are payable.

Fixed assets and depreciation

We state fixed assets at cost less accumulated depreciation and any impairment losses (see the accounting policies in respect of "impairment" and "reversals of impairment" on page 86). Depreciation is charged to the income and expenditure account on a straight-line basis over the estimated useful lives of the fixed assets. We use the following useful lives :

Leasehold improvements	– 3 years or if shorter the life of the respective leases
Furniture and fixtures	– 3 years
Office equipment	– 5 years
Personal computers and software	– 3 years
Mainframe computers and application systems	– 4 years
Motor vehicles	– 4 years

Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the fixed assets. All other expenditure is recognised in the income and expenditure account as an expense as incurred.

Investments

We state our investments in debt securities, which we intend and are able to hold to maturity, at amortised cost less any provisions for impairments (see the accounting policies in respect of "impairment" and "reversals of impairment" on page 86). We account for purchases and sales of debt securities on the settlement date.

We recognise profits or losses on sale of debt securities when they arise.

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 SFC :

- (a) parties that the SFC has the ability, directly or indirectly, to control or to significantly influence in making financial and operating decisions;
- (b) parties that have the ability, directly or indirectly, to control or to significantly influence the SFC in making financial and operating decisions; and
- (c) parties that are subject to common control or common significant influence.

Related parties may be individuals or corporate entities. As the SFC is an entity controlled by the Government of the Hong Kong Special Administrative Region, we are not required by International Accounting Standards 24 to disclose transactions with other government controlled enterprises in the financial statements.

Translation of foreign currencies

We translate foreign currency transactions during the year into Hong Kong dollars at the exchange rates ruling at the transaction dates. We translate monetary assets and liabilities denominated in foreign currencies into Hong Kong dollars at the exchange rates ruling at the balance sheet date. We record exchange gains and losses on translation in the income and expenditure account.

Other receivables

We state other receivables at their cost less impairment losses (see the accounting policies in respect of "impairment" and "reversal of impairment" on page 86).

Cash and cash equivalents

Cash and cash equivalents comprise cash balances and bank deposits.

Other payables

We state other payables at their cost.

Investment in subsidiaries

In the SFC's balance sheet, an investment in a subsidiary is stated at cost less any impairment losses.

3. Significant accounting policies (cont'd)

Impairment

We review the carrying amounts of the SFC's assets at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, we estimate the asset's recoverable amount. We recognise in the income and expenditure account an impairment loss whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

(a) Calculation of recoverable amount

We calculate the recoverable amount of the SFC's investments in held-to-maturity debt securities and receivables by discounting their expected future cash flows to their present value at the original effective interest rate inherent in the asset. We do not discount receivables with a short duration in the calculation of their recoverable amount.

The recoverable amount of other assets is the greater of their net selling price and value in use. In assessing value in use, we discount the estimated future cash flows to their present value at a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, we determine the recoverable amount for the cash-generating unit to which the asset belongs.

(b) Reversals of impairment

We reverse an impairment loss in respect of an asset if the circumstances and events that have led to the write down or write-off cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future.

We reverse an impairment loss only to the extent that the asset's carrying amount does not exceed the carrying amount that we would have determined, net of depreciation or amortisation, if we had not recognised any impairment loss.

Provisions and contingent liabilities

We recognise a provision in the balance sheet when the SFC has a legal or constructive obligation as a result of a past event, and it is probable that the SFC will require an outflow of economic benefits to settle the obligation. If the effect is material, we determine provisions by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, we disclose the obligation as a contingent liability, unless the probability of outflow of economic benefits is remote. We also disclose possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events as contingent liabilities unless the probability of outflow of economic benefits is remote.

4. Taxation

Section 3(3) of the SFO exempts the SFC from Hong Kong taxes.

5. Investment income

	2004 \$'000	2003 \$'000
Interest income	28,730	34,468
Premium on held-to-maturity debt securities	(7,480)	(2,397)
Discount on held-to-maturity debt securities	60	702
	21,310	32,773

6. Other income

	2004 \$'000	2003 \$'000
Legal costs recovered	–	91
Investigation costs awarded	462	708
Sale of SFC publications	459	444
Profit on sale of fixed assets	–	6
Exchange difference	699	–
Others	129	70
	1,749	1,319

7. Staff costs

	2004	2003
	\$'000	\$'000
Directors' fees	1,603	1,404
Directors' salaries and allowances	25,666	22,850
Directors' variable pay	1,298	400
Directors' retirement benefits	223	212
Staff salaries and allowances	279,639	258,053
Retirement benefits	10,558	10,486
Medical and life insurance	9,484	8,709
Overtime pay	347	284
	328,818	302,398

The number of staff as at 31 March 2004 was 419, comprising 385 regular staff (382 for SFC and 3 for Investor Compensation Company Limited) and 34 temporary staff (At 31 March 2003: total staff number was 403, comprised 363 regular staff and 40 temporary staff).

Directors' emoluments fell within these ranges :

	2004	2003
	No. of directors	No. of directors
\$0 to \$1,000,000	8	6
\$2,500,001 to \$3,000,000	1	–
\$3,500,001 to \$4,000,000	–	1
\$4,000,001 to \$4,500,000	3	3
\$4,500,001 to \$5,000,000	1	–
\$6,500,001 to \$7,000,000	1	1
	14	11

Emoluments paid to independent non-executive directors during the year amounted to \$1,603,000 (2003 : \$1,404,000).

Aggregate remuneration of the five highest paid individuals in 2003/2004, representing the emoluments of five executive directors, was \$24,360,000 (2002/2003 : \$23,462,000 for five executive directors).

7. Staff costs (cont'd)

Retirement benefits

We provide retirement benefits to our staff through a defined contribution scheme under the Occupational Retirement Schemes Ordinance (ORSO Scheme) and a Mandatory Provident Fund Scheme (MPF Scheme) :

(a) ORSO Scheme

General grade staff For general grade staff, we make monthly contributions equal to 12% of the fixed pay of each staff member. We reinvest forfeited contributions for general grade staff, who leave the SFC prior to qualifying for 100% disbursement of the contributions, into the total pool of contributions that will be shared by the existing members in the scheme at the end of the scheme year. The amount so reinvested during the year was \$80,000 (2003 : \$113,000).

Professional staff For professional staff, we make monthly contributions equal to 5% of their fixed pay subject to a cap of \$4,166 per month. We use forfeited contributions in respect of professional staff, who leave the SFC prior to qualifying for 100% disbursement of the contributions, to offset the SFC's future contributions. The amount so forfeited during the year was \$773,000 (2003 : \$743,000) and the amount so forfeited available at the balance sheet date was \$61,000 (2003 : \$57,000).

This scheme has obtained an exemption under Section 5 of the MPF Schemes Ordinance.

(b) MPF Scheme

We have participated in a master trust MPF Scheme since December 2000 and made contributions to the MPF Scheme in accordance with the statutory requirements of the MPF Schemes Ordinance.

8. Other expenses

	2004 \$'000	2003 \$'000
Training and development	2,569	2,511
Legal and professional services	7,780	9,615
(Release of)/provision for legal claims and costs	(1,500)	2,347
Information and systems services	16,416	15,956
Auditors' remuneration	221	175
General office and insurance	5,859	4,524
SCEFI (Steering Committee on the Enhancement of Financial Infrastructure)	3,534	2,729
External relations	2,062	1,632
Loss on disposal of fixed assets	60	–
	37,001	39,489

9. Fixed assets

(a) The Group

	Furniture, fixtures and leasehold improvements \$'000	Office equipment \$'000	Mainframe computers and application systems \$'000	Personal computers and software \$'000	Motor vehicles \$'000	Total \$'000
Cost						
At 1 April 2003	34,144	9,473	100,273	21,128	1,456	166,474
Additions	20,491	2,067	5,727	2,051	–	30,336
Disposals	(24,072)	(2,770)	(1,290)	(2,916)	–	(31,048)
At 31 March 2004	30,563	8,770	104,710	20,263	1,456	165,762
Depreciation						
At 1 April 2003	33,122	8,127	73,235	19,558	1,456	135,498
Charge for the year	7,847	968	16,405	1,986	–	27,206
Written back on disposals	(24,072)	(2,704)	(1,288)	(2,915)	–	(30,979)
At 31 March 2004	16,897	6,391	88,352	18,629	1,456	131,725
Net book value						
At 31 March 2004	13,666	2,379	16,358	1,634	–	34,037
Net book value						
At 31 March 2003	1,022	1,346	27,038	1,570	–	30,976

9. Fixed assets (cont'd)

(b) The SFC

	Furniture, fixtures and leasehold improvements \$'000	Office equipment \$'000	Mainframe computers and application systems \$'000	Personal computers and software \$'000	Motor vehicles \$'000	Total \$'000
Cost						
At 1 April 2003	34,144	9,473	100,273	21,128	1,456	166,474
Additions	20,161	2,035	5,727	1,760	–	29,683
Disposals	(24,072)	(2,770)	(1,290)	(2,916)	–	(31,048)
At 31 March 2004	30,233	8,738	104,710	19,972	1,456	165,109
Depreciation						
At 1 April 2003	33,122	8,127	73,235	19,558	1,456	135,498
Charge for the year	7,737	962	16,405	1,889	–	26,993
Written back on disposals	(24,072)	(2,704)	(1,288)	(2,915)	–	(30,979)
At 31 March 2004	16,787	6,385	88,352	18,532	1,456	131,512
Net book value						
At 31 March 2004	13,446	2,353	16,358	1,440	–	33,597
Net book value						
At 31 March 2003	1,022	1,346	27,038	1,570	–	30,976

10. Held-to-maturity debt securities

The Group and the SFC

	2004	2003
	\$'000	\$'000
Maturing after one year		
In the second to third years – unlisted	22,518	120,034
– listed outside Hong Kong	43,811	254,184
After three years – unlisted	–	14,576
	66,329	388,794
Maturing within one year – unlisted	187,907	25,030
– listed outside Hong Kong	391,895	14,006
	579,802	39,036
	646,131	427,830
Cost at 31 March – unlisted	210,425	159,640
– listed outside Hong Kong	435,706	268,190
	646,131	427,830
Market value at 31 March – unlisted	218,053	187,827
– listed outside Hong Kong	437,051	259,735
	655,104	447,562

11. 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. Both FinNet and ICC are incorporated in Hong Kong.

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 facilitate the administration and management of the Investor Compensation Fund established under the SFO.

Both companies are wholly owned subsidiaries of the SFC. As at 31 March 2004, the investments in subsidiaries, which is stated at cost less any impairment losses, amounted to \$2.2. The balance was too small to appear on the balance sheet which was expressed in thousand dollars.

