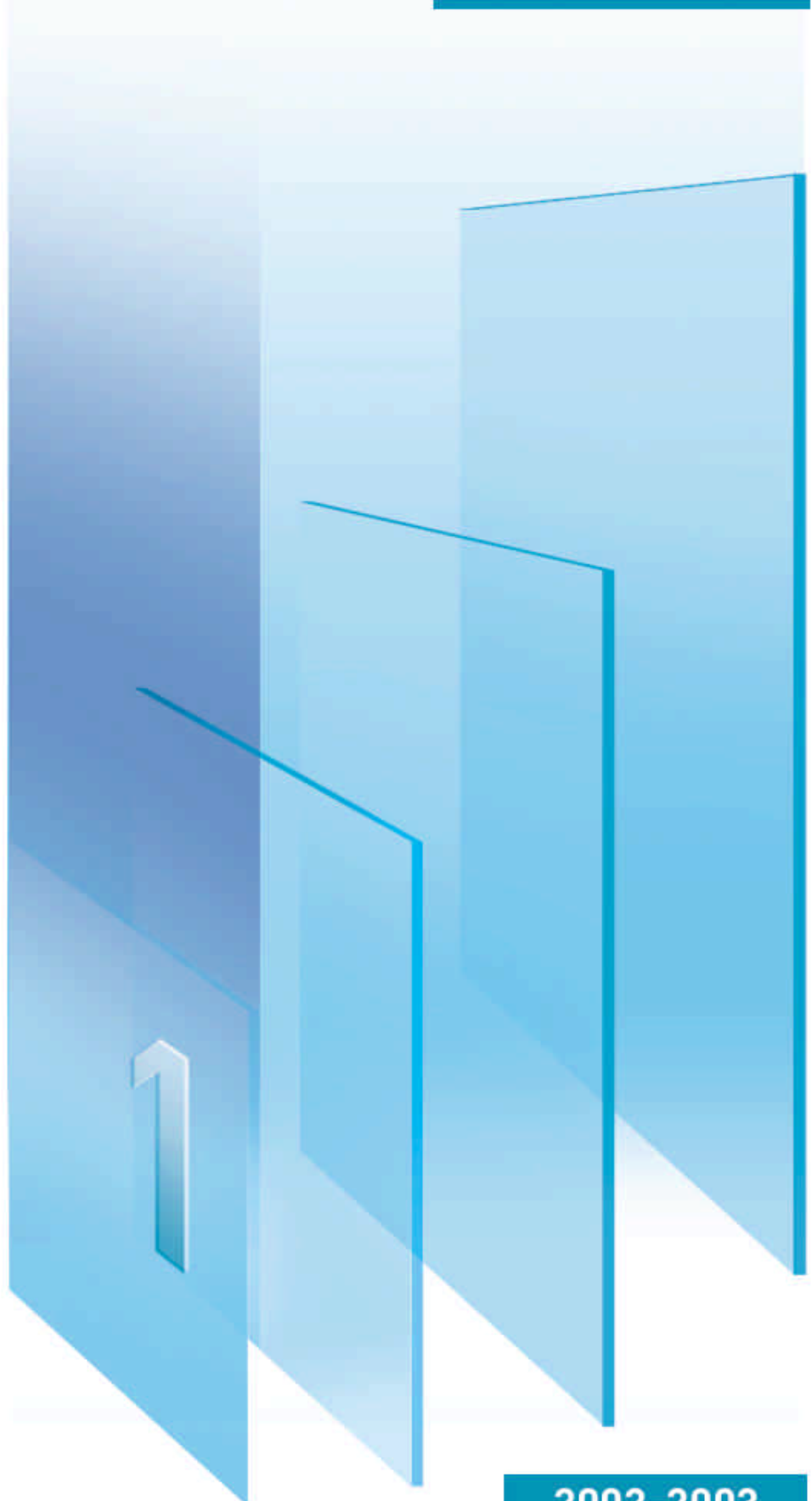




SECURITIES AND  
FUTURES COMMISSION  
證券及期貨事務監察委員會

# Quarterly Report

April - June 2002



2002-2003



## Table of Contents

Operations Highlights	1
Review of Operations	3
Securities and Futures Commission Condensed Financial Statements	11
Unified Exchange Compensation Fund Condensed Financial Statements	15
Commodity Exchange Compensation Fund Condensed Financial Statements	23
Appendix	29

*This is the Securities and Futures Commission's first Quarterly Report for the financial year from 1 April 2002 to 31 March 2003. The report aims to enhance the transparency and accountability of the Commission.*

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## Operations Highlights

1 April to 30 June 2002

1. The Securities and Futures Commission (SFC) recorded a deficit of \$7 million in the quarter, significantly lower than the projected deficit of \$29 million. Reserves stood at \$617 million.
2. Total revenue fell 16% from a year ago. Levy income, the SFC's major revenue source, declined as average daily market turnover shrank 18% to \$8.2 billion in the quarter. Total expenditure dropped 8% with major reductions in staff costs and other expenditures. The SFC had 405 staff as of 30 June 2002.
3. The preparation of the 38 pieces of the subsidiary legislation underpinning the Securities and Futures Ordinance is underway. In the quarter, the SFC consulted the public on nine items and published conclusions on 17 items. A total of 18 pieces of subsidiary legislation have been submitted to the Legislative Council for review.
4. The SFC has proposed a dual filing framework to enhance the effectiveness of the disclosure regulatory regime in Hong Kong. Listed companies and listing applicants will be required to file corporate disclosure materials and listing documents simultaneously with the Stock Exchange and the SFC.
5. The SFC identified a problem intermediary - Lawsons Securities Company - and has taken action to preserve assets of the firm's clients.
6. The regulation of firms engaging in margin financing has been strengthened by improving the Financial Resources Rules. A working group was also formed to review the financial regulatory framework for intermediaries.
7. To enhance investor protection, the Shareholders Group was formalized as an SFC standing committee.
8. The Financial Market Development Task Force proposed to simplify the procedures and lower the costs for issuing debts and equity, and relax short selling restrictions.
9. The SFC has received HKEx's report on the 28 May disruption of the Automated Trading System of the derivatives market and will monitor its implementation of the report's recommendations.
10. The SFC released guidelines on the public offering of hedge funds. Meanwhile, the annual Fund Management Activities Survey found that assets under management in Hong Kong totalled \$1,484 billion as at 31 December 2001.
11. The SFC continued to facilitate the rule changes requested by HKEx on the introduction of new products: more structured products, Dow Jones Industrial Average Futures Contracts to be settled in Hong Kong dollars, and new stock futures and options classes on listed companies.
12. The SFC disciplined 14 registrants for misconduct and prosecuted nine entities for breaches of laws including market manipulation. Two cases of alleged insider dealing have been referred to the Financial Secretary.

