



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

# Quarterly Report

October - December 2001





## Table of Contents

Operations Highlights	1
Review of Operations	3
Securities and Futures Commission Condensed Financial Statements	10
Unified Exchange Compensation Fund Condensed Financial Statements	14
Commodity Exchange Compensation Fund Condensed Financial Statements	22



## Operations Highlights

1 October to 31 December 2001

1. By the end of December 2001, the Securities and Futures Commission (SFC) recorded a deficit of \$43.6 million for the past three quarters, higher than the approved budgeted deficit of \$35.6 million. Reserves stood at \$634.6 million. The SFC has already implemented a wage and hiring freeze and additional cost control measures were introduced during the quarter.
2. Revenue was reduced as levy income decreased with the shrinkage of market turnover. The average daily turnover for the quarter was \$7.3 billion, far below the \$11 billion a day assumed in the approved estimate. Reduction in fee income and other incomes also contributed to the decline in revenues. Increases in operating expenditure - largely due to staff increases needed to cope with additional regulatory functions transferred from the Hong Kong Exchanges and Clearing Limited (HKEx) in 2000 - accounted for part of the deficit. Further expenditure was incurred in external relations due to promotion of closer working relations with Mainland and overseas regulators.
3. Work on legislative reform continued during the quarter and the clause-by-clause examination of the Securities and Futures Bill by the Legislative Council Bills Committee was concluded on 26 October. The Committee held its last meeting on 14 January 2002 to consider written responses on outstanding issues and draft Committee Stage Amendments. It is expected that the Bill will be passed by the Legislative Council in early 2002 and come into force later in the year.
4. To upgrade Hong Kong's regulatory standards, six consultation papers were issued during the quarter, including the Consultation Paper on the Offering of Hedge Funds and others relating to draft rules under the Securities and Futures Bill. Three Codes, including the Revised Hong Kong Codes on Takeovers and Mergers and Share Repurchases (Phase 1 revision), the Code of Conduct for Share Registrars and the Corporate Finance Adviser Code of Conduct, became effective during the quarter.
5. The SFC continued to work closely with the Stock Exchange on Listing Rules reform. Following the implementation of the amended Listing Rules of the Growth Enterprise Market on 1 October, the revised Listing Rules for derivative warrants became effective on 10 December. The SFC, after carefully assessing the arguments for and against the inclusion of a director responsibility statement on the listing documents of warrants, has also agreed that the Listing Rules can be waived to accept corporate responsibility in substitution. The warrant market was successfully re-launched in January 2002.
6. On market development, the SFC is consulting the public on the implementation of a scripless market in a bid to increase market efficiency and to reduce risks and costs. Guidelines for the authorisation of Index Tracking Funds and the regulation of Automated Trading Services were released in January and February 2002 respectively. Meanwhile, the Hong Kong



Futures Exchange (HKFE) has launched the International Stock Futures and International Stock Options as well as the 3-year Exchange Fund Note Futures Contract during the quarter. Certain restrictions on short selling in relation to specified types of transaction were also removed to enhance market liquidity.