FinNet has not commenced operation. The balance sheet of FinNet as at 31 March 2004 and the income and expenditure account for the year were immaterial. Therefore, we have not accounted for its result in the consolidated financial statements.

The financial statements of ICC are included in the consolidated financial statements.

12. Debtors, deposits and prepayments

The SFC

There is no amount due from ICC as at 31 March 2004 (2003: \$1,258,000).

13. Non-current liabilities

The Group and the SFC

Non-current liabilities represent deferred lease incentives and provision for premises reinstatement cost. Deferred lease incentives consist of incentives granted by our landlord in connection with the lease of our office premises. We recognise the deferred lease incentives in our income and expenditure account on a straight line basis over the lease period from 2004 to 2013 as an integral part of the lease expense.

14. 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 31 March 2004. Therefore we do not provide ageing analysis on debtors and creditors.

15. Initial funding by Government

The Government provided funds to pay for the SFC's initial non-recurrent and capital expenditure. These funds are not repayable to the Government.

16. Capital commitments

Capital commitments outstanding at 31 March 2004 not provided for in the financial statements were as follows:

	2004 \$'000	2003 \$'000
Authorised and contracted for	11,015	15,990
Authorised but not contracted for	11,353	11,969

17. Commitment to pay rents for offices

We have entered into a new operating lease for the SFC's office premises for 10 years starting 1 July 2003. The lease is subject to a rent review on 1 July 2008. The rent we will have to pay after 1 July 2008 will be fixed in 2008 based on the market rent prevailing in 2008 but subject to a cap set out in the lease agreement.

At 31 March 2004 the minimum amount we are committed to pay in rent for our offices up to 30 June 2008 is as follows :

	The Group		The SFC	
	2004 \$'000	2003 \$'000	2004 \$'000	2003 \$'000
Payable next year	14,648	–	14,350	–
Payable in one to five years	86,483	93,825	86,098	93,825
Payable in more than five years	–	6,623	–	6,623
	101,131	100,448	100,448	100,448

During the year ended 31 March 2004, \$18,561,000 was recognised as an expense in the income and expenditure account in respect of operating leases (2003 : \$20,010,000). Other than office rents we have no obligations relating to operating leases.

18. Related party transactions

We have a related party relationship with the Unified Exchange Compensation Fund (the UECF), the Commodity Exchange Compensation Fund (the CECF), Investor Compensation Fund (the ICF), Securities Ordinance (Chapter 333) - Dealers' Deposits Fund, Commodities Trading Ordinance (Chapter 250) - Dealers' Deposits Fund and Securities Ordinance (Chapter 333) - Securities Margin Financiers' Security Fund. We have the following significant related party transactions during the year:

- (a) Reimbursement from the ICF for all the ICC's expenses, which is in accordance with Section 242(1) of the SFO; and
- (b) Matters disclosed in note 20.

19. Financial instruments

Financial assets of the SFC comprise held-to-maturity debt securities.

(a) Credit risk

The Financial Secretary has approved our investment policy which only allows the SFC to invest in dated securities or in bank deposits with banks. The policy also limits the exposure to each organisation and each country, except for US Treasury, to not more than 15% and 20% of the total investment respectively. During the year, the SFC complied with the above investment policy and, as a result, was not exposed to significant credit risk.

(b) Interest rate risk

The activities of the SFC do not expose it to significant interest rate risk.

(c) Exchange rate risk

The Financial Secretary has approved our investment policy which also allows the SFC to invest in US dollar dated securities. As the HK dollar is pegged to the US dollar, the SFC was not exposed to significant foreign exchange risk.

20. Contingent liabilities

The SFC has given an undertaking to the Government to make refunds for overpayment of Special Levy as a condition for the transfer of the Special Levy surplus of \$2 million plus accrued interest to the UECF. No provision has been made in these financial statements in respect of such undertaking, as the likelihood of a claim being made for a refund of an overpayment is considered to be remote.

21. Comparative figures

Deferred lease incentives have been shown in these financial statements as non-current liabilities as this reflects more appropriately the nature of this item. The comparative figures have been reclassified to conform with the current year's presentation.

Investor Compensation Fund (the Fund)

Report of the Investor Compensation Fund Committee (the Committee)

The members of the Committee present their first year annual report and the audited financial statements for the year ended 31 March 2004.

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 98 to 106.

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

5. Auditors

KPMG were first appointed as auditors of the Fund in 2003 upon inception of the Fund. KPMG retired and, being eligible, offer themselves for re-appointment.

On behalf of the Committee

Mark Dickens, JP
Chairman

4 May 2004

Auditors' Report To The Securities & Futures Commission (the SFC)

We have audited the financial statements of the Investor Compensation Fund (the Fund) established under Part XII of the Securities and Futures Ordinance set out on pages 98 to 106 which have been prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

Respective responsibilities of the SFC and auditors

The Securities and Futures Ordinance requires the SFC to keep proper accounts of the Fund and to prepare financial statements of the Fund in respect of each financial year. The directors of the SFC do so on the basis that these financial statements should give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and 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 solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

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 judgements made by the SFC in the preparation of the financial statements and of whether the accounting policies are appropriate to the Fund's circumstances, consistently applied and 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 as at 31 March 2004 and of its surplus and cash flows for the year then ended, and have been properly prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

KPMG

Certified Public Accountants

Hong Kong

4 May 2004

Investor Compensation Fund Financial Statements

Income And Expenditure Account

For the year ended 31 March 2004

(Expressed in Hong Kong dollars)

	Note	2004 \$'000
Income		
Net investment income	3&5	4,643
Transaction levy from the SEHK	3&6	144,177
Contract levy from the HKFE	3&7	10,340
		159,160
Expenses		
ICC expenses	8	4,434
Auditors' remuneration		50
Bank charges		55
Professional fees		12
		4,551
Surplus		154,609
Accumulated surplus brought forward		–
Accumulated surplus carried forward		154,609

The notes on pages 102 to 106 form part of these financial statements.

Balance Sheet

At 31 March 2004

(Expressed in Hong Kong dollars)

	Note	2004 \$'000
Current assets		
Debt securities	9	174,286
Interest receivable		1,656
Due from ICC		1,778
Levy receivable from the SEHK		16,415
Levy receivable from the HKFE		1,163
Fixed and call deposits with banks		766,964
Cash at bank		13
		962,275
Current liabilities		
Accounts payable and accrued charges		66
		962,209
Net current assets		
		962,209
Net assets		
Representing :		
<u>Compensation fund</u>		
Contributions from UECF	10	699,640
Contributions from CECF	10	107,960
Accumulated surplus		154,609
		962,209

Approved and authorised for issue by the Securities and Futures Commission (the SFC) on 4 May 2004 and signed on its behalf by

Andrew L T Sheng
Chairman of the SFC

Anna H Y Wu
Non-executive Director of the SFC

The notes on pages 102 to 106 form part of these financial statements.

Investor Compensation Fund Financial Statements

Statement of Changes in Equity

For the year ended 31 March 2004

(Expressed in Hong Kong dollars)

	Note	2004 \$'000
Compensation fund balance as at 1 April		–
Surplus for the year		154,609
Contributions from UECF	10	699,640
Contributions from CECF	10	107,960
Compensation fund balance as at 31 March		962,209

The notes on pages 102 to 106 form part of these financial statements.

Cash Flow Statement

For the year ended 31 March 2004
(Expressed in Hong Kong dollars)

	2004 \$'000
Cash flows from operating activities	
Surplus for the year	154,609
Net investment income	(4,643)
Increase in levies receivable	(17,578)
Increase in accounts receivable	(1,778)
Increase in accounts payable and accrued charges	66
Net cash from operating activities	130,676
Cash flows from investing activities	
Purchase of debt securities	(218,378)
Sale or maturity of debt securities	43,000
Interest received	4,079
Net cash used in investing activities	(171,299)
Cash flows from financing activities	
Contributions received from UECF	699,640
Contributions received from CECF	107,960
Net cash from financing activities	807,600
Net increase in cash and cash equivalents	766,977
Cash and cash equivalents at beginning of the year	–
Cash and cash equivalents at end of the year	766,977

Analysis of the balance of cash and cash equivalents :

	2004 \$'000
Cash at bank	13
Fixed and call deposits with banks	766,964
	766,977

Notes to the Financial Statements

For the year ended 31 March 2004
(Expressed in Hong Kong dollars)

1. Purpose, limitation and principal activity

The Securities and Futures Ordinance (SFO) provides for the establishment of the Investor Compensation Fund (the Fund) to compensate investors who suffer a loss due to the default of an intermediary in relation to trading of products on Hong Kong Exchanges and Clearing Limited. The defaulting intermediary must be licensed or registered with the Securities and Futures Commission (SFC) for dealing in securities, futures contracts or securities margin financing.

The SFC is primarily responsible for the administration and management of the Fund in accordance with Section 238 of the SFO, but has transferred some functions to the Investor Compensation Company Ltd. (ICC) under Section 80 of the SFO. ICC is thus responsible for receipt, determination and payment of valid claims against the Fund in respect of defaults of intermediaries occurring on or after 1 April 2003. Upon making payment to a claimant, the SFC is subrogated to the claimant's right against the defaulter.

Pursuant to Section 244 of the SFO, the Chief Executive in Council has by order set the maximum amount of compensation at \$150,000 per claimant for a single default in relation to securities traded at the Stock Exchange of Hong Kong Limited (SEHK) or futures contracts traded at the Hong Kong Futures Exchange Limited (HKFE).

If amounts owed to claimants against the Fund exceed the Fund's net assets, the SFC would apportion compensation payments to claimants as provided in the Securities & Futures (Investor Compensation-Claims) Rules. The SFC would pay unpaid claim amounts when funds became available in the Fund.

2. Money constituting the Fund

The Fund mainly consists of the amounts paid from the two 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 Fund and the Commodities Dealers' Deposits Fund after repaying the dealers' deposits and any money due to the registered dealers in accordance with Section 76 (11) of Schedule 10 of the SFO.

Other sources of money for the Fund include the levies chargeable on securities traded on the SEHK and futures contracts traded on the HKFE, and returns earned on the investment of the Fund.

3. Significant accounting policies

Basis of preparation

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

Recognition of income

Net investment income Net investment income comprises (i) interest income from bank deposits and debt securities; (ii) unrealised gain or loss on revaluation of debt securities and (iii) realised gain or loss on redemption and disposal of debt securities. We record interest income 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.

3. Significant accounting policies (Cont'd)

Translation of foreign currencies

We translate foreign currency transactions during the year into Hong Kong dollars at the exchange rates ruling at the transaction dates. We translate monetary assets and liabilities denominated in foreign currencies into Hong Kong dollars at the exchange rates ruling at the balance sheet date. We record exchange gains and losses on translation in the income and expenditure account.