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13. The SFC has for the first time broadcast a 12-episode investor education video series on public vehicles, reaching millions of commuters.
  14. The *Annual Report 2001-2002* was laid before the Legislative Council on 15 May. The SFC also published the *Securities Regulation in Hong Kong*, a collection of speeches and articles by chairmen of stock and futures exchanges and members of the Commission. The SFC enhanced its website by adding an *e-Regulatory Handbook* and a section on the Securities and Futures Ordinance.
  15. The SFC hosted the Asian Roundtable for the International Organization of Securities Commissions (IOSCO) Internet Project Team.

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



## Review of Operations

1 April to 30 June 2002

This is the Securities and Futures Commission's first *Quarterly Report* for the financial year starting 1 April 2002.

A string of corporate accounting scandals affected US markets and hurt investors' confidence. Investors are waking up to the significance of corporate governance and are demanding changes. The US Securities and Exchange Commission (SEC) has already proposed a range of measures to address issues like the independence of accountants, accounting standards, disclosure requirements, etc.

At the core of good corporate governance practices is transparency and the quality of corporate accounting and disclosure. Investors must have access to information in order to judge and evaluate a company and its management performances, and then make investment decisions for themselves. Like all major markets in the world, Hong Kong operates a disclosure-based regulatory system. On 6 May, the SFC consulted the market on a dual filing requirement, which aims to strengthen the enforcement of corporate disclosure.


Meanwhile, the SFC has stepped up investigations into corporate misgovernance, one of the Commission's enforcement priorities this year.

The downturn in US markets put pressure on global equity markets. During the quarter, the Hang Seng Index dropped from a peak of 11,975 on 17 May to a low of 10,356 on 26 June. It closed at 10,599 on 28 June, 4% lower than the previous quarter's 11,033 close and 23% lower than the 13,043 close recorded on 29 June 2001.

### Financial Highlights

Internally, cost control remains high on the agenda. The Commission recorded a deficit of about \$7 million in the first quarter. This was better than our projected deficit of \$29 million in our approved budget, but compared less favourably with the surplus of \$2 million for the same period last year. At the end of June, the reserves stood at \$617 million, equivalent to 1.37 times the approved annual operating expenditure of \$450 million.

Total revenue was down by about 16% compared with the same period of last year. About half of the reduction was due to a decrease in levy income as stock market turnover shrank to \$8.2 billion a day from \$10 billion. Fees and charges also decreased with fewer corporate finance activities. Investment income declined because interest rates remained low and part of the investment funding was drawn down to fund the SFC's operations.



A host of cost control measures, including headcount and wage freeze implemented last year, kept expenditure in check. Total expenditure (including depreciation) was down by 8% over the same quarter last year. Staff costs dropped by 5% because of the freeze on variable pay. The total number of staff at the end of June was 405, comprising 350 permanent staff and 55 temporary staff, lower than the 415 three months earlier. Other expenditures also decreased considerably in the absence of major projects such as a market study last year.

The SFC's investment of two shares of \$1 each in FinNet Limited has been accounted for in this quarter's financial statements. A wholly owned subsidiary of the SFC, FinNet Limited, was set up to operate an electronic communications and transaction-enabling network for regulators, financial institutions and intermediaries. The company has not commenced operations and therefore had no income or expenditure. The two-dollar investment does not show up in the balance sheet which is expressed in thousand dollars, but is disclosed in the notes.

### **The Securities and Futures Ordinance**

Following the enactment of the Securities and Futures Ordinance on 13 March, the SFC has worked intensively on the preparation of 38 pieces of the subsidiary legislation which underpin the Ordinance. During the quarter, the SFC released seven consultation papers on nine pieces of subsidiary legislation for public consultation and issued 13 conclusion papers on 16 pieces of subsidiary legislation and one set of guidelines. (Please refer to the appendix for details.)

A key piece of subsidiary legislation concerns the introduction of a dual filing framework, thereby making the SFC the statutory regulator of corporate disclosure. The proposed Securities and Futures (Stock Market Listing) Rules require listed companies and listing applicants to file with the SFC listing documents and disclosure materials (e.g. annual reports, circulars to shareholders for approval of connected transactions, announcement of price sensitive developments, explanations of sudden share price movements). Anyone who recklessly or intentionally provides false or misleading information when making a disclosure - in other words, anyone who lies to the public - will then be subject to the statutory powers of the SFC. The SFC will employ its investigatory powers in establishing the facts and gathering evidence.

A subcommittee of the Legislative Council House Committee has been set up under the chairmanship of The Hon Sin Chung-kai to consider the draft subsidiary legislation. On 29 April, the subcommittee met to consider three items of the draft subsidiary legislation. On 6 and 7 June, the subcommittee met to consider a second batch of 15 items.

The SFC ran consultation seminars for a total of 690 market participants during the quarter.

## Strengthening the Regulatory Framework

The number of registrants and exempt persons had fallen marginally from a quarter ago.

Number of SFC Registrants under Various Ordinances and Exempt Persons			
	30 Jun 2002	31 Mar 2002	30 Jun 2001
Securities Ordinance (excluding Securities Margin Financiers)	22,189	22,420	23,211
Securities Ordinance (as Securities Margin Financiers)	218	214	266
Commodities Trading Ordinance	4,648	4,711	5,110
Leveraged Foreign Exchange Trading Ordinance	947	935	840
Exempt Persons	177	181	199
<b>Total</b>	<b>28,179</b>	<b>28,461</b>	<b>29,626</b>

During the quarter, the SFC's risk-based monitoring system identified a problem intermediary - Lawsons Securities Company. The SFC found in an inspection of Lawsons that there were deficiencies in its internal control and settlement procedures. The SFC instructed Lawsons to appoint an independent accountancy firm to conduct a circularization of client account balances and a review of its internal control. The independent accountant reported a significant discrepancy between Lawsons' stock records and the records of the Central Clearing and Settlement System. To preserve clients' assets, the SFC issued a restriction notice and then an injunction to restrict the sole proprietor from dealing with his and the firm's assets. Administrators have also been appointed to manage his property.