7. The SFC took disciplinary action against 13 registrants for a variety of acts of misconduct and successfully prosecuted 13 parties for breaches of the Securities (Disclosure of Interests) Ordinance, unregistered dealing and the creation of false and misleading trading activities. The SFC has also referred one case of alleged insider dealing to the Financial Secretary in October for him to consider the appointment of an Insider Dealing Tribunal.
8. Investor education remains high on the SFC agenda. New educational columns, “In the Eyes of the SFC” and “Intelligence” were published in Sing Pao and Money Times respectively. Fifteen 3-minute segments called “Chit Chat on Facts” were also broadcasted on Commercial Radio 1 to explain investment-related topics. The SFC also organised a new round of Teachers’ Workshops to provide secondary school teachers with the basic knowledge about the securities, futures and funds industries so that they could pass on that knowledge to their students. A number of educational leaflets and articles were also published to increase investor awareness on topical investment issues, such as Equity-Linked Notes and unauthorised trading.
9. On the international front, the SFC organised and participated in several major conferences during the quarter: the three-day City & Financial conferences on corporate governance, equity research and hedge funds; the Chongqing financial conference to promote Hong Kong’s financial services and the Asian Securities Analysts Federation 2001 Conference. The Commission also hosted the “Hong Kong Regional Discussion Workshop on the Hague Conference’s Project on Indirectly Held Securities” and the “Ecology on Corporate Governance” Workshop for market practitioners.
10. To address the issues raised in the independent stakeholder survey conducted in 2001, the SFC has started publishing consultation comments and detailed consultation conclusions on its website, and released the new “SFC Alert”, a monthly newsletter to communicate with stakeholders and investors in a user-friendly way. The Commission has also been streamlining and upgrading its internal workflow with the application of information technology. These measures aim to enhance the Commission’s efficiency and accountability within the current resource constraints.



## Review of Operations

1 October to 31 December 2001

This is the Securities and Futures Commission's (SFC) third Quarterly Report for the financial year 2001/2002.

I announced in the last Quarterly Report that the SFC had implemented a wage and hiring freeze in view of the economic downturn and a higher than budget deficit. Additional cost control measures were introduced during the quarter. Despite the tight control on expenditure, the SFC continued to enhance its efficiency with various initiatives, such as staff training and workflow automation, the objective of which is to enable the Commission to do more, in a more effective manner, with fewer resources.

Not only does the SFC want to do more; it aims to do better. That's why we engaged in 2001 an independent consultant to conduct a stakeholder survey in order to understand how stakeholders view the SFC's programmes, its effectiveness as a regulator, and the areas where it should apply more focus. The results were published in December.

During the quarter, the Hang Seng Index reached a high of 11,847 on 12 December, rising from a low of 9,798 on 22 October. It closed at 11,397 on 31 December, 14.5% higher than the previous quarter's 9,951 close – but still 24.5% lower than the end of last year when the index was at 15,096.

### Financial Highlights

In the quarter, overall revenue fell by 31.6% compared with the corresponding quarter of last year, while total expenditure including depreciation was 5.9% higher, resulting in a deficit of \$25.6 million. Compared with the previous quarter, revenue was 1.4% lower, while expenditure was 4% higher, mainly due to increases in other expenditure and depreciation charges.

For the past three quarters, the Commission has recorded a deficit of \$43.6 million, higher than the approved budgeted deficit of \$35.6 million. The higher than budget deficit was essentially due to the declining levy revenue as a result of the shrinkage in market turnover. Although the average daily turnover during the third quarter has risen to \$7.3 billion from last quarter's \$6.8 billion, it was still far below the turnover of \$11 billion a day projected in the approved estimate. By the end of December 2001, the Commission's reserves stood at \$634.6 million.

Comparison of the three quarters results between years shows that the Commission has swung from a surplus of \$100.5 million last year to a deficit of \$43.6 million this year. Over two thirds of the change in operating results were due to the decline in revenue. Since market turnover shrank from \$11.5 billion per day to \$8.1 billion per day during the first nine months of the financial year (despite this year's full period effect of the increase of levy rate from 0.004% to 0.005% which became effective from 12 June 2000), levy income fell by \$53.9 million or 25.8%. License fees and corporate finance charges fell by 14%, while investment income fell by 25.7% due to lower corporate finance activities and lower interest rates respectively. Other income fell by \$31 million due to the one-off court award in 2000.



On the expenditure side, operating expenditure during the first three quarters increased by 12% largely as a result of three factors. Staff costs increased by 11% for the first nine months, due to the full year effect of staff increases, which were required to cope with additional regulatory functions transferred from the Hong Kong Exchanges and Clearing Limited (HKEx) in 2000. Other expenses were higher due to increases in outsourcing of computer operation services, external consultancy for market studies and external relations for working with Mainland and overseas regulators. As of 31 December, the total number of staff was 415 comprising 354 permanent staff and 61 temporary staff. Depreciation increased by about 30.3%, reflecting the SFC's commitment to capital expenditure on computer systems development with a view to enhancing productivity and services through the utilisation of information technology.