Investments

We classify our investments as current assets and state these investments at fair value with any resultant unrealised gain or loss recognised in the income and expenditure account. The fair value of the securities is their published closing prices or quoted bid prices at the balance sheet date. We account for purchases and sales of debt securities on the settlement date.

Impairment

We review the carrying amounts of the Fund's assets at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, we estimate the asset's recoverable amount. We recognise in the income and expenditure account an impairment loss whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

(i) Calculation of recoverable amount

We calculate the recoverable amount of the Fund's receivables by discounting their expected future cash flows to their present value at the original effective interest rate inherent in the asset. We do not discount receivables with a short duration in the calculation of their recoverable amount.

(ii) Reversals of impairment

We reverse an impairment loss in respect of a receivable if the circumstances and events that have led to the write down or write-off cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future.

Other receivables

We state other receivables at their cost less impairment losses.

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 SFC.

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.

Investor Compensation Fund Financial Statements

3. Significant accounting policies (Cont'd)

Contingent liability

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

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. Net investment income

	2004 \$'000
Interest Income from bank deposits and debt securities	4,254
Unrealised gain on revaluation of debt securities	389
Net investment income	4,643

6. Transaction levy from the SEHK

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

7. Contract levy from the HKFE

From 1 April 2003, the Fund received a contract levy chargeable under the SFO 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.

12. Financial instruments

Financial assets of the Fund comprise debt securities.

(i) Credit risk

The Fund's investment policy only allows the Fund to invest in pooled funds, fixed rate dated securities or in bank deposits. Other than those holdings of pooled funds and fixed rate dated securities issued by the US Treasury and multilateral agencies with AAA credit rating, the policy limits the Fund's exposure to each organisation and each country to not more than 15% and 20% of the total investment respectively. During the year, the Fund complied with the above investment policy and, as a result, was not exposed to significant credit risk.

(ii) Exchange rate risk

The Fund's investment policy allows the Fund to have US dollar foreign exchange exposure. As the HK dollar is pegged with the US dollar, the Fund was not exposed to significant foreign exchange risk.

(iii) Market risk

The investment activities of the Fund expose it to various types of market risks which are associated with the markets in which it invests, to the extent of the amount invested in debt securities. Such risk will be reflected in the price and the carrying value of the financial assets concerned.

13. Contingent liabilities

As at the date of this report, the Fund has received claims against three intermediaries. 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 \$450,000.

Unified Exchange Compensation Fund (the Fund)

Report of the Securities Compensation Fund Committee (the Committee)

The members of the Committee present their annual report and the audited financial statements for the year ended 31 March 2004.

1. Establishment of the Fund

Part X of the Securities Ordinance (Chapter 333) established the Fund. However, when the Securities and Futures Ordinance (SFO) and its subsidiary legislation came into effect from 1 April 2003, a new single investor compensation fund (ICF) was formed to ultimately replace the Fund and the Commodity Exchange Compensation Fund. After reserving sufficient money in the Fund to meet claims against it and its other liabilities, the SFC will eventually transfer the remaining balance of the Fund to the ICF.

Part X of the Securities Ordinance remains effective in respect of the operation of the Fund to the extent described in Section 74 of Schedule 10 of the SFO.

2. Financial results

The Committee presents the financial results which are set out in the financial statements on pages 109 to 119.

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, JP

Mrs Alexa Lam

Mr David M. Roberts

Mr Kwong Ki Chi, GBS, JP

(membership ceased on 16 April 2003)

Mr Paul Chow Man Yiu, JP

(appointed on 19 May 2003)

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 year.

5. Auditors

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

On behalf of the Committee

Mark Dickens, JP

Chairman

30 April 2004

Auditors' Report To The Securities & Futures Commission (the SFC)

We have audited the financial statements of the Unified Exchange Compensation Fund (the Fund) established under Section 99 of the Hong Kong Securities Ordinance set out on pages 109 to 119 which have been prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

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 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 judgements and 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 solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

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 judgements made by the SFC in the preparation of the financial statements and of whether the accounting policies are appropriate to the Fund's circumstances, consistently applied and 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 as at 31 March 2004 and of its surplus and cash flows for the year then ended, and have been properly prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

KPMG

Certified Public Accountants
Hong Kong

30 April 2004

Income and Expenditure Account

For the year ended 31 March 2004

(Expressed in Hong Kong dollars)

	Note	2004 \$'000	2003 \$'000
Income			
Net investment income	3&5	8,687	40,541
Transaction levy	3&6	(4)	68,560
Compensation refund from claimants	7	31,810	–
Recoveries	3&9	107,899	720
		148,392	109,821
Expenses			
Provision for compensation (reversed) / made	3&11	(3,799)	15,591
Recoveries re-distributed to claimants	3	–	1,868
Auditors' remuneration		37	41
Bank charges		110	253
Exchange difference		–	11
Professional fees		138	196
Sundry expenses		54	5
		(3,460)	17,965
Surplus for the year		151,852	91,856
Accumulated deficit brought forward		(165,136)	(256,992)
Accumulated deficit carried forward		(13,284)	(165,136)

The notes on pages 113 to 119 form part of these financial statements.

Unified Exchange Compensation Fund Financial Statements

Balance Sheet

At 31 March 2004

(Expressed in Hong Kong dollars)

	Note	2004 \$'000	2003 \$'000
Current assets			
Debt securities	8	160,985	555,930
Equity securities received under subrogation	9	7,251	–
Interest receivable		2,024	5,580
Levy receivable		–	5,607
Fixed and call deposits with banks		167,407	339,687
Cash at bank		215	17
		337,882	906,821
Current liabilities			
Accounts payable and accrued charges		4,522	4,590
Provision for compensation	3&11	9,545	30,628
		14,067	35,218
Net current assets			
		323,815	871,603
Net assets			
		323,815	871,603
Representing :			
<u>Compensation fund</u>			
Contributions from the SEHK	10	46,450	46,450
Excess transaction levy from the SEHK	13	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	14	3,002	3,002
Accumulated deficit		(13,284)	(165,136)
		1,023,455	871,603
Contributions to Investor Compensation Fund	15	(699,640)	–
		323,815	871,603

Approved and authorised for issue by the Securities Compensation Fund Committee on behalf of the Securities and Futures Commission on 30 April 2004 and signed on its behalf by

Mark Dickens
Chairman

Alexa Lam
Committee Member

T Brian Stevenson
Committee Member

The notes on pages 113 to 119 form part of these financial statements.

Statement of Changes in Equity

For the year ended 31 March 2004

(Expressed in Hong Kong dollars)

	Note	2004 \$'000	2003 \$'000
Compensation fund balance as at 1 April		871,603	779,747
Surplus for the year		151,852	91,856
Contributions to Investor Compensation Fund	15	(699,640)	–
Compensation fund balance as at 31 March		323,815	871,603

The notes on pages 113 to 119 form part of these financial statements.

Unified Exchange Compensation Fund Financial Statements

Cash Flow Statement

For the year ended 31 March 2004

(Expressed in Hong Kong dollars)

	2004 \$'000	2003 \$'000
Cash flows from operating activities		
Surplus for the year	151,852	91,856
Net investment income	(8,687)	(40,541)
Decrease in levy receivable	5,607	641
Increase in equity securities received under subrogation	(7,251)	–
Decrease in provision for compensation	(21,083)	(9,985)
(Decrease) / Increase in accounts payable and accrued charges	(68)	1,866
Net cash from operating activities	120,370	43,837
Cash flows from investing activities		
Debt securities redeemed	220,000	391,500
Debt securities sold	166,824	–
Debt securities bought	–	(219,563)
Interest received	20,364	43,996
Net cash from investing activities	407,188	215,933
Cash flows from financing activities		
Additional contribution from the SFC	–	30,000
Contributions to Investor Compensation Fund	(699,640)	–
Net cash (used in) / from financing activities	(699,640)	30,000
Net (decrease) / increase in cash and cash equivalents	(172,082)	289,770
Cash and cash equivalents at beginning of the year	339,704	49,934
Cash and cash equivalents at end of the year	167,622	339,704

Analysis of the balance of cash and cash equivalents :

	2004 \$'000	2003 \$'000
Cash at bank	215	17
Fixed and call deposits with banks	167,407	339,687
	167,622	339,704

Notes to the Financial Statements

For the year ended 31 March 2004
(Expressed in Hong Kong dollars)

1. Purpose, limitation and principal activity

The Fund provides compensation to investors who suffer a loss due to the default of an exchange participant of the Stock Exchange of Hong Kong Limited (the SEHK). Part X of the Securities Ordinance governs its operation.

The SEHK receives and determines claims against the Fund. The SFC maintains and invests the money of the Fund and makes payments to claimants. Upon making payment to a claimant, the SFC is subrogated to the claimant's rights against the defaulter.

The Securities Ordinance limits to \$8 million the total amount that may be paid per exchange participant default. If allowed claims exceed the limit, payments are made proportionally to claimants. The SEHK, with the approval of the SFC, can decide to increase the limit if it considers, among other things, that the assets of the Fund so permit. For eight defaults since 1998, the SEHK proposed and the SFC approved increases in the limit via payment of up to \$150,000 per claimant or, if higher, the claimant's proportional share of the \$8 million limit.

If amounts owed to claimants against the Fund exceed the Fund's net assets, the SFC would apportion compensation payments to claimants as provided in the Securities Ordinance. Unpaid claim amounts would be charged against future receipts by the Fund and paid when funds were available.

After the Securities and Futures Ordinance (SFO) and its subsidiary legislation came into effect from 1 April 2003, a new single investor compensation fund (ICF) was formed to ultimately replace the Fund and the Commodity Exchange Compensation Fund. After allowing a sufficient sum of money in the Fund to meet claims against it and its other liabilities, the SFC will eventually transfer the remaining balance of the Fund into the ICF. Claims for any defaults occurring after 31 March 2003 should be made against the ICF. If the sum of money in the Fund is not sufficient to meet its liabilities, the SFC shall pay into the Fund from the ICF the appropriate sum of money according to Section 242 of the SFO.

Apart from the above change and Section 112 of the Securities Ordinance, under Section 74 of Schedule 10 of the SFO, Part X of the Securities Ordinance remains effective in respect of the operation of the Fund.

2. Money constituting the Fund

Before 1 April 2003, the SEHK was required to keep deposited with the SFC \$50,000 for each SEHK trading right under the Securities Ordinance. When the SFC makes compensation payments out of the deposits, the SFC may require the SEHK to replenish the net amount paid after the SFC has exhausted its subrogated rights against the defaulter. The SFC pays to the SEHK the investment return earned on any remaining deposits net of Fund expenses. During the year, the SFC did not make such payment as the total of the compensation payments exceeded the deposits received from the SEHK (2003 : nil).