To enhance the risk management of intermediaries engaging in margin financing business, the SFC amended the Financial Resources Rules (FRR): raising the haircut ratio on illiquid collateral stocks and warrants, and implementing a borrowing-to-margin loan ratio. The amendments received overwhelming support at the Financial Affairs Panel of the Legislative Council on 6 May 2002 and will become effective on 1 October.

In May, the SFC formed a Working Group on Review of Financial Regulatory Framework for Intermediaries. The Group aims to develop a robust risk-based financial and capital regulatory framework for Hong Kong's intermediaries. It will analyze intermediaries' major risk areas under the current regulatory framework, in particular risk inherent in securities margin financing.

Statistical Information and Financial Position of the Securities Market (note1)		
	As at 31 Mar 2002	As at 31 Mar 2001
Total number of securities intermediaries (note 2)	717	725
Total number of active cash clients	599,625	640,872
Total number of active margin clients	59,473	63,381

<b>Balance Sheet</b>	<b>(\$ Million)</b>	<b>(\$ Million)</b>
Cash in hand and at bank (note 3)	56,615	52,115
Amounts receivable from margin clients	13,255	13,810
Amounts receivable from clients and other dealers arising from dealing in securities	40,957	50,342
Other assets	26,124	25,684
<b>Total assets</b>	<b>136,951</b>	<b>141,951</b>
Amounts payable to clients and other dealers arising from dealing in securities	62,234	52,221
Total borrowings from financial institutions	6,671	5,651
Other liabilities	18,481	33,637
Total shareholders' fund	49,565	50,442
<b>Total liabilities and shareholders' fund</b>	<b>136,951</b>	<b>141,951</b>

Note 1: The above data were extracted from the monthly FRR returns submitted by securities dealers and securities margin financiers.

Note 2: Including registered dealers and registered margin financiers.

Note 3: Cash in hand and at bank includes trust monies held on behalf of clients.

During the quarter, various new guidelines and code amendments were released with a view to clarifying the regulatory requirements, and bringing them in line with international standards.

<b>Codes and Guidelines which Took Effect between 1 April and 30 June 2002</b>		<b>Effective Date</b>
Hedge Funds Guidelines		2 May
Hedge Funds Application Checklist		17 May
Addendum to the Guidance Note for Short Selling Reporting and Stock Lending		
Record Keeping Requirements		14 June
Amendment to the Code of Conduct for Persons Registered with the SFC		28 June

The Shareholders Group was formalized as an SFC standing committee in June. Membership of the Group now better represents investor interests. The Group will continue to provide input on issues related to shareholders' rights and interests.

### **Facilitating Market Development**

On 28 June, the Financial Market Development Task Force submitted its first phase recommendations to the Financial Secretary, Mr Antony Leung. To promote the development of Hong Kong's debt, equity and futures markets, the SFC will work with the Government and Hong Kong Exchanges and Clearing Limited (HKEx) to implement the "quick win" proposals recommended by the Task Force. The proposals include streamlining procedures and lowering costs for the public offering of debts and equity, and relaxing short selling rules.



As part of the Task Force's recommendations to improve market liquidity, an Addendum to Guidance Note on Short Selling Reporting and Stock Lending Record Keeping Requirements was issued to clarify the Commission's policy on the existing short selling regulations. Other "quick win" proposals will be implemented from October, in phases where necessary.

In the area of infrastructure development, a consultation on scripless trading ended in May. The Commission is considering the submissions and will issue the consultation conclusions shortly.

The SFC received an investigation report from HKEx on the 28 May disruption of the Automated Trading Systems (HKATS) of the derivatives market. The report found that the incident was caused by technical problems concerning its Uninterruptible Power Supply System (UPS). The SFC will closely monitor HKEx's implementation of the report's recommendations to ensure system reliability.

On product development, Hong Kong will become one of the world's few places where hedge funds are available in the retail market. Following extensive public consultation, the SFC introduced in May guidelines on how hedge funds may be authorized for public sale. The first hedge funds will be authorized around the end of September.

The SFC during the quarter authorized nine new unit trusts/mutual funds.

<b>Number of Authorized Collective Investment Schemes</b>			
	<b>30 Jun 2002</b>	<b>31 Mar 2002</b>	<b>30 Jun 2001</b>
Unit Trusts and Mutual Funds	1,899	1,890	1,848
Investment-Linked Assurance Schemes	109	100	80
Pooled Retirement Funds	39	39	40
Immigration-linked Investment Funds	0	0	0
MPF Master Trust/Industry Schemes	49	49	49
MPF Pooled Investment Funds	220	217	214
Other Schemes	24	21	19
<b>Total</b>	<b>2,340</b>	<b>2,316</b>	<b>2,250</b>

To facilitate the formulation of policies for the fund management industry, the SFC carries out a yearly Fund Management Activities Survey (FMAS). The results of FMAS 2001, released in May, showed that total assets under management as of 31 December 2001 amounted to \$1,484 billion, with 69% coming from non-Hong Kong investors.

The SFC has been working on the mutual recognition of fund managers with jurisdictions having comparable regulatory standards. It was announced in May that the SFC would recognise Australian licensed fund managers for management of Hong Kong authorized funds as part of the co-operation and recognition initiative between the SFC and the Australian Securities and Investment Commission (ASIC).

HKEx continued to bring new products to the market: Dow Jones Industrial Average Futures Contracts, which are settled in Hong Kong dollars to facilitate retail investors; and new stock futures and options classes on China Petroleum and Chemical Corporation (SINOPEC), China National Offshore Oil Corporation (CNOOC) and Huaneng Power International.

The relaunch of derivative warrants trading in January served as a useful precedent for other structured products including equity linked instruments. HKEx further amended its Listing Rules to provide flexibility for all structured products while ensuring adequate risk disclosure in the listing documents and marketing materials. The amendments to the Listing Rules were approved by the SFC and became effective on 1 July. HKEx also increased the contract size of 1-month and 3-month HIBOR futures contracts by fivefold.