As a result of the rising deficit, the Commission decided to further cut back operating expenditure wherever possible. It has instituted since November 2001 a hiring and pay freeze, as well as imposing a zero-based budgeting approach. This meant that all expenditure would have to be justified from zero base, not because it was so incurred in the past.

As reported in the last Quarterly Report, the deficit for the year as a whole is expected to be much higher than the budgeted deficit of \$52.9 million. The latest revised estimate for the financial year 2001/2002 is that the deficit would rise to \$87.9 million, about \$35 million worse than anticipated, mainly due to a \$86.8 million or 19.4% deterioration in the income for the year. Estimated overall expenditure would be slashed by 10.3% compared with the approved budget, due to stringent cost saving measures.

Based upon current estimates, we may be able to hold the deficit at the estimated level of \$87.9 million, barring no further deterioration in the income level.

### The Securities and Futures Bill

The modernisation of Hong Kong's securities legislation through the composite Securities and Futures Bill is close to fruition. The SFC continued to commit significant staff resources to facilitating the vetting of the Bill during the quarter. The clause-by-clause examination of the Bill by the Legislative Council Bills Committee concluded on 26 October and the second round discussion of Committee Stage Amendments (CSAs) finished ahead of schedule on 14 December. The Bills Committee held its last meeting on 14 January 2002 to consider written responses on outstanding issues and draft CSAs proposed in response to Members' comments and suggestions made during the last round of meetings. It is expected that the Bill will be passed by the Legislative Council in early 2002 and come into force later in the year, bringing a new and consolidated regulatory framework to the Hong Kong securities industry.

### Enhancing Regulatory Framework

By the end of December 2001, the number of SFC registrants and exempt persons fell by 1.6% to 29,380, compared with 29,865 at the end of 2000.

Number of SFC Registrants under Various Ordinances and Exempt Persons			
	December 2001	September 2001	December 2000
Securities Ordinance (exclude Securities Margin Financiers)	23,207	23,712	23,330
Securities Ordinance (as Securities Margin Financiers)	219	239	272
Commodities Trading Ordinance	4,841	4,981	5,120
Leveraged Foreign Exchange Trading Ordinance	917	920	946
Exempt Persons	196	197	197
<b>Total</b>	<b>29,380</b>	<b>30,049</b>	<b>29,865</b>



The SFC issued six consultation papers during the quarter, compared with three last quarter and one issued in the same quarter last year. These consultation papers concerned key sets of draft rules under the Securities and Futures Bill and new Codes and Guidelines.

SFC Consultation Papers Issued during the Period 1 October to 31 December 2001			
Issue Date	Closing Date	Consultation Paper	Status
19 October	19 November	A Consultation Document on the Draft Securities and Futures (Unsolicited Calls - Exclusion) Rules	Completed
26 October	7 December	A Consultation Paper on the Offering of Hedge Funds	Completed
16 November	17 December	A Consultation Document on the Draft Securities and Futures (Licensed Persons and Registered Institutions) Rules	Completed
30 November	29 December	A Consultation Document on the Draft Securities and Futures (Recognised Counterparty) Rules	Completed
19 December	26 January 2002	A Consultation Document on the Draft Securities and Futures (Disclosure of Interests - Securities Borrowing and Lending) Rules	Completed
21 December	31 January 2002	A Consultation Document on the Draft Securities and Futures (Accounts and Audit) Rules	Completed

In addition, three Codes and Guidelines came into effect during the quarter to bring regulatory practice in line with international development and raise intermediaries' professional standards.