The SEHK and the SFC have made contributions of their own money to the Fund. The SFC determines to retain investment returns earned on these contributions in the Fund.

Other sources of money for the Fund include: recoveries; SEHK replenishments detailed in note 12; special levy surplus detailed in note 14; and transaction levy detailed in note 6.

3. Significant accounting policies

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

Basis of preparation

Under the SFO, the Fund will continue in operation until all claims against it and all its liabilities have been settled. As the Fund will eventually cease operation, we have prepared these financial statements on a break-up basis with assets stated at recoverable amounts. We have not provided for potential future claims and recoveries as these cannot be reliably estimated. We have also not provided in the financial statements for all expenses expected to be incurred subsequent to the balance sheet date and up to the date operations will cease as these are estimated to be immaterial.

Recognition of income

Net Investment income Net investment income comprises (i) interest income from bank deposits and debt securities, (ii) unrealised gain or loss on revaluation of debt securities and (iii) realised gain or loss on redemption and disposal of debt securities. We record interest income on an accrual basis.

Transaction levy We record transaction levy as income at a fixed rate of every leviabie SEHK transaction on an accrual basis.

Recoveries We recognise recoveries pursuant to Section 118 of the Securities Ordinance as income to the Fund and recoveries re-distributed to claimants as expenses. We record recoveries received and re-distributed on a receipt basis.

Replenishments by the SEHK We record replenishments from the SEHK pursuant to Section 107 of the Securities Ordinance as income of the Fund on a receipt basis. For the purpose of calculating the amount to be replenished by the SEHK, we deem compensation payments up to the amount of \$8,000,000 for each default to be charged to the contribution from the SEHK.

Translation of foreign currencies

We translate foreign currency transactions during the year into Hong Kong dollars at the exchange rates ruling at the transaction dates. We translate monetary assets and liabilities denominated in foreign currencies into Hong Kong dollars at the exchange rates ruling at the balance sheet date. We record exchange gains and losses on translation in the income and expenditure account.

Investments

As we have prepared the financial statements on a break-up basis, we classify our investments in debt securities as current assets and state these securities at fair value with any resultant unrealised gain or loss recognised in the income and expenditure account. The fair value of the securities is their quoted bid prices at the balance sheet date. We account for purchases and sales of debt securities on the settlement date.

Impairment

We review the carrying amounts of the Fund's assets at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, we estimate the asset's recoverable amount. We recognise in the income and expenditure account an impairment loss whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

3. Significant accounting policies (cont'd)

(i) Calculation of recoverable amount

We calculate the recoverable amount of the Fund's receivables by discounting their expected future cash flows to their present value at the original effective interest rate inherent in the asset. We do not discount receivables with a short duration in the calculation of their recoverable amount.

(ii) Reversals of impairment

We reverse an impairment loss in respect of a receivable if the circumstances and events that have led to the write down or write-off cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future.

Other receivables

We state other receivables at their cost less impairment losses.

Provision for compensation

We make provision for liabilities arising from claims resulting from defaults occurring before 1 April 2003 for which the SEHK has published a notice calling for claims pursuant to either Section 112 of the Securities Ordinance or Section 74(4) of Schedule 10 of the SFO. The provision covers all such claims received up to the date on which the financial statements are approved by the Committee.

As a result of the enactment of the amendments to Section 113 of the Securities Ordinance in November 1998, the maximum liability of the Fund to claims for each default case can exceed the normal \$8,000,000 limit.

Other payables

We state other payables at cost.

Contingent liabilities

Unless the probability of outflow of economic benefits is remote, we disclose obligations as contingent liabilities 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.

Related parties

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

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

Unified Exchange Compensation Fund Financial Statements

4. Taxation

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

5. Net investment income

	2004 \$'000	2003 \$'000
Interest income from bank deposits and debt securities	14,463	34,209
Unrealised (loss) / gain on revaluation of debt securities	(5,776)	6,332
Net investment income	8,687	40,541

6. Transaction levy

From 1 September 2001 to 31 March 2003, the Fund received a transaction levy chargeable at 0.002% of every leviable SEHK transaction. After the SFO came into effect on 1 April 2003, transaction levy was paid into the ICF. No transaction levy was received by the Fund for the year.

7. Compensation refund from claimants

The joint liquidators of C.A. Pacific Securities Ltd. (In Liquidation) and C.A. Pacific Finance Ltd. (In Liquidation) have obtained the court's approval to distribute shares to clients, starting from 30 June, 2003. The clients could either keep the compensation payment paid by the Fund or return the compensation payment before 29 October 2003 to the Fund to get back the shares allotted to them from the liquidators, subject to paying a processing fee to the liquidators. If a client elected to retain the compensation payment, the liquidators would allocate shares between the client and the Fund proportionally to the client's loss and the amount of the compensation payment as the Fund is subrogated to the client's rights to the extent of the compensation payments.

During the year, the Fund received shares from the liquidators as a result of those clients who chose to keep the compensation payment, which is detailed in note 9. Up to 29 October 2003, the Fund also received repayments of compensation of \$31,810,000 from those clients who chose to take the allocated shares. This amount has been recognised in the income and expenditure account.

Unified Exchange Compensation Fund Financial Statements

11. Provision for compensation

	2004 \$'000	2003 \$'000
Balance brought forward	30,628	40,613
Less : Amount paid during the year	(17,284)	(25,576)
Unused provision reversed during the year	(3,799)	(4,443)
Additional provision made for the year	-	20,034
Add : Net provision (reversed)/made	(3,799)	15,591
Balance carried forward	9,545	30,628

We made provision for claims in respect of four SEHK exchange participants for which the SEHK has published a notice calling for claims. The maximum liabilities of the Fund in respect of three of these defaulted cases exceed the normal \$8 million limit provided by Section 109(3) of the Securities Ordinance.

12. Replenishments from the SEHK

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

Up to 31 March 2004, the SEHK has replenished \$16,360,000 to the Fund. In compliance with Section 107 of the Securities Ordinance, if no further recoveries were to be collected, the SFC may require the SEHK to further replenish \$72,729,000 to the Fund as follows :

	2004 \$'000
Compensation paid up to the \$8 million limit as set out in Section 109(3) of the Securities Ordinance	99,091
Less : Recoveries received for compensation paid up to \$8 million	(26,387)
Add : Recoveries re-distributed to claimants	16,385
Less : Replenishments from the SEHK	(16,360)
Net amount SFC may request SEHK for replenishment	72,729

Under Section 74(3) of Schedule 10 of the SFO, the SFC having allowed sufficient funds to meet claims, may reimburse the SEHK for the deposits paid by the SEHK into the Fund for each trading right. The reimbursement of these SEHK deposits may be set off against further replenishments required from the SEHK.

13. Excess transaction levy from the SEHK

The SEHK paid these amounts to the Fund from 1992 to 1994 under an agreement with the SFC and the Financial Secretary concerning the SEHK's budget and its receipt of transaction levy.

14. Special levy surplus

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

15. Contributions to Investor Compensation Fund

When the SFO and its subsidiary legislation came into effect from 1 April 2003, a new single investor compensation fund (ICF) was formed to ultimately replace the Fund and the Commodity Exchange Compensation Fund. Under section 74(2) of Schedule 10 of the SFO, the SFC may after 1 April 2003 pay into the ICF, which came into operation after 1 April 2003, such sum of money from the Fund as it considers appropriate. During the year, the SFC paid \$699,640,000 into the ICF from the Fund.

16. Related party transactions

We have related party relationships with the ICF, the SFC and the SEHK. During the year, there were no significant related party transactions other than those disclosed in the financial statements (refer to notes 6, 8, 10, 12, 13 and 15).

17. Financial instruments

Financial assets of the Fund comprise debt securities.

(i) Credit risk

The Fund's investment policy only allows the Fund to invest in fixed rate dated securities or in bank deposits. The policy also limits the Fund's exposure to each organisation and each country to not more than 15% and 20% of the total investment respectively. During the year, the Fund complied with the above investment policy and, as a result, was not exposed to significant credit risk.

(ii) Exchange rate risk

All our debt securities are denominated in Hong Kong dollars and, as a result, the Fund was not exposed to foreign exchange risk.

(iii) Market risk

The investment activities of the Fund expose it to various types of market risks which are associated with the markets in which it invests, to the extent of the amount invested in debt securities. Such risk will be reflected in the price and the carrying value of the financial assets concerned.

18. Contingent liabilities

As at the date of this report, claims against eight exchange participants have been received by the SEHK, where the validity of these claims is under investigation by the SEHK and for those claims the SEHK has not sought the SFC's approval to increase the limit over \$8 million. Thus, these claims are subject to the normal \$8 million limit pursuant to Section 109 of the Securities Ordinance. We have not made any provision in these financial statements for any of these claims. Under these circumstances, the maximum liability of the Fund to these claims is \$64 million (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 annual report and the audited financial statements for the year ended 31 March 2004.

1. Establishment of the Fund

Part VIII of the Commodities Trading Ordinance (Chapter 250) established the Fund. However, when the Securities and Futures Ordinance (SFO) and its subsidiary legislation came into effect from 1 April 2003, a new single investor compensation fund (ICF) was formed to ultimately replace the Fund and the Unified Exchange Compensation Fund. After reserving sufficient money in the Fund to meet claims against it and its other liabilities, the SFC will eventually transfer the remaining balance of the Fund to the ICF.

Part VIII of the Commodities Trading Ordinance remains effective in respect of the operation of the Fund to the extent described in Section 75(1) of Schedule 10 of the SFO.

2. Financial results

The Committee presents the financial results which are set out in the financial statements on pages 122 to 130.

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, JP

Mrs Alexa Lam

Mr William D Grossman (membership ceased on 13 May 2003)

Mr Lobo Lee (appointed on 19 May 2003 and membership ceased on 3 June 2003)

Mr Mark Ho (membership ceased on 3 June 2003)

Mr Calvin Tai (appointed on 16 June 2003)

Mr Lawrence Fok (appointed on 16 June 2003)

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 year.