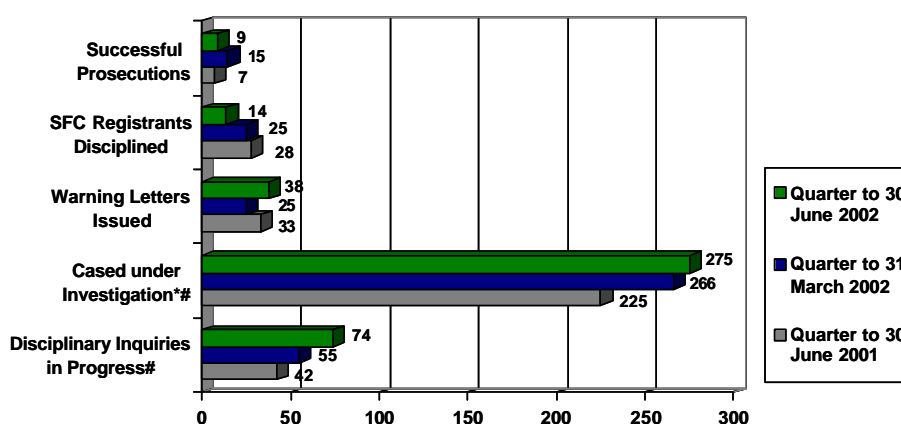
### Enforcement

In addition to corporate misgovernance, the SFC has said that serious misconduct by intermediaries and market misconduct (including market manipulation and insider dealing) are also top priorities in the coming year.

During the quarter, the SFC took disciplinary action against 14 registrants for misconduct. There were two revocations and four suspensions of registrations, one registration surrendered, six public reprimands and one private reprimand. The SFC successfully prosecuted nine entities for breaches of the Securities (Disclosure of Interests) Ordinance and the Protection of Investors Ordinance, and for market manipulation. The Commission also assisted in the successful prosecution in the District Court of two individuals by the Police for manipulating the shares of a listed company.

The SFC in April referred two cases of suspected insider dealing to the Financial Secretary for consideration of appointment of an Insider Dealing Tribunal.

### Statistics on Enforcement Actions



\* Some cases are ongoing investigations from the previous quarters.

# Number of cases as of end of quarters.



## Promoting Investor Awareness

The SFC participated in the Hong Kong Financial Sector Exhibition titled "Quality of the Markets" from 28 June to 2 July. The exhibition featured the latest developments in Hong Kong's financial system, regulations, and products.

To spread investor protection messages, the SFC has for the first time broadcast video dramas on 2,400 public buses and 200 light buses. The 12-episode series, titled *Invest with Your Heads Up*, began on 15 May. A popular investor knowledge radio quiz co-organised by Radio Television Hong Kong and the SFC was extended for three weeks and ended on 17 May. The SFC regularly contributes investor education articles to the newspapers.

A new Chinese cartoon leaflet called *Wise Ways when Dealing with Brokers* was published and distributed at 519 offices of district council members.

The SFC also issues timely warnings on the *Investor Alert* section of the SFC website. During the quarter, two Open Letters to Investors were issued - one on the role of the SFC in relation to corporate transactions and the other on partnership with the market in maintaining a transparent and fair market.


In the quarter, the SFC received 1,229 investor enquiries and 195 public complaints against registrants, listed companies and market misconduct. These compared with 927 enquiries and 177 complaints in the previous quarter, and 649 and 137 cases a year ago.

## Enhancing Communications with Stakeholders

The SFC published the *Annual Report 2001-2002* and the *Securities Regulation in Hong Kong* in the quarter. Laid before the Legislative Council on 15 May, the *Annual Report 2001-2002* reviewed the Commission's work and governance matters in details, and discussed future plans. The *Securities Regulation in Hong Kong* is a collection of selected speeches and articles by Chairmen of the stock and futures exchanges, and members of the SFC since the formation of the SFC in 1989. It gives readers background for understanding the development of Hong Kong's regulatory framework.

An *e-Regulatory Handbook*, launched in May on the SFC website, provides a one-stop guide to the regulatory requirements for various regulated activities. It comprises two volumes: the first describes the SFC's regulatory philosophy and the second carries all the most updated SFC codes, guidelines, and important circulars on business standards.

We also published the monthly *SFC Alert* - which has since June been distributed in all 12 Consumer Advice Centres of the Consumer Council - and the Spring issue of the research-based and analytical *Quarterly Bulletin*.



The Commission set up in April a dedicated website section on the Securities and Futures Ordinance. The section offers useful background and updates on the Ordinance. We also introduced an e-mail alert service. Investors and financial intermediaries who sign up for this service will receive e-mails containing hyperlinks to updates on the SFC website.

### **International Co-operation**

The SFC hosted the Asian Roundtable for Internet Project Team of the International Organization of Securities Commissions (IOSCO) on 24 and 25 June. More than 60 representatives from 13 jurisdictions discussed trends and risk profile of securities trading on the Internet. The SFC was also represented at the IOSCO Chairs Committee meeting. The Chairs Committee discussed issues arising from major corporate failures such as disclosure and auditing standards.

On enforcement co-operation, the Commission received from overseas regulators 10 requests: seven for investigatory assistance and three for non-public information.

### **Looking Ahead**

Understandably, the debates on accounting standards and other corporate governance related matters will continue to be priority issues in leading markets and in Hong Kong. The SFC will closely monitor the developments in these areas with a view to bringing our regulations in line with international standards.

Improving corporate governance standards entails regulators and market participants working closely together. As the SFC will become a statutory regulator of corporate disclosure, HKEx will continue to be the frontline regulator of listed companies responsible for the administration of the non-statutory Listing Rules. The dual filing framework is complementary to other measures targeted at enhancing the corporate governance of listed companies. The SFC, HKEx and other relevant bodies are actively examining various proposals and policies.

The financial position of the Commission for the next quarter is difficult to project under current market conditions. The budgeted deficit in the second quarter to 30 September 2002 is \$29 million. Based on current information and tight expenditure control, there is no reason to believe that the deficit will be exceeded.