Codes and Guidelines to Take Effect During the Period 1 October to 31 December 2001	
	Effective Date
Revised Hong Kong Codes on Takeovers and Mergers and Share Repurchases	19 October (Phase 1) 1 February 2002 (Phase 2)
Code of Conduct for Share Registrars	1 November
Corporate Finance Adviser Code of Conduct	1 December

To offer more investment choices for small investors, the SFC announced a deregulation through the removal of the \$50,000 minimum subscription requirement imposed on Hong Kong dollar money market funds. Circulars were also sent to fund managers and other SFC registrants to provide them with guidelines on the suspension of authorised funds, dealing in equity-linked instruments and debt collection practice.

On Listing Rules reforms, the SFC continued to work closely with the Stock Exchange. Following the implementation of the amended Listing Rules of the Growth Enterprise Market on 1 October, the revised Listing Rules for derivative warrants were agreed upon between the SFC and the HKEx and became effective on 10 December. Under the new rules, derivative warrant issuers are required to provide liquidity for warrants that they have listed and some of the restrictions in the placing guidelines for derivative warrants were also eased. The SFC, after carefully assessing the arguments for and against the inclusion of a director responsibility statement on the listing documents of warrants, has also agreed that the Listing Rules can be waived to accept corporate responsibility in substitution. The warrant market was successfully re-launched in January 2002.



### Facilitating Market Development

Market development activities continued during the quarter. On infrastructural development, the SFC is consulting the public on the implementation of a scripless market in February 2002 in a bid to raise market efficiency and to reduce risks and costs. The SFC also released the Guidelines on Index Tracking Funds and Guidelines for the Regulation of Automated Trading Services in January and February 2002 respectively.

By the end of December 2001, there were altogether 2,314 collective investment schemes authorised by the SFC, an increase of 4.9% over the previous year's 2,205.

Number of Authorised Collective Investment Schemes			
	December 2001	September 2001	December 2000
Unit Trusts and Mutual Funds	1,893	1,870	1,791
Investment-Linked Assurance Schemes	98	93	72
Pooled Retirement Funds	39	40	42
Immigration-Linked Investment Funds	0	0	2
MPF Master Trust / Industry Schemes	49	49	49
MPF Pooled Investment Funds*	217	214	230
Other Schemes	18	21	19
<b>Total</b>	<b>2,314</b>	<b>2,287</b>	<b>2,205</b>

\*Some funds included in this category are also offered as retail unit trusts.

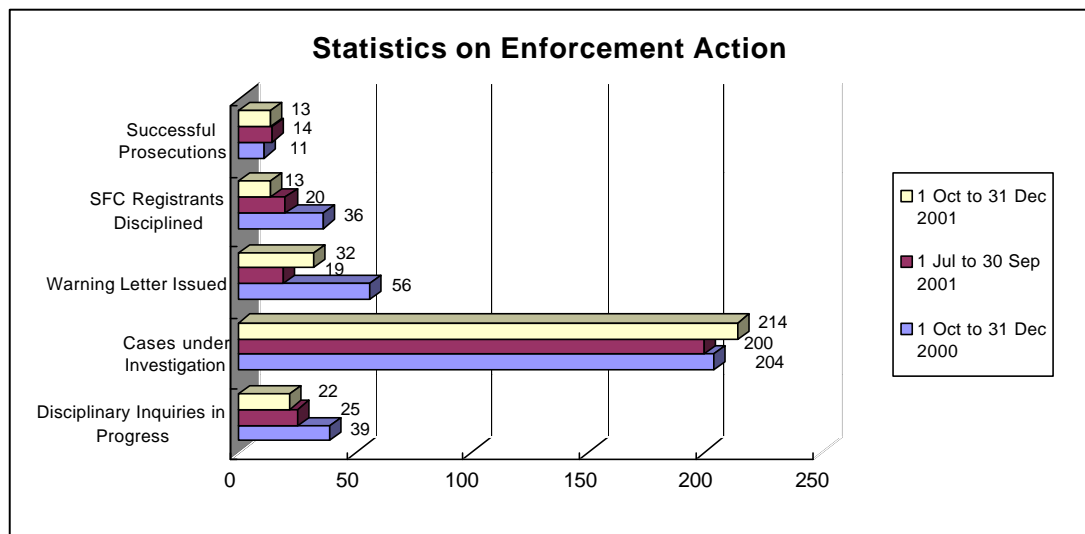
To provide investors with a wider choice of investment alternatives, the Hong Kong Futures Exchange (HKFE) on 4 October launched the International Stock Futures and International Stock Options, the underlying stocks of which are blue-chip stocks listed on the exchanges of the US, Japan, Korea and Taiwan. The HKFE also launched the 3-year Exchange Fund Note Futures Contract on 19 November.