5. Auditors

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

On behalf of the Committee

Mark Dickens, JP

Chairman

30 April 2004

Auditors' Report To The Securities & Futures Commission (the SFC)

We have audited the financial statements of the Commodity Exchange Compensation Fund (the Fund) established under Section 77 of the Hong Kong Commodities Trading Ordinance set out on pages 122 to 130 which have been prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

Respective responsibilities of the SFC and auditors

The Hong Kong Commodities Trading Ordinance requires the SFC to keep proper accounts of the Fund and to prepare financial statements of the Fund in respect of each financial year. The directors of the SFC do so on the basis that these financial statements should give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and 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 solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

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 judgements made by the SFC in the preparation of the financial statements and of whether the accounting policies are appropriate to the Fund's circumstances, consistently applied and 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 as at 31 March 2004 and of its surplus and cash flows for the year then ended, and have been properly prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

KPMG

Certified Public Accountants
Hong Kong

30 April 2004

Commodity Exchange Compensation Fund Financial Statements

Income and Expenditure Account

For the year ended 31 March 2004

(Expressed in Hong Kong dollars)

	Note	2004 \$'000	2003 \$'000
Income			
Net investment income	3&5	731	6,063
Contract levy	3&6	–	6,987
Recoveries	3	–	14
		731	13,064
Expenses			
Auditors' remuneration		37	41
Bank charges		21	60
Professional fees		22	27
Sundry expenses		2	1
		82	129
Surplus for the year		649	12,935
Accumulated surplus brought forward		107,613	94,678
Accumulated surplus carried forward		108,262	107,613

The notes on pages 126 to 130 form part of these financial statements.

Balance Sheet

At 31 March 2004

(Expressed in Hong Kong dollars)

	Note	2004 \$'000	2003 \$'000
Current assets			
Debt securities	7	–	75,633
Interest receivable		–	957
Levy receivable		–	772
Fixed and call deposits with banks		524	51,767
Cash at bank		5	136
		529	129,265
Current liabilities			
Accounts payable and accrued charges		227	252
		302	129,013
Net current assets			
		302	129,013
Net assets			
Representing :			
<u>Compensation fund</u>			
Contributions from the HKFE	8	–	21,400
Accumulated surplus		108,262	107,613
		108,262	129,013
Contributions to Investor Compensation Fund	9	(107,960)	–
		302	129,013

Approved and authorised for issue by the Futures Compensation Fund Committee on behalf of the Securities and Futures Commission on 30 April 2004 and signed on its behalf by

Mark Dickens
Chairman

Alexa Lam
Committee Member

T Brian Stevenson
Committee Member

The notes on pages 126 to 130 form part of these financial statements.

Commodity Exchange Compensation Fund Financial Statements

Statement of Changes in Equity

For the year ended 31 March 2004

(Expressed in Hong Kong dollars)

	Note	2004 \$'000	2003 \$'000
Compensation fund balance as at 1 April		129,013	116,278
Surplus for the year		649	12,935
Net contributions refunded to the HKFE	8	–	(200)
Contributions reimbursed to the HKFE	8	(21,400)	–
Contributions to Investor Compensation Fund	9	(107,960)	–
Compensation fund balance as at 31 March		302	129,013

The notes on pages 126 to 130 form part of these financial statements.

Cash Flow Statement

For the year ended 31 March 2004
(Expressed in Hong Kong dollars)

	2004 \$'000	2003 \$'000
Cash flows from operating activities		
Surplus for the year	649	12,935
Net investment income	(731)	(6,063)
Decrease / (Increase) in levy receivable	772	(291)
Decrease in accounts payable and accrued charges	(25)	(1)
Net cash from operating activities	665	6,580
Cash flows from investing activities		
Debt securities redeemed	23,000	51,700
Debt securities sold	51,555	–
Debt securities bought	–	(16,732)
Interest received	2,766	6,818
Net cash from investing activities	77,321	41,786
Cash flows from financing activities		
Net contribution refunded to the HKFE	–	(200)
Contributions reimbursed to the HKFE	(21,400)	–
Contributions to Investor Compensation Fund	(107,960)	–
Net cash used in financing activities	(129,360)	(200)
Net (decrease) / increase in cash and cash equivalents	(51,374)	48,166
Cash and cash equivalents at beginning of the year	51,903	3,737
Cash and cash equivalents at end of the year	529	51,903

Analysis of the balance of cash and cash equivalents :

	2004 \$'000	2003 \$'000
Cash at bank	5	136
Fixed and call deposits with banks	524	51,767
	529	51,903

Notes to the Financial Statements

For the year ended 31 March 2004
(Expressed in Hong Kong dollars)

1. Purpose, limitation and principal activity

The Fund provides compensation to investors who suffer a loss due to the default of an exchange participant of the Hong Kong Futures Exchange Limited (the HKFE). Part VIII of the Commodities Trading Ordinance governs its operation.

The HKFE receives and determines claims against the Fund. The SFC maintains and invests the money of the Fund and makes payments to claimants. Upon making payment to a claimant, the SFC is subrogated to the claimant's rights against the defaulter.

The Commodities Trading Ordinance limits to \$2 million the total amount that may be paid per exchange participant default. If allowed claims exceed the limit, payments are made proportionally to claimants. The HKFE, with the approval of the SFC, can decide to increase the limit if it considers that the assets of the Fund so permit.

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 Commodities Trading Ordinance. Unpaid claim amounts would be charged against future receipts by the Fund and paid when funds were available.

After the Securities and Futures Ordinance (SFO) and its subsidiary legislation came into effect from 1 April 2003, a new single investor compensation fund (ICF) was formed to ultimately replace the Fund and the Unified Exchange Compensation Fund. After allowing a sufficient sum of money in the Fund to meet claims against it and its other liabilities, the SFC will eventually transfer the remaining balance of the Fund into the ICF. Claims for any defaults occurring after 31 March 2003 shall be made against the ICF. If the sum of money in the Fund is not sufficient to meet its liabilities, the SFC shall pay into the Fund from the ICF the appropriate sum of money according to Section 242 of the SFO.

Apart from the above change and Section 89 of the Commodities Trading Ordinance, under Section 75(1) of Schedule 10 of the SFO, Part VIII of the Commodities Trading Ordinance remains effective in respect of the operation of the Fund.

2. Money constituting the Fund

Under the Commodities Trading Ordinance, the HKFE was required to keep deposited with the SFC \$100,000 for each holder of HKFE trading rights before 1 April 2003. The SFC has discretion to add to the Fund the investment return earned on the deposits net of Fund expenses or pay interest to the HKFE. In practice, the SFC adds the investment return to the Fund.

Other sources of money for the Fund include a contract levy chargeable on contracts traded on the HKFE before the SFO came into effect on 1 April 2003 and recoveries.

3. Significant accounting policies

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

Basis of preparation

Under the SFO, the Fund will continue in operation until all claims against it and all its liabilities have been settled. As the Fund will eventually cease operation, we have prepared these financial statements on a break-up basis with assets stated at recoverable amounts. We have not provided in the financial statements for all expenses expected to be incurred subsequent to the balance sheet date and up to the date operations will cease as these are estimated to be immaterial.

Recognition of income

Net Investment income Net investment income comprised (i) interest income from bank deposits and debt securities, (ii) unrealised gain or loss on revaluation of debt securities and (iii) realised gain or loss on redemption and disposal of debt securities. We record interest income on an accrual basis.

Contract levy We record contract levy as income at a fixed rate on every leviabale HKFE transaction on an accrual basis.

Recoveries We record recoveries pursuant to Section 95 of the Commodities Trading Ordinance as income on a receipt basis to the Fund.

Investments

As we have prepared the financial statements on a break-up basis, we classify our investments in debt securities as current assets and state these securities at fair value with any resultant unrealised gain or loss recognised in the income and expenditure account. The fair value of the securities is their quoted bid prices at the balance sheet date. We account for purchases and sales of debt securities on the settlement date.

Impairment

We review the carrying amounts of the Fund's assets at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, we estimate the asset's recoverable amount. We recognise in the income and expenditure account an impairment loss whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

(i) Calculation of recoverable amount

We calculate the recoverable amount of the Fund's receivables by discounting their expected future cash flows to their present value at the original effective interest rate inherent in the asset. We do not discount receivables with a short duration in the calculation of their recoverable amount.

(ii) Reversals of impairment

We reverse an impairment loss in respect of a receivable if the circumstances and events that have led to the write down or write-off cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future.

Commodity Exchange Compensation Fund Financial Statements

3. Significant accounting policies (Cont'd)

Other receivables

We state other receivables at their cost less impairment losses.

Provision for compensation

We make provision for compensation for known liabilities arising from claims for pecuniary losses suffered by persons as a result of defaults occurring prior to 1 April 2003 on the part of the exchange participants of the HKFE which are determined up to the date on which the financial statements are approved by the Committee. We charge such provisions as expenses through the income and expenditure account.

Other payables

We state other payables at cost.

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

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

5. Net investment income

	2004 \$'000	2003 \$'000
Interest income from bank deposits and debt securities	1,474	5,104
(Loss) / gain on revaluation of debt securities	(743)	959
Net investment income	<u>731</u>	<u>6,063</u>

6. Contract levy

Before 1 April 2003, the Fund received a contract levy chargeable at \$0.5 per every leviable HKFE transaction except for Mini-Hang Seng Index Futures Contracts, Stock futures contracts and Options on Stock futures contracts which are chargeable at \$0.1 per transaction. After the SFO came into effect on 1 April 2003, contract levy was paid into the ICF. No contract levy was received by the Fund for the year.

7. Debt securities

	2004 \$'000	2003 \$'000
Maturing after one year		
In the second to third years – unlisted	–	37,318
After three years – unlisted	–	3,510
	–	40,828
Maturing within one year – unlisted	–	34,805
	–	75,633

During the year, the Fund sold debt securities of nominal value \$49.5 million to the ICF at market price.

8. Contributions from the HKFE

	2004 \$'000	2003 \$'000
Balance brought forward	21,400	21,600
Add: Contributions received during the year	400	700
Less : Refunds to outgoing holders of trading rights	(400)	(900)
Less : Contributions reimbursed to the HKFE	(21,400)	–
Balance carried forward	–	21,400

Under Section 75(3) of Schedule 10 of the SFO, the SFC may apply any excess of the Fund over amounts necessary for satisfying claims and outstanding liabilities of the Fund to reimburse the HKFE for the amounts which the HKFE has deposited into the Fund as required under Section 82 of the Commodities Trading Ordinance. During the year, SFC reimbursed the HKFE \$21.4 million.

9. Contributions to Investor Compensation Fund

When the SFO and its subsidiary legislation came into effect from 1 April 2003, a new single investor compensation fund (ICF) was formed to ultimately replace the Fund and the Unified Exchange Compensation Fund. Under Section 75(2) of Schedule 10 of the SFO, the SFC may after 1 April 2003 pay into the ICF, which came into operation after 1 April 2003, such sum of money from the Fund as it considers appropriate. During the year, the SFC paid \$107,960,000 into the ICF from the Fund.

10. Related party transactions

We have related party relationships with the ICF, the SFC and the HKFE. During the year, there were no significant related party transactions other than those disclosed in the financial statements (refer to notes 7 to 9).

11. Financial instruments

The Fund had Hong Kong dollar deposits with banks only and, as a result, was not subject to significant interest rate, foreign exchange and credit risk.