Andrew Sheng  
Chairman

14 August 2002

## Securities and Futures Commission

Income and Expenditure Account  
For the quarter ended 30 June 2002  
(Expressed in Hong Kong dollars)

	Note	Unaudited Quarter ended 30 June 2002 \$'000	Unaudited Quarter ended 30 June 2001 \$'000
<b>Income</b>			
Levies		54,061	62,592
Fees and charges		27,702	32,997
Investment income		8,604	12,605
Other income		588	532
		<u>90,955</u>	<u>108,726</u>
<b>Expenses</b>			
Staff costs		76,574	80,900
Premises			
- rent		5,002	5,002
- other		2,826	2,821
Other expenses		8,353	12,878
		<u>92,755</u>	<u>101,601</u>
Depreciation		5,185	4,927
		<u>97,940</u>	<u>106,528</u>
<b>(Deficit)/surplus</b>	2	<u>(6,985)</u>	<u>2,198</u>

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

The notes on page 14 form an integral part of the condensed financial statements.

## Securities and Futures Commission

### Balance Sheet

At 30 June 2002

(Expressed in Hong Kong dollars)

<u>Note</u>	<u>Unaudited</u> <u>At 30 June 2002</u> \$'000	<u>Audited</u> <u>At 31 March 2002</u> \$'000
<b>Non-current assets</b>		
Fixed assets	37,335	39,868
Held-to-maturity debt securities	310,531	298,110
<b>Current assets</b>		
Held-to-maturity debt securities	297,793	319,113
Bank deposits	27,990	38,815
Debtors, deposits and prepayments	31,250	24,049
Cash at bank and in hand	643	1,076
	<u>357,676</u>	<u>383,053</u>
<b>Current liabilities</b>		
Provision for contribution to the Unified Exchange Compensation Fund	30,000	30,000
Fees received in advance	30,598	33,301
Creditors and accrued charges	27,936	33,737
	<u>88,534</u>	<u>97,038</u>
<b>Net current assets</b>	<u>269,142</u>	<u>286,015</u>
<b>Net assets</b>	<u>617,008</u>	<u>623,993</u>
<b>Funding and reserves</b>		
Initial funding by Government	42,840	42,840
Accumulated Surplus	2 574,168	581,153
	<u>617,008</u>	<u>623,993</u>

The notes on page 14 form an integral part of the condensed financial statements.

## Securities and Futures Commission

Cash Flow Statement  
For the quarter ended 30 June 2002  
(Expressed in Hong Kong dollars)

	Unaudited Quarter ended 30 June 2002 \$'000	Unaudited Quarter ended 30 June 2001 \$'000
<b>Net cash outflow from operating activities</b>	(24,198)	(15,715)
<b>Returns on investments - interest received</b>	8,111	11,851
<b>Investing activities</b>		
Held-to-maturity debt securities redeemed	9,000	45,000
Fixed assets bought	(4,171)	(3,677)
Fixed assets sold	-	91
<b>Net cash inflow from investing activities</b>	4,829	41,414
(Decrease)/increase in cash and cash equivalents	(11,258)	37,550
Cash and cash equivalents at beginning of the quarter	39,891	107,093
<b>Cash and cash equivalents at end of the quarter</b>	<u>28,633</u>	<u>144,643</u>
<b>Reconciliation of (deficit)/surplus for the quarter to net cash outflow from operating activities :</b>		
(Deficit)/surplus	(6,985)	2,198
Investment income	(8,604)	(12,605)
Depreciation	5,185	4,927
Loss/(profit) on sale of fixed assets	2	(43)
Increase in debtors, deposits and prepayments	(6,809)	(7,433)
Decrease in creditors and accrued charges	(4,284)	(1,506)
Decrease in fees received in advance	(2,703)	(1,253)
<b>Net cash outflow from operating activities</b>	<u>(24,198)</u>	<u>(15,715)</u>
<b>Analysis of the balance of cash and cash equivalents :</b>		
	Unaudited At 30 June 2002 \$'000	Unaudited At 30 June 2001 \$'000
Bank deposits	27,990	141,923
Cash at bank and in hand	643	2,720
	<u>28,633</u>	<u>144,643</u>

# Securities and Futures Commission

## Notes to the Condensed Financial Statements

For the quarter ended 30 June 2002

(Expressed in Hong Kong dollars)

### 1. Basis of preparation

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

The interim financial report is unaudited and the financial information relating to the financial year ended 31 March 2002 included in this report does not constitute the SFC's statutory accounts for that financial year but is derived from those accounts.

The same accounting policies adopted in the financial statements for the year ended 31 March 2002 have been applied to the interim financial report.

### 2. Accumulated surplus

Movements of accumulated surplus during the quarter are as follows :

	<b><u>Unaudited</u></b>
	\$'000
Balance at 31 March 2002	581,153
Deficit for the quarter	(6,985)
Balance at 30 June 2002	<u>574,168</u>

### 3. Changes since 31 March 2002

We recognised our investment of 2 shares of \$1 each in FinNet Limited during the quarter. However, the investment was not shown in the balance sheet which was expressed in thousand dollars. We formed the company on 6 November 2000 with an authorised share capital of \$10,000 and issued share capital of \$2. It is a wholly owned subsidiary of the SFC.

Its objective is to operate an electronic network to facilitate payment and delivery transactions and interconnection of all financial institutions and financial entities operating in Hong Kong. Since it has not commenced operation and our investment in it is immaterial, we have not prepared consolidated financial statements.





## **Unified Exchange Compensation Fund (the Fund)**

### **Report of the Securities Compensation Fund Committee (the Committee)**

The members of the Committee present their quarterly report and the unaudited condensed financial statements for the quarter ended 30 June 2002.

#### **1. ESTABLISHMENT OF THE FUND**

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

#### **2. FINANCIAL RESULTS**

The Committee presents the financial results which are set out in the condensed financial statements on pages 16 to 22.

#### **3. MEMBERS OF THE COMMITTEE**

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

Mr. Mark Dickens, JP  
Mrs. Alexa Lam  
Mr. David M. Roberts  
Mr. Kwong Ki Chi, GBS  
Mr. T. Brian Stevenson, SBS

#### **4. INTERESTS IN CONTRACTS**

No contract of significance to which the Fund was a party and in which a Committee Member had a material interest, whether directly or indirectly, subsisted at the balance sheet date or at any time during the quarter.