To enhance market liquidity, the SFC has made the Securities (Miscellaneous) (Amendment) (No.2) Rules 2001, which allows stock futures market-makers to short naked underlying securities for the purpose of hedging their stock futures positions. The Rules came into effect on 26 October. In the meantime, the Stock Exchange rule amendments in relation to the tick rule (that prohibits a short sale to be made below the best current ask price) exemption for index arbitrage and market-making transactions were approved by the Commission and took effect from 3 December.

### Enforcement Action

The SFC is committed to ensuring investors' interests are protected through firm and fair enforcement action. During the quarter, the SFC took disciplinary action against 13 registrants for a variety of acts of misconduct leading to revocation, suspension and public reprimand. It also successfully prosecuted 13 parties for breaches of the Securities (Disclosure of Interests) Ordinance, unregistered dealing and the creation of false and misleading trading activities. In October, the SFC referred one case of alleged insider dealing to the Financial Secretary for him to consider the appointment of an Insider Dealing Tribunal. In November, the SFC persuaded a listed company to withdraw the use of an index-linked incentive scheme for marketing its property project.





### Promoting Investor Awareness

In response to the findings of the Retail Investor Survey (completed in July 2001) which indicated that newspaper columns and radio segments are the most cost-effective investor education programmes, new educational columns, “In the Eyes of the SFC” and “Intelligence” were published in Sing Pao and Money Times respectively. Fifteen 3-minute segments called “Chit Chat on Facts” were also broadcasted on Commercial Radio 1 to explain investment-related topics in response to questions from audience.

To “train the trainers” and inculcate a healthy attitude towards investment, the SFC organised another round of Teachers’ Workshops for secondary school teachers (a previous round of Workshops was conducted last year). The 15 Workshops provided teachers with basic knowledge about the securities, futures and funds industries and allowed them to pass on that knowledge to their students. A total of 693 teachers have enrolled for the Workshops.

A number of educational leaflets and articles were published during the quarter to increase investor awareness on topical investment issues. The “Invest Wisely” leaflet explained the concepts and risks of Equity-Linked Notes; the article entitled “Speculating on Index Rebalancing can be Risky” warned investors against the possible market volatility arising from the Morgan Stanley Capital International index re-balancing exercise; the “Investor Alert” section on the SFC website has been expanded to include advice to investors on how they could prevent unauthorised trading and avoid indulging in over-trading.

During the quarter, the SFC received 755 enquiries and 204 complaints against registrants, listed companies and market misconduct, compared with 742 enquiries and 203 complaints during the previous quarter. The corresponding figures for the same quarter last year were 942 enquiries and 140 complaints.

### Strengthening External Relations

The SFC organised and participated in several major conferences in the quarter. In association with the Hong Kong Securities Institute (HKSI) and an event organiser, City & Financial of the UK, the SFC organised three conferences from 29 to 31 October covering the subjects of “Corporate Governance in the Pan Chinese Market”, “The Future of Equity Research” and “The Regulation of Hedge Funds in Asia”. Over 500 market practitioners attended the conferences.



In November, the Commission participated in a financial conference in Chongqing, China, which was co-organised by the Hong Kong Monetary Authority, HKEx, the Hong Kong Trade Development Council and the SFC. The objective was to promote Hong Kong's financial services and explain the regulatory structure of the Hong Kong markets.