12. Contingent liabilities

As at the date of this report, there is no outstanding claim against the Fund (2003 : nil).

Committees, Panels and Tribunal

Committees of the SFC

Advisory Committee

Advises the Commission on any matter of policy regarding the performance of its functions.

<p>Chairman Andrew L T Sheng, SBS, JP</p>	<p>Members Ashley Alder Didier Balme (to 31.05.03) Thaddeus Beczak Ambrose Cheung Paul Chow, JP Paul Fan, JP Eddy Fong, SBS, JP (from 01.06.03) Mario Francescotti</p>	<p>Brett P Goodin (to 31.05.03) Christina Hui (to 31.05.03) Stephen C C Hui Alexa Lam Christine Loh Roger Luk, JP (from 01.06.03) Samuel Poon Dr. Eden Woon</p>
<p>No of meetings 5</p>		<p>Average Attendance Rate (%) 66%</p>

Takeovers and Mergers Panel

Administers the Code on Takeovers and Mergers.

<p>Chairman Kevin Westley</p> <p>Deputy Chairmen Clifton Chiu Henry H L Fan, SBS, JP</p>	<p>Members Nicholas Allen Ian Boyce Malcolm Brown David Carse, SBS, JP (to 19.09.03) Edward Cheng Stephen Clark David Graham Teresa Ko Clement Kwok Angelina Lee, JP John Lees</p>	<p>Alfred Li Liu Chee-ming David Lui John Maguire (from 01.04.03) C Roger Moss (to 31.03.04) Gavin Nesbitt Patricia Shih Frank Slevin May Tan Carlson Tong David Webb V-Nee Yeh</p>
<p>No of meeting 1</p>		<p>Average Attendance Rate (%) 100%</p>

Committees, Panels and Tribunal

Takeovers Appeal Committee

Reviews disciplinary rulings of the Takeovers and Mergers Panel at the request of an aggrieved party for the sole purpose of determining whether any sanction imposed by the Panel is unfair or excessive.

<p>Chairman Timothy G Freshwater (from 01.04.03)</p> <p>Deputy Chairman Rajat K Jindal (from 01.04.03)</p>	<p>Members Nicholas Allen Ian Boyce Malcolm Brown David Carse, SBS, JP (to 19.09.03) Edward Cheng Clifton Chiu Stephen Clark Henry H L Fan, SBS, JP (from 01.04.03) David Graham Teresa Ko Clement Kwok Angelina Lee, JP John Lees</p>	<p>Alfred Li Liu Chee-ming David Lui John Maguire (from 01.04.03) C Roger Moss (to 31.03.04) Gavin Nesbitt Patricia Shih Frank Slevin May Tan Carlson Tong David Webb Kevin Westley V-Nee Yeh</p>
<p>No of meeting 0 Average Attendance Rate (%) N/A</p>		

Committee on Unit Trusts

Authorises collective investment schemes commonly regarded as mutual funds and unit trusts; imposes conditions on the authorisation of such schemes and grants waivers.

<p>Chairman Alexa Lam</p>	<p>Full Members Prof. Ka-Keung C Chan Paul Chow, JP (from 01.04.03 to 15.05.03) Vincent Duhamel (from 01.04.03) Roger Hepper (from 01.04.03) Stuart Leckie, JP George Long Darren McShane Alastair Murray Edith Ngan (from 09.09.03 to 15.03.04) Lin-Yoke Seetoh (to 09.09.03)</p>	<p>Paul Smith Tina So Anna H Y Wu, SBS, JP</p> <p>Alternate Members Austin Caffrey (to 10.11.03) Teh-Hsiu Fu (to 05.12.03) Joseph Ho David Hughes Frank Kusse K K Tse Scobie Ward</p>
<p>No of meetings 3 Average Attendance Rate (%) 64%</p>		

Committee on Investment-Linked Assurance and Pooled Retirement Funds

Authorises investment-linked assurance schemes and pooled retirement funds; imposes conditions on the authorisation of investment-linked assurance schemes and pooled retirement funds and grants waivers.

Chairman Alexa Lam	Full Members Rex Auyeung Desmond Chan Prof. Ka-Keung C Chan August Chow Anthony Lau (to 13.05.03) Stuart Leckie, JP Terry Lo (from 13.05.03) Darren McShane	Alastair Murray Tina So Anna H Y Wu, SBS, JP Alternate Members Francine Kwong Kevin Lee Simon Ng Oscar Wong
No of meeting 0	Average Attendance Rate (%) N/A	

Committee on Real Estate Investment Trusts (Set up on 1 September 2003)

Advises the Commission on general policy matters or regulatory issues that are related to the Code on REITs, the overall market development of REITs, the property or securities market or investment management in Hong Kong or elsewhere, professional practices or guidelines that are involved in the operation of REITs, and fund investment or management in general.

Chairman Alexa Lam	Members Henry Cheong Martin Cubbon Eddy Fong, SBS, JP Roger Hepper	Heung Shu Fai C Y Leung, JP Stephen Po Paul Smith David Richardson
No of meeting 1	Average Attendance Rate (%) 80%	

Securities Compensation Fund Committee

Administers the Unified Exchange Compensation Fund (Fund) and regulates its procedures in accordance with Part X of the repealed Securities Ordinance which, under Section 74 of Schedule 10 to the Securities and Futures Ordinance, continues to apply to and in relation to any claim for compensation from the Fund made before 1 April 2003.

Chairman Mark Dickens, JP	Members Kwong Ki Chi, GBS, JP (to 16.04.03) Paul Chow, JP (from 19.05.03)	Alexa Lam David M Roberts T Brian Stevenson, SBS
No of meeting* 0	Average Attendance Rate (%) N/A	

* Although no meeting was held during the year, a total of 18 resolutions were considered and signed by the members of the Committee.

Committees, Panels and Tribunal

Futures Compensation Fund Committee

Administers the Commodity Exchange Compensation Fund (Fund) and regulates its procedures in accordance with Part VIII of the repealed Commodities Trading Ordinance which, under Section 75 of Schedule 10 to the Securities and Futures Ordinance, continues to apply to and in relation to any claim for compensation from the Fund made before 1 April 2003.

Chairman Mark Dickens, JP	Members Lawrence Fok (from 16.06.03) William D Grossman (to 13.05.03) Mark Ho (to 03.06.03) Alexa Lam	Lobo Lee (from 19.05.03 to 03.06.03) T Brian Stevenson, SBS Calvin Tai (from 16.06.03)
No of meeting* 0	Average Attendance Rate (%)	N/A

*Although no meeting was held during the year, a total of 10 resolutions were considered and signed by the members of the Committee.

Investor Compensation Fund Committee (Set up on 1 April 2003)

Administers the Investor Compensation Fund and regulates its procedures in accordance with the Securities and Futures Ordinance.

Chairman Mark Dickens, JP	Members Paul Chow, JP Frederick J Grede (to 29.06.03)	Alexa Lam Anna H Y Wu, SBS, JP
No of meetings 2	Average Attendance Rate (%)	100%

Investor Education Advisory Committee

Provides ideas and support to the Commission in setting its investor education targets.

Chairman Peter Au-Yang (from 16.06.03) Alexa Lam (to 15.06.03)	Full Members Edward Chow (to 31.03.04) Robert Chow (from 01.04.03) Lawrence Fok The Hon. Ho Chun Yan Albert (from 01.04.03 to 31.03.04) Dr. Saimond Ip (from 01.04.03 to 31.03.04) Ivy Lai Li Kai Ming (to 14.11.03) Prof. Lui Yu Hon (to 31.03.04)	Roger Luk, JP (from 01.04.03 to 31.03.04) Edith Ngan (from 18.09.03 to 12.03.04) Lin Yoke Seetoh (to 14.09.03) Howard Sou (from 01.04.03) Wilfred Wong (from 01.04.03 to 31.03.04) Alternate Members Henry Law (to 31.03.04) Sally Wong (from 01.04.03) Wong Koon Shing
No of meetings 4	Average Attendance Rate (%)	83%

Academic and Accreditation Advisory Committee

Approves industry-based courses and examinations for the purpose of meeting the competence requirement; endorses applications from professional bodies and tertiary institutions as recognised institutions for providing continuous professional training; advises the Commission on areas to study in the context of enhancing Hong Kong's position as an international financial centre; provides input for the development of industry related courses and training programs.

Chairman Alexa Lam	Members Prof. Charles D Booth Prof. Eric C Chang (to 18.02.04) Prof. Stephen Y L Cheung Albert Thomas Da Rosa, Junior Stephen C C Hui	Sandra Y M Lee Vincent M K H Lee Prof. Paul B McGuinness Derek Shek Prof. Raymond W M So (from 19.02.04)
No of meetings 4		Average Attendance Rate (%) 84%

Shareholders Group

Advises on issues relating to shareholders' rights and interests.

Chairman Ashley Alder	Members Jamie Allen Rex Auyeung Prof. Andrew Chan Lennon W L Chan Albert J H Cheng (from 17.06.03) David Cheung (from 17.06.03) Vincent Duhamel	Heung Shu Fai David Lui Richard Mak (from 17.06.03) David T K Sun Mark Taylor (to 16.06.03) Prof. Judy Tsui (to 16.06.03) David Webb V-Nee Yeh (to 16.06.03)
No of meetings 7		Average Attendance Rate (%) 65%

SFC Dual Filing Advisory Group (Set up on 16 May 2003)

Advises on treatment of cases under the Dual Filing regime and the relevant regulatory provisions, as well as on related policy issues.

Chairman Members present in each Committee meeting will elect a Chairman among themselves at the beginning of that meeting.	Members Dennis Cassidy Teresa Ko W Gage McAfee Mike Scales	Frank J Slevin Carlson Tong Peter P W Tse Tony Tsoi V-Nee Yeh
No of meetings 3		Average Attendance Rate (%) 74%

Committees, Panels and Tribunal

SFC (HKEC Listing) Committee

Exercises powers and functions equivalent to those of the Main Board and GEM Listing Committees of the Stock Exchange when real or potential conflicts of interests arise between the interests of HKEx and those of the proper performance of the Stock Exchange's listing functions. In such cases, the relevant Stock Exchange functions may be exercised by the SFC.

<p>Chairman Members present in each Committee meeting will elect a Chairman among themselves at the beginning of that meeting.</p>	<p>Members Thaddeus Beczak Eric Cheng Stephen Clark Mark Dickens, JP Alexa Lam</p>	<p>Alan Linning Patricia Shih Tina So Carlson Tong V-Nee Yeh</p>
No of meeting 0	Average Attendance Rate (%) N/A	

Share Registrars' Disciplinary Committee

Hears and determines disciplinary matters relating to share registrars in the first instance.