On behalf of the Committee

Mark Dickens  
Chairman

24 July 2002

## Unified Exchange Compensation Fund

Income and Expenditure Account  
For the quarter ended 30 June 2002  
(Expressed in Hong Kong dollars)

	Unaudited Quarter ended 30 June 2002 \$'000	Unaudited Quarter ended 30 June 2001 \$'000
<b>Income</b>		
Investment Income	11,354	10,033
Unrealised gain on revaluation of debt securities	4,673	-
	<u>16,027</u>	<u>10,033</u>
<b>Expenses</b>		
Auditors' remuneration	11	11
Bank charges	69	36
Professional fees	47	71
Sundry expenses	1	1
	<u>128</u>	<u>119</u>
<b>Surplus</b>	15,899	9,914
<b>Accumulated surplus brought forward</b>	237,778	191,534
<b>Accumulated surplus carried forward</b>	<u>253,677</u>	<u>201,448</u>

The notes on pages 20 to 22 form an integral part of the condensed financial statements.

## Unified Exchange Compensation Fund

### Balance Sheet

At 30 June 2002

(Expressed in Hong Kong dollars)

	Note	Unaudited At 30 June 2002 \$'000	Audited At 31 March 2002 \$'000
<b>Current assets</b>			
Debt securities		738,775	728,519
Contributions receivable		30,000	30,000
Interest receivable		5,582	8,383
Levy receivable		5,471	6,248
Bank fixed and call deposits		75,608	49,723
Cash at bank		181	211
		855,617	823,084
<b>Current liabilities</b>			
Accounts payable and accrued charges		2,677	2,724
Provision for compensation	3	60,372	40,613
		63,049	43,337
<b>Net current assets</b>			
		792,568	779,747
<b>Net assets</b>			
		792,568	779,747
Representing:			
<b>Compensation fund</b>			
Contributions from the SEHK		46,450	46,450
less: Compensation paid	2	(80,743)	(80,743)
Provision for compensation	3	(28,343)	(12,343)
add: Recoveries	4	10,038	11,277
Replenishments from the SEHK		16,360	16,360
		(36,238)	(18,999)
Excess transaction levy from the SEHK		353,787	353,787
Special contribution		3,500	3,500
Additional contributions from the SEHK and the SFC		630,000	630,000
Special levy surplus		3,002	3,002
Transaction levy		61,280	41,181
Accumulated surplus		253,677	237,778
		1,305,246	1,269,248
less: Compensation paid	2	(444,411)	(442,232)
Provision for compensation	3	(32,029)	(28,270)
		828,806	798,746
		792,568	779,747

The notes on pages 20 to 22 form an integral part of the condensed financial statements.

## Unified Exchange Compensation Fund

### Statement of Recognised Gains and Losses

For the quarter ended 30 June 2002

(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited Quarter ended 30 June 2002 \$'000	Unaudited Quarter ended 30 June 2001 \$'000
Recoveries received	4	59	2,459
Recoveries re-distributed to claimants	4	(1,298)	-
Transaction levy		20,099	-
(Increase)/decrease in provision for compensation		(19,759)	84,677
Compensation paid out of the Fund	2	(2,179)	(3,189)
<b>Net gains not recognised in the income and expenditure account</b>		<u>(3,078)</u>	<u>83,947</u>
Surplus		<u>15,899</u>	<u>9,914</u>
<b>Total recognised gains</b>		<u><u>12,821</u></u>	<u><u>93,861</u></u>

The notes on pages 20 to 22 form an integral part of the condensed financial statements.


## Unified Exchange Compensation Fund

### Cash Flow Statement

For the quarter ended 30 June 2002

(Expressed in Hong Kong dollars)

	Unaudited Quarter ended 30 June 2002 \$'000	Unaudited Quarter ended 30 June 2001 \$'000
<b>Net cash outflow from operating activities</b>	(175)	(124)
<b>Returns on investments</b> - interest received	14,155	11,729
<b>Investing activities</b>		
Debt securities redeemed	78,000	25,000
Debt securities bought	(83,583)	-
<b>Net cash (outflow)/inflow from investing activities</b>	(5,583)	25,000
<b>Financing</b>		
Recoveries received	59	2,459
Recoveries re-distributed to claimants	(1,298)	-
Transaction levy received	20,876	-
Compensation paid	(2,179)	(3,189)
<b>Net cash inflow/(outflow) from financing</b>	17,458	(730)
Increase in cash and cash equivalents	25,855	35,875
Cash and cash equivalent at beginning of the quarter	49,934	132,185
<b>Cash and cash equivalent at end of the quarter</b>	75,789	168,060
<b>Reconciliation of surplus for the quarter to net cash outflow from operating activities:</b>		
Surplus	15,899	9,914
Investment Income	(16,027)	(10,033)
Decrease in accounts payable and accrued charges	(47)	(5)
<b>Net cash outflow from operating activities</b>	(175)	(124)
<b>Analysis of changes in financing:</b>	<b>Recoveries</b>	<b>Compensation Paid</b>
Balance at 1 April 2001	9,854	(501,975)
Cash inflow/(outflow) from financing	2,459	(3,189)
Balance at 30 June 2001	12,313	(505,164)
Balance at 1 April 2002	11,277	(522,975)
Cash outflow from financing	(1,239)	(2,179)
Balance at 30 June 2002	10,038	(525,154)
<b>Analysis of the balance of cash and cash equivalents:</b>	<b>Unaudited At 30 June 2002 \$'000</b>	<b>Unaudited At 30 June 2001 \$'000</b>
Cash at bank	181	40
Bank fixed and call deposits	75,608	168,020
	75,789	168,060



**Unified Exchange Compensation Fund**  
**Notes to the Condensed Financial Statements**  
**For the quarter ended 30 June 2002**  
*(Expressed in Hong Kong dollars)*

**1. ACCOUNTING POLICIES**

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

The interim financial report is unaudited and the financial information relating to the financial year ended 31 March 2002 included in this report does not constitute the Fund's statutory accounts for that financial year but is derived from those accounts.

The same accounting policies adopted in the financial statements for the year ended 31 March 2002 have been applied to the interim financial report.