The SFC also served as the Special Adviser to the Asian Securities Analysts Federation 2001 Conference hosted by the HKSI from 3 to 5 December. Attended by more than 200 industry representatives from around the world, the conference's theme was "Asia – The Third Global Financial Zone". It provided a forum for market practitioners to exchange views on key market issues.

Two industry workshops were also held in the SFC office, namely the "Hong Kong Regional Discussion Workshop on the Hague Conference's Project on Indirectly Held Securities" and the "Ecology on Corporate Governance" Workshop. About 100 representatives from the legal profession and the financial services industry in the region attended the workshops.

The SFC continued to participate in the work of the International Organisation of Securities Commissions (IOSCO) and attended the Standing Committee 5 meeting in October to discuss with overseas regulators issues of common concern in relation to the funds industry. On 31 January and 1 February 2002, the Commission hosted in Hong Kong meetings of the IOSCO Executive Committee, Technical Committee and the Advisory Board of the Emerging Market Committee. About 100 senior regulators from around the world attended the meetings.

### **Becoming a Quality Regulator**

The SFC released the results of a landmark survey of stakeholders<sup>#</sup> in December. Conducted earlier in 2001 by an independent market research firm, the survey found that stakeholders regard the SFC highly and believe that its programmes have had a positive impact on the securities and futures markets in Hong Kong. Many believe that the SFC is generally "heading in the right direction". Stakeholders indicated that they wanted the SFC to be more transparent in how it decides on policy positions following public consultation; increase dialogue with stakeholders; enhance corporate governance and enforcement; reduce compliance costs and focus on training its staff to meet the demands of a changing market.

Stakeholders' feedback will help the SFC refine its future regulatory policies and approach. In fact, the SFC has taken a number of steps to address some of the issues that stakeholders raised in the survey. For example, the SFC now publishes consultation comments and detailed consultation conclusions on its website, as well as the new "SFC Alert", a monthly newsletter which aims to get news and topical issues to stakeholders and investors alike in a user-friendly way. It has also revised its press releases to focus on regulatory messages for the market. All of these steps are aimed at improving the information flow between the SFC and its stakeholders.

In addition to regularly providing training programmes to staff members on the latest development in the industry, management and language skills as well as computer operations, the SFC has also been streamlining and upgrading its internal workflow with the application of information technology (IT). A recent example is an e-payment facility developed to enable the Commission to pay service vendors electronically. In 2000, the SFC was awarded an

-----  
<sup>#</sup> These include: securities/futures brokers, financial advisers, asset/fund managers, insurance companies, investment banks, banks, listed companies, accounting firms, law firms, HKEx, investor advocates, financial media, LegCo aides and share registrars.



ISO 9001 Certificate for the design and provision of IT services and subsequently – in November 2001 – an ISO surveillance audit was carried out, finding “zero non-conformities” and confirming the quality of the Commission’ s IT services.

Meanwhile, the SFC has been working hard to improve its transparency and raise the standards of information disclosure. The SFC Annual Report 2000/2001 won two awards during the quarter: the Gold Award in the Non-profit Making and Charitable Organisations category of the Best Annual Report Awards presented by the Hong Kong Management Association and the Platinum Award of the Best Corporate Governance Disclosure Awards 2001 presented by the Hong Kong Society of Accountants.

### **Looking Ahead**

In view of the imminent passage of the Securities and Futures Bill, the continuous upgrade of local financial infrastructure and the introduction of complex and innovative investment products, the Hong Kong markets will be undergoing major structural changes.

The Hong Kong economy cannot avoid being affected by the global deflationary cycle. As it entered the third quarter with a deficit , the SFC is mindful of the need for efficient resource utilisation and stringent cost controls, and so will continue to deliver quality regulatory functions while striving to remain within strict resource constraint. In 2002, the SFC will be focusing on key initiatives, such as the implementation of the new Bill and the supervision of a market that is developing the next generation of intermediaries and products, as well as re-engineering our processes and regulatory functions to facilitate and empower these changes.