<p>Chairman Martin Rogers</p> <p>Deputy Chairman Stephen Clark</p>	<p>Members Nicholas Allen Roger T Best, JP Rebecca Chow Henry H L Fan, SBS, JP David Graham David Halperin Prof. Betty M F Ho (to 30.06.03) Mark Johnson Teresa Ko Dr. Bill Kwok Alan Lee</p>	<p>Clifford Levy Mark Lin Teresa Ma Michael W Scales T Brian Stevenson, SBS David T K Sun Carlson Tong Jason Webber Kevin Westley James Wong V-Nee Yeh</p>
No of meeting 0	Average Attendance Rate (%) N/A	

Internal Committees

Audit Committee

Reviews the annual financial statements; reviews the management's procedures to monitor the effectiveness of the systems of accounting and internal control; recommends to the Commission the appointment of external auditors; considers the scope and planning of the external audit; reviews audit findings set out in the external auditors' management letters and management's responses to them and monitors the subsequent implementation of agreed improvements; and considers any other matters referred to it by the Commission.

<p>Chairman T Brian Stevenson, SBS</p> <p>Deputy Chairman Anna H Y Wu, SBS, JP</p>	<p>Member Raymond P L Kwok</p>
No of meetings 5	Average Attendance Rate (%) 93%

Budget Committee

Reviews and approves proposed parameters and the basis for annual budget compilation; reviews the annual budget prior to its submission to the Commission; reviews the implementation or progress of the approved annual budget half yearly and recommends to the Commission any appropriate actions; and considers any other matters referred to it by the Commission.

<p>Chairman Henry H L Fan, SBS, JP (to 14.11.03) Raymond P L Kwok (from 17.11.03)</p> <p>Deputy Chairman Christopher Cheng, JP (from 17.11.03)</p>	<p>Members Peter Au-Yang (from 17.11.03) Mark Dickens, JP Andrew L T Sheng, SBS, JP</p>
No of meeting 1	Average Attendance Rate (%) 80%

Committees, Panels and Tribunal

Management Committee

Performs administrative, financial and management functions as delegated by the SFC.

Chairman Andrew L T Sheng, SBS, JP	Members Ashley Alder Peter Au-Yang (from 26.05.03) Mark Dickens, JP Gerald Greiner Geoffrey Harris	Brian Ho Alexa Lam Alan Linning Keith Lui Stephen Po (from 22.04.03) Andrew Young
No of meetings 13		Average Attendance Rate (%) 81%

Remuneration Committee

Reviews policy on the structure of staff remuneration and recommends amendments; reviews reports on trends in salary and benefits and recommends any periodic adjustments; and considers any other matters referred to it by the Commission.

Chairman Daniel R Fung, SBS, SC Deputy Chairman Henry H L Fan, SBS, JP (to 14.11.03) Anna H Y Wu, SBS, JP (from 17.11.03)	Members Christopher Cheng, JP (from 15.11.03) Raymond P L Kwok Dr. York Liao, JP (from 26.05.03) T Brian Stevenson, SBS The Hon Jasper Tsang Yok Sing, GBS, JP
No of meeting 1	Average Attendance Rate (%) 100%

Independent Panels and Tribunal

Arbitration Panel under Securities and Futures (Leveraged Foreign Exchange Trading) (Arbitration) Rules

The panel resolves disputes in accordance with the Securities and Futures (Leveraged Foreign Exchange Trading) (Arbitration) Rules.

<p>Chairman Anthony K T Yuen</p> <p>Deputy Chairman Tam Ping Shing</p>	<p>Members Alan K W Chan Davy K K Kwan Lam Yim Nam</p>	<p>Joseph Y W Pang Ronald P C Tam Eddie C S Tan</p>
--	---	---

Securities and Futures Appeals Panel

The panel is an independent statutory body whose members are appointed by the Chief Executive to hear appeals from decisions made by the Commission relating to the registration of intermediaries and certain other matters.

<p>Chairman Alan Hoo, SC, JP</p> <p>Deputy Chairman Patrick P T Fung, SC FCIArb</p>	<p>Members Nicholas Allen Iain F Bruce Ella Cheng Marvin K T Cheung, SBS, JP Peter Clarke Timothy G Freshwater</p>	<p>Dudley L Harding Rajat K Jindal Dannis J H Lee, BBS Michael T P Sze Peter S H Wong Roderick B Woo, JP</p>
---	---	--

Securities and Futures Appeals Tribunal (Set up on 1 April 2003)

The Tribunal is an independent statutory body whose members are appointed by the Chief Executive to hear appeals from decisions made by the Commission relating to the registration of intermediaries and certain other matters.

<p>Chairman The Hon Mr Justice Stone, Judge of the Court of First Instance of the High Court</p>	<p>Members Dr. Au King Lun Roger T Best, JP Simon Brookhouse (to 01.10.03) Prof. Ka-Keung C Chan Fong Hup Shirley Fung David Graham Stephen C C Hui Teresa Ko Dr. Bill Kwok Kenneth H W Kwok, SC</p>	<p>Clement K M Kwok Vincent Marshall K H Lee Angelina Lee, JP Roger Luk, JP David T K Sun Tang Kwai-Nang, JP Tse Kam-Keung Samuel N Tsiens Dr. Michael F S Tsui Gordon R Ward Wilfred W S Wong</p>
---	---	--

Consultations, Codes and Guidelines

The following were published in 2003-2004:

Consultation Papers: 6

1.	SFC and FSTB Joint Consultation Paper on the Proposal to Empower the Securities and Futures Commission to Initiate a Derivative Action on Behalf of a Company	May 2003
2.	SFC and HKEx Joint Consultation Paper on the Regulation of Sponsors and Independent Financial Advisers	May 2003
3.	Consultation Paper on a Proposed Amendment to the Securities and Futures (Price Stabilizing) Rules in Relation to Recognition of Overseas Rules	July 2003
4.	Consultation Paper on the Securities and Futures (Contracts Limits and Reportable Positions) (Amendment) Rules 2003 and Proposed Amendments to the Guidance Note on Position Limits and Large Open Position Reporting Requirements	September 2003
5.	Consultation Paper on Draft Guidelines on Good Disclosure of Securities Services Related Fees and Charges	October 2003
6.	Consultation Paper on the Regulatory Framework for Addressing Analyst Conflicts of Interest	March 2004

Conclusions: 8

1.	Consultation Conclusions on the Draft Guidelines for Persons Using the Internet to Collect Applications for Securities in a Public Offering	April 2003
2.	Consultation Conclusions on the Draft Code on Real Estate Investment Trusts	July 2003
3.	Consultation Conclusions on Proposals for a Scripless Securities Market	September 2003
4.	Consultation Conclusions on the Draft Guidelines for Regulating Index Tracking Exchange Traded Funds under the Code on Unit Trusts and Mutual Funds	October 2003
5.	SFC and FSTB Joint Consultation Conclusions on the Proposal to Empower the Securities and Futures Commission to Initiate a Derivative Action on Behalf of a Company	November 2003
6.	Consultation Conclusions on Proposed Amendment to the Securities and Futures (Price Stabilizing) Rules in relation to Recognition of Overseas Rules	November 2003
7.	SFC and FSTB Joint Consultation Conclusions on Proposed Amendments to the Companies Ordinance to Facilitate Offers of Shares and Debentures	November 2003
8.	Consultation Conclusions on the Securities and Futures (Contracts Limits and Reportable Positions) (Amendment) Rules 2003 and Proposed Amendments to the Guidance Note on Position Limits and Large Open Position Reporting Requirements	March 2004

Codes & Guidelines: 5

1.	Guidelines for Electronic Public Offerings	April 2003
2.	Code on Real Estate Investment Trusts	July 2003
3.	Licensing Information Booklet	August 2003
4.	Guidelines for Regulating Index Tracking Exchange Traded Funds	October 2003
5.	Codes on Takeovers and Mergers and Share Repurchases updates	February 2004

Index

> A

Advisory Committee
pp.7, 13

Asia Pacific Group (APG)
An autonomous regional anti-money laundering body established at the Fourth Asia/Pacific Money Laundering Symposium in Bangkok.
p.76

Audit Committee
p.13

Australian Securities and Investments Commission (ASIC)
An independent Australian government body responsible for regulating financial markets, securities, futures and corporations. It is also responsible for consumer protection in superannuation, insurance, deposit taking and credit.
pp.43, 69, 74

Automated Trading Services (ATS)
Services provided by means of electronic facilities (except those provided by a recognised exchange company or clearing house) whereby offers to sell or purchase securities or futures contracts are regularly made or accepted in a way that results in a binding transaction in accordance with established methods.
pp.23, 59

> B

Boiler Rooms
Frauds in which unscrupulous but plausible salespeople cold call potential investors and use high pressure sales tactics to persuade them to buy real or bogus investments.
pp.55, 70

Budget 2003-2004
pp.3, 67

Budget Committee
p.15

> C

Capital Investment Entrant Scheme (CIES)
The Scheme introduced by the HKSAR Government to facilitate the entry for residence by capital investment entrants, i.e. persons who make capital investment in Hong Kong but would not be engaged in the running of any business here.
pp.37, 43

Central Clearing and Settlement System (Third Generation) (CCASS/3)
The new clearing and settlement system launched by HKEx for its cash market.
pp.4, 59

Chief Executive, HKSAR
pp.10, 12, 55, 68

China Futures Association
One of the Mainland associations responsible for administering the industry qualification and awarding qualification to individuals who have passed the relevant examinations. The other one is the Securities Association of China (SAC). The two associations grant practicing qualification to individuals engaging in the futures and securities industry respectively under the delegated authority by the CSRC.
p.37

China Securities Regulatory Commission (CSRC)
The authorised department under the State Council that governs the securities and futures markets of China.
pp.7, 37, 55, 69, 76

Closer Economic Partnership Arrangement (CEPA)
An agreement between the Central People's Government and the HKSAR Government to strengthen trade and investment co-operation and promote joint development.
pp.3, 37

Commissione Nazionale per le Società e la Borsa (National Companies and Exchange Commission of Italy) (CONSOB)
The public authority responsible for regulating the Italian securities market and protecting the investing public.
p.75

Committee on Payment and Settlement System (CPSS)
A forum for the central banks of the Group of Ten countries (G10) to monitor and analyse developments in domestic payment, settlement and clearing systems as well as in cross-border and multi-currency settlement schemes.
p.75

Commodities Trading Ordinance
pp.23, 64

Commodity Exchange Compensation Fund (CECF)
The fund that provides compensation to investors who suffered a loss due to the default of an Exchange Participant of the Hong Kong Futures Exchange Ltd before implementation of the SFO.
p.61