**2. COMPENSATION PAID**

	\$'000
Compensation paid up to the \$8 million limit as set out in Section 109(3) of the Securities Ordinance	
Balance as at 1 April 2001	72,582
Add: compensation paid during the year ended 31 March 2002	8,161
	<hr/>
Balance as at 31 March 2002	80,743
Add: compensation paid during the quarter ended 30 June 2002	-
	<hr/>
Balance as at 30 June 2002	<u>80,743</u>
Compensation paid in excess of the \$8 million limit pursuant to Section 113(5A) of the Securities Ordinance	
Balance as at 1 April 2001	429,393
Add: compensation paid during the year ended 31 March 2002	12,839
	<hr/>
Balance as at 31 March 2002	442,232
Add: compensation paid during the quarter ended 30 June 2002	2,179
	<hr/>
Balance as at 30 June 2002	<u>444,411</u>

**Unified Exchange Compensation Fund**  
**Notes to the Condensed Financial Statements**  
**For the quarter ended 30 June 2002**  
*(Expressed in Hong Kong dollars)*

**2. COMPENSATION PAID - Cont'd**

	\$'000
Total compensation paid as at 31 March 2002	<u>522,975</u>
Total compensation paid as at 30 June 2002	<u>525,154</u>

In eight defaults since 1998, the SEHK proposed and the SFC approved increases in the \$8 million limit via payment of up to \$150,000 per claimant or if higher the claimant's proportional share of the \$8 million limit. The relevant defaults where we made payments during the quarter ended 30 June 2002 were:

Chark Fung Securities Co. Ltd	\$189,000
Win Successful Securities Limited	\$1,990,000

**3. PROVISION FOR COMPENSATION**

	\$'000
Provision for compensation to be paid up to the \$8 million limit	
Balance as at 1 April 2001	10,880
Less: amount paid during the year ended 31 March 2002	(8,161)
unused provision reversed during the year ended 31 March 2002	(372)
Add: additional provision made for the year ended 31 March 2002	9,996
Balance as at 31 March 2002	<u>12,343</u>
Add: additional provision made during the quarter ended 30 June 2002	16,000
Balance as at 30 June 2002	<u>28,343</u>

**Unified Exchange Compensation Fund**  
**Notes to the Condensed Financial Statements**  
**For the quarter ended 30 June 2002**  
*(Expressed in Hong Kong dollars)*

**3. PROVISION FOR COMPENSATION - Cont'd**

	\$'000
Provision for compensation to be paid in excess of the \$8 million limit	
Balance as at 1 April 2001	112,400
Less: amount paid during the year ended 31 March 2002	(12,839)
unused provision reversed during the year ended 31 March 2002	(84,701)
Add: additional provision made during the year ended 31 March 2002	13,410
	<hr/>
Balance as at 31 March 2002	28,270
Less: amount paid during the quarter ended 30 June 2002	(2,179)
unused provision reversed during the quarter ended 30 June 2002	(339)
Add: additional provision made for the quarter ended 30 June 2002	6,277
	<hr/>
Balance as at 30 June 2002	<u>32,029</u>

We made provision for unprocessed claims in respect of eight SEHK exchange participants for which the SEHK has published a notice calling for claims pursuant to Section 112 of the Securities Ordinance. The maximum liabilities of the Fund in respect of seven of these default cases can exceed the normal \$8 million limit. In respect of two of these default cases, we revised the provision according to claims being processed.

**4. RECOVERIES**

In exercising its subrogated rights, the SFC recovered \$59,000 for the Fund in the quarter ended 30 June 2002 (quarter ended 30 June 2001 : \$2,459,000). During the quarter, the Fund re-distributed recoveries of \$1,298,000 to claimants (quarter ended 30 June 2001 : Nil).

**5. CONTINGENT LIABILITIES**

As at the date of this report, the SEHK has received claims against seven exchange participants. They are subject to the normal \$8 million ceiling pursuant to Section 109 of the Securities Ordinance. The validity of these claims is under investigation. We have not made any provision for these claims. The maximum contingent liability of the Fund to these claims is \$56 million.





## **Commodity Exchange Compensation Fund (the Fund)**

### **Report of the Futures Compensation Fund Committee (the Committee)**

The members of the Committee present their quarterly report and the unaudited condensed financial statements for the quarter ended 30 June 2002.

#### **1. ESTABLISHMENT OF THE FUND**

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

#### **2. FINANCIAL RESULTS**

The Committee presents the financial results which are set out in the condensed financial statements on pages 24 to 28.

#### **3. MEMBERS OF THE COMMITTEE**

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

Mr. Mark Dickens, JP  
Mrs. Alexa Lam  
Mr. William D. Grossman  
Mr. Mark Ho  
Mr. T. Brian Stevenson, SBS

#### **4. INTERESTS IN CONTRACTS**

No contract of significance to which the Fund was a party and in which a Committee Member had a material interest, whether directly or indirectly, subsisted at the balance sheet date or at any time during the quarter.

On behalf of the Committee

Mark Dickens  
Chairman

24 July 2002

## Commodity Exchange Compensation Fund

Income and Expenditure Account  
For the quarter ended 30 June 2002  
(Expressed in Hong Kong dollars)

	Unaudited Quarter ended 30 June 2002 \$'000	Unaudited Quarter ended 30 June 2001 \$'000
<b>Income</b>		
Investment Income	1,762	1,678
Unrealised gain on revaluation of debt securities	790	-
	<u>2,552</u>	<u>1,678</u>
<b>Expenses</b>		
Auditors' remuneration	10	11
Bank charges	14	12
Professional fees	4	14
Sundry expenses	1	1
	<u>29</u>	<u>38</u>
<b>Surplus</b>	2,523	1,640
<b>Accumulated surplus brought forward</b>	42,641	35,596
<b>Accumulated surplus carried forward</b>	<u>45,164</u>	<u>37,236</u>

The notes on page 28 form an integral part of the condensed financial statements.

## Commodity Exchange Compensation Fund

### Balance Sheet

At 30 June 2002

(Expressed in Hong Kong dollars)

	<u>Note</u>	<u>Unaudited</u> <u>At 30 June 2002</u> \$'000	<u>Audited</u> <u>At 31 March 2002</u> \$'000
<b>Current assets</b>			
Debt securities		112,456	111,159
Interest receivable		688	1,154
Levy receivable		461	481
Bank fixed and call deposits		6,824	3,677
Cash at bank		3	60
		<hr/>	<hr/>
		120,432	116,531
<b>Current liabilities</b>			
Accounts payable and accrued charges		222	253
		<hr/>	<hr/>
<b>Net current assets</b>		120,210	116,278
		<hr/>	<hr/>
<b>Net assets</b>		120,210	116,278
		<hr/>	<hr/>
Representing:			
<b><u>Compensation fund</u></b>			
Contributions from HKFE	2	21,500	21,600
Contract levy	3	65,152	63,643
Accumulated surplus		45,164	42,641
		<hr/>	<hr/>
		131,816	127,884
deduct: Compensation paid		(24,457)	(24,457)
add: Recoveries		12,851	12,851
		<hr/>	<hr/>
		120,210	116,278
		<hr/>	<hr/>

The notes on page 28 form an integral part of the condensed financial statements.