Companies Ordinance (CO)
p.31

Complaints Control Committee
p.71

Consumer Council
pp.31, 41

Continuous Professional Training (CPT)
The systematic maintenance, improvement and broadening of knowledge and skills to enable individual SFC licensees carrying on regulated activities to perform their duties competently and professionally.
p.37

Corporate Governance
pp.6, 12, 31

> D

Derivatives Clearing and Settlement System (DCASS)
The new clearing and settlement system launched by HKEx for its derivatives market.
pp.4, 60

Director of Audit
p.16

Directors of the Commission
p.10

Disciplinary Actions
p.52

Disclosure of Interests
pp.23, 49, 63

Dual Filing
pp.5, 22, 32, 49, 67

➤ E

Electronic Investor Resources Centre (eIRC)
An SFC operated website to provide investors with educational information on investments and regulations.
p.25

Equity-Linked Products
Structured financial products with embedded "short" positions in options which allow an investor to take a bull, bear, or range view on the underlying asset.
p.42

Exchange Traded Funds (ETFs)
Basically index funds that are listed and traded on exchanges just like stocks.
pp.4, 37, 43, 58

Exchanges and Clearing Houses (Merger) Ordinance
p.23

Expert Group
The three-member group appointed by the Financial Secretary in September 2002 to review the operation of Hong Kong's securities and futures market regulatory structure
p.32

➤ F

Financial Action Task Force on Money Laundering (FATF)
An inter-governmental body established by the G-7 Summit to develop and promote policies, both at national and international levels, to combat money laundering and terrorist financing.
p.76

Financial Resources Rules (FRR)
The rules that set out the capital requirements with which intermediaries have to comply in order to become and remain licensed by the SFC.
p.41

Financial Secretary
pp.10, 13, 68

Financial Services Authority (FSA)
An independent organisation responsible for regulating financial services in the UK. It is the single statutory regulator responsible for the authorisation and supervision of deposit taking, insurance and investment business.
p.69

Financial Services and the Treasury Bureau (FSTB)
pp.5, 60

Financial Services Network (FinNet)
A business-to-business network built to support financial communities in Hong Kong in conducting secure electronic transactions, information delivery and peer-to-peer communication.
p.59, 70

Financial Stability Forum
An international Forum that promotes financial stability through information exchange and international co-operation in financial supervision and surveillance.
p.75

➤ G

Growth Enterprise Market (GEM)
pp.5, 24

➤ H

Hang Seng China Enterprises Index
p.58

Hang Seng Index (HSI)
pp.3, 24

Hay Report
The report by the consultant Hay Group Limited on a study of the remuneration packages of senior executives of selected statutory and other bodies. The study was commissioned by the HKSAR Government in 2002 to provide guidelines to individual organisations for them to adjust or refine their remuneration policies and arrangements.
p.68

Hedge Funds
No legal definition but may refer to a wide range of investment vehicles, which can vary substantially in terms of size, strategy, business model and organisational structure, among other characteristics.
pp.41, 42

Hong Kong Exchanges and Clearing Ltd (HKEx)
pp.4, 32, 37, 48, 58

Hong Kong Futures Exchange Ltd (HKFE)
A subsidiary of HKEx where derivatives products such as futures and options are traded.
p.58

Hong Kong Monetary Authority (HKMA)
pp.55, 69

Hong Kong Police (Police)
p.55

Hong Kong Securities Clearing Company Ltd (HKSCC)
p.58

Hong Kong Securities Institute
pp.37, 69

Hong Kong Special Administrative Region (HKSAR)
pp.5, 10, 12

➤ I

Independent Commission Against Corruption (ICAC)
pp.17, 55

Independent Financial Advisers (IFAs)
pp.4, 31

Initial Public Offerings (IPOs)
pp.3, 31, 41, 60

Insider Dealing Tribunal (IDT)
pp.5, 50

International Organization of Securities Commissions (IOSCO)
The leading international grouping of securities market regulators and its current membership comprises regulatory bodies around the world who have day to day responsibility for securities regulation and the administration of securities laws.
pp.5, 36, 61, 74

<p>Investor Compensation Company Ltd (ICC) An independent investor compensation company established under the SFO to manage the new compensation fund and process claims. <i>pp.22, 61</i></p> <hr/> <p>Investor Compensation Fund <i>pp.22, 61</i></p> <hr/> <p>Investor Participant Accounts A depository account for safekeeping investors' stocks, that gives them legal protection and control over their shareholdings. Both individual and corporate investors may open stock accounts in CCASS and become Investor Participants. <i>pp.4, 60</i></p>	<p>> N</p> <hr/> <p>Non-Executive Directors (NEDs) <i>pp.7, 11, 12</i></p> <hr/> <p>> O</p> <hr/> <p>Ombudsman <i>p.18</i></p> <hr/> <p>Open University of Hong Kong <i>p.71</i></p> <hr/> <p>> P</p> <hr/> <p>Penny Stocks Incident An incident on 26 July 2002 when prices of many lower priced stocks plunged after the publication of an HKEx consultation paper on initial listing and continuing listing eligibility and cancellation of listing procedures. <i>p.5</i></p> <hr/> <p>Performance Pledges <i>p.19</i></p> <hr/> <p>Price Stabilizing Rules <i>p.63</i></p> <hr/> <p>Process Review Panel (PRP) An independent body appointed by the Chief Executive to review the SFC's internal operations and procedures to ensure that they are fair and consistently followed. <i>p.16</i></p> <hr/> <p>Prosecutions <i>p.50</i></p> <hr/> <p>Protection of Investors Ordinance (PIO) <i>pp.23, 32, 52</i></p> <hr/> <p>> R</p> <hr/> <p>Real Estate Investment Trusts (REITs) Collective investment schemes constituted as a trust that invest primarily in real estate with the aim to provide returns to holders derived from the rental income of the real estate. <i>pp.4, 37, 43</i></p> <hr/> <p>Remuneration Committee <i>p.14</i></p> <hr/> <p>> S</p> <hr/> <p>Scripless Market A scripless securities market provides the enabling environment for straight-through-processing, eliminates the risks associated with paper scrip, reduces the cost of ownership transfer and enhances the processing efficiency of securities transactions. <i>p.60</i></p> <hr/> <p>Secretary for Justice <i>p.33</i></p>
<p>> J</p> <hr/> <p>Joint Financial Intelligence Unit (JFIU) The Unit jointly run by the Hong Kong Police and the Customs & Excise Department to receive reports about suspicious financial activity. <i>p.55</i></p> <hr/> <p>> L</p> <hr/> <p>Legislative Council (LegCo) <i>pp.13, 31, 41</i></p> <hr/> <p>Leveraged Foreign Exchange Trading Ordinance <i>pp.23, 64</i></p> <hr/> <p>> M</p> <hr/> <p>Management Committee <i>p.15</i></p> <hr/> <p>Mandatory Provident Fund (MPF) <i>p.42</i></p> <hr/> <p>Mandatory Provident Fund Schemes Authority (MPFA) <i>p.69</i></p> <hr/> <p>Market Misconduct <i>p.22</i></p> <hr/> <p>Market Misconduct Tribunal (MMT) <i>pp.22, 33</i></p> <hr/> <p>Memorandum of Regulatory Co-operation (MORC) The memorandum signed between the CSRC, Shanghai Stock Exchange, Shenzhen Stock Exchange, SEHK and the SFC to promote mutual assistance and the exchange of information so that the parties may effectively perform their respective duties according to law. <i>p.77</i></p> <hr/> <p>Memorandum of Understanding (MOU) Co-operative arrangements or agreements the SFC signed with other local or international organisations. <i>pp.5, 44, 74</i></p> <hr/> <p>Multilateral Memorandum of Understanding (MMOU) The multilateral MOU that enhances the level of IOSCO members' co-operation and information exchange to combat cross-border frauds and other securities violations, and improve their ability to enforce securities regulation worldwide. <i>pp.55, 74</i></p>	

Securities Association of China (SAC)
See China Futures Association above.
p.37

Securities and Exchange Commission (SEC)
The securities market regulator created by the US Congress, whose primary mission is to protect investors and maintain the integrity of the securities markets. It oversees the stock exchanges, broker-dealers, investment advisors, mutual funds, and public utility holding companies.
pp.69, 75

Securities and Futures Appeals Panel (SFAP)
The part-time panel that hears appeals against the SFC's decisions concerning licensing and disciplinary matters made before the commencement of the SFO.
pp.17, 54, 65

Securities and Futures Appeals Tribunal (SFAT)
An independent full-time appeals tribunal established under the SFO to replace the SFAP but with a wider jurisdiction.
pp.17, 23, 54, 65

Securities and Futures (Clearing Houses) Ordinance
p.23

Securities and Futures Commission Ordinance (SFCO)
pp.5, 23, 64

Securities and Futures Ordinance (SFO)
pp.4, 23, 31, 36, 40, 48, 61, 63

Securities (Disclosure of Interests) Ordinance
pp.23, 32

Securities (Insider Dealing) Ordinance
p.23

Securities Ordinance
pp.23, 50

Severe Acute Respiratory Syndrome (SARS)
pp.3, 73

Shanghai Stock Exchange
p.77

Shareholders Group
p.31

Shenzhen Stock Exchange
p.77

Short Selling
pp.52, 58

Single Licensing Regime
pp.23, 36

Sponsors [Listing]
pp.4, 31, 50

Staffing
p.68

Steering Committee on the Enhancement of Financial Infrastructure (SCEFI)
The committee set up in 1999 to recommend improvements to the financial infrastructure of Hong Kong's securities and futures industry.
p.60

Stock Exchange of Hong Kong Ltd (SEHK)
A subsidiary of HKEx where a wide range of securities including equities, debts, unit trusts, exchange-traded funds and warrants are traded.
pp.22, 31, 39, 58

Stock Exchanges Unification Ordinance
p.23

SWIFT
An industry-owned co-operative supplying secure, standardised messaging services and interface software to financial institutions worldwide.
p.60

➤ T

Takeovers and Mergers Panel
p.30, 65

Takeovers Executive
p.30

➤ U

Undertakings for Collective Investment in Transferable Securities (UCITS)
Collective investment funds as referred to by the European Commission.
p.21

Unified Exchange Compensation Fund (UECF)
The fund that provides compensation to investors who suffered a loss due to the default of an Exchange Participant of the Stock Exchange of Hong Kong Ltd before implementation of the SFO.
p.61

Unit Trust and Mutual Funds
p.42

V

➤ Vocational Training Council
p.37

W

➤ Website
p.72

Working Group on Review of the Financial Regulatory Framework for Licensed Corporations
An SFC working group comprising representatives from the industry, academia and the Consumer Council. It reviews the practices of pooling and re-pledging client collateral and the risks involved in securities margin financing and examines the effectiveness of the overall financial regulatory framework for the securities industry, with a view to enhancing investor protection.
p.41