## Commodity Exchange Compensation Fund

### Statement of Recognised Gains and Losses

For the quarter ended 30 June 2002

(Expressed in Hong Kong dollars)

	<u>Note</u>	<u>Unaudited Quarter ended 30 June 2002</u> \$'000	<u>Unaudited Quarter ended 30 June 2001</u> \$'000
Net refund of contributions to HKFE		(100)	(100)
Contract levy	3	1,509	1,366
<b>Net gains not recognised in the income and expenditure account</b>		<u>1,409</u>	<u>1,266</u>
Surplus		<u>2,523</u>	<u>1,640</u>
<b>Total recognised gains</b>		<u><u>3,932</u></u>	<u><u>2,906</u></u>

The notes on page 28 form an integral part of the condensed financial statements.

## Commodity Exchange Compensation Fund

### Cash Flow Statement

For the quarter ended 30 June 2002

(Expressed in Hong Kong dollars)

	Unaudited Quarter ended 30 June 2002 \$'000	Unaudited Quarter ended 30 June 2001 \$'000
<b>Net cash outflow from operating activities</b>	(60)	(59)
<b>Returns on investments</b> - interest received	2,228	1,646
<b>Investing activities</b>		
Debt securities redeemed	7,000	8,000
Debt securities bought	(7,507)	-
<b>Net cash (outflow)/inflow from investing activities</b>	(507)	8,000
<b>Financing</b>		
Net contribution refunded to HKFE	(100)	(100)
Contract levy received	1,529	1,506
<b>Net cash inflow from financing</b>	1,429	1,406
Increase in cash and cash equivalents	3,090	10,993
Cash and cash equivalents at beginning of the quarter	3,737	19,149
<b>Cash and cash equivalents at end of the quarter</b>	<u>6,827</u>	<u>30,142</u>
<b>Reconciliation of surplus for the quarter to net cash outflow from operating activities:</b>		
Surplus	2,523	1,640
Investment income	(2,552)	(1,677)
Decrease in accounts payable and accrued charges	(31)	(22)
<b>Net cash outflow from operating activities</b>	<u>(60)</u>	<u>(59)</u>
<b>Analysis of the balance of cash and cash equivalents:</b>		
	Unaudited At 30 June 2002 \$'000	Unaudited At 30 June 2001 \$'000
Cash at bank	3	19
Bank fixed and call deposits	6,824	30,123
	<u>6,827</u>	<u>30,142</u>

## Commodity Exchange Compensation Fund

### Notes to the Condensed Financial Statements

For the quarter ended 30 June 2002

(Expressed in Hong Kong dollars)

#### 1. ACCOUNTING POLICIES

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

The interim financial report is unaudited and the financial information relating to the financial year ended 31 March 2002 included in this report does not constitute the Fund's statutory accounts for that financial year but is derived from those accounts.

The same accounting policies adopted in the financial statements for the year ended 31 March 2002 have been applied to the interim financial report.

#### 2. CONTRIBUTIONS FROM HKFE

	\$'000
Balance as at 1 April 2001	21,300
Add: Contributions received during the year ended 31 March 2002	800
Deduct: Refunds to outgoing shareholders during the year ended 31 March 2002	(500)
	<hr/>
Balance as at 31 March 2002	21,600
Add: Contributions received during the quarter ended 30 June 2002	300
Deduct: Refunds to outgoing shareholders during the quarter ended 30 June 2002	(400)
	<hr/>
Balance as at 30 June 2002	<u>21,500</u>

#### 3. CONTRACT LEVY

During the quarter ended 30 June 2002, the Fund recognised \$1,509,000 contract levy (quarter ended 30 June 2001: \$1,366,000).

## Appendix

Consultation Papers Issued between 1 April and 30 June 2002			
Issue Date	Closing Date	Consultation Paper	Status
3 Apr	30 Apr	(i) S&F (Levy) Order (ii) S&F (Levy Rules)	Completed
6 May	7 Jun	(i) S&F (Stock Market Listing) Rules (ii) S&F (Transfer of Functions - Stock Exchange Company) Order	Completed
16 May	8 Jun	S&F (Disclosure of Interests - Exclusion) Rules	Completed
24 May	21 Jun	S&F (Short Selling Exemption and Stock Lending) Rules	Completed
5 Jun	26 Jun	S&F <sup>1</sup> (Leveraged Foreign Exchange Trading - Exemption) Rules	Completed
14 Jun	12 Jul	S&F (Financial Resources) Rules	Consultation
26 Jun	25 Jul	S&F (Insurance) Rules	Consultation

Consultation Conclusions Issued between 1 April and 30 June 2002	
S&F (Licensed Persons and Registered Institutions) Rules	
S&F (Information) Rules	
S&F (Leveraged Foreign Exchange Trading - Arbitration) Rules	
S&F (Contract Limits and Reportable Positions) Rules	
S&F (Recognized Counterparty) Rules	
S&F (Associated Entities) Rules	
S&F (Gold Purchase) Notice	
(i) S&F (Investor Compensation Levy)	
(ii) S&F (Investor Compensation - Compensation Limits) Rules	
(iii) S&F (Transfer of Functions - Investor Compensation Company) Order	
(iv) S&F (Investor Compensation - Claims) Rules	
S&F (Professional Investors) Rules	
S&F (Registration of Commission Disciplinary Orders) Rules	
(i) S&F (Levy) Order	
(ii) S&F (Levy) Rules	
S&F (Contract Notes, Statements of Account and Receipts) Rules	
SFC <sup>2</sup> Disciplinary Fining Guidelines	

Note 1 : S&F stands for Securities and Futures.

Note 2 : SFC stands for Securities and Futures Commission.