Andrew Sheng  
Chairman

8 February 2002



## Securities and Futures Commission

### Income and Expenditure Account

For the nine months ended 31 December 2001

(Expressed in Hong Kong Dollars)

	Note	Unaudited Three Months Ended		Unaudited Nine Months Ended	
		31 Dec 2001	31 Dec 2000	31 Dec 2001	31 Dec 2000
		\$' 000	\$' 000	\$' 000	\$' 000
<b>Income</b>					
Levies		46,654	63,014	155,088	209,000
Fees and charges		26,174	28,609	85,343	99,276
Investment income		8,956	13,903	32,809	44,184
Other income		405	14,596	1,060	32,043
		<u>82,189</u>	<u>120,122</u>	<u>274,300</u>	<u>384,503</u>
		-----	-----	-----	-----
<b>Expenses</b>					
Staff costs		80,476	78,923	242,152	218,223
Premises					
- rent		5,003	5,003	15,007	15,007
- other		2,798	2,462	8,416	7,368
Other expenses		12,509	9,869	34,447	29,639
		<u>100,786</u>	<u>96,257</u>	<u>300,022</u>	<u>270,237</u>
		-----	-----	-----	-----
Depreciation		6,979	5,497	17,891	13,728
		<u>107,765</u>	<u>101,754</u>	<u>317,913</u>	<u>283,965</u>
		-----	-----	-----	-----
<b>(Deficits)/Surplus</b>	2	<u>(25,576)</u>	<u>18,368</u>	<u>(43,613)</u>	<u>100,538</u>

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

The notes on page 13 form an integral part of the condensed financial statements.



## Securities and Futures Commission

### Balance Sheet

At 31 December 2001

(Expressed in Hong Kong Dollars)

	<u>Note</u>	Unaudited At 31 Dec 2001 \$'000	Audited At 31 Mar 2001 \$'000
<b>Non-current assets</b>			
Fixed assets		39,822	38,696
Held-to-maturity debt securities		361,192	370,204
<b>Current assets</b>			
Held-to-maturity debt securities		41,993	277,046
Bank deposits		270,191	102,624
Debtors, deposits and prepayments		22,602	29,821
Cash at bank and in hand		803	4,469
		<u>335,589</u>	<u>413,960</u>
		-----	-----
<b>Current liabilities</b>			
Provision for contribution to the Unified Exchange Compensation Fund		30,000	66,174
Fees received in advance		35,502	31,271
Creditors and accrued charges		36,515	47,216
		<u>102,017</u>	<u>144,661</u>
		-----	-----
<b>Net current assets</b>		<u>233,572</u>	<u>269,299</u>
		-----	-----
<b>Net assets</b>		<u>634,586</u>	<u>678,199</u>
<b>Funding and reserves</b>			
<b>Initial funding by Government</b>		42,840	42,840
<b>Accumulated Surplus</b>	2	591,746	635,359
		<u>634,586</u>	<u>678,199</u>

The notes on page 13 form part of the condensed financial statements.



## Securities and Futures Commission

### Cash Flow Statement

For the nine months ended 31 December 2001

(Expressed in Hong Kong dollars)

	Unaudited Nine months ended <u>31 Dec 2001</u> \$'000	Unaudited Nine months ended <u>31 Dec 2000</u> \$'000
<b>Net cash (outflow)/inflow from operating activities</b>	(54,581)	69,803
<b>Returns on investments - interest received</b>	29,630	40,421
<b>Payment to the Unified Exchange Compensation Fund</b>	(36,174)	(150,000)
<b>Investing activities</b>		
Held-to-maturity debt securities bought	-	(175,125)
Held-to-maturity debt securities redeemed	244,000	-
Held-to-maturity debt securities sold	-	198,184
Fixed assets bought	(19,067)	(18,628)
Fixed assets sold	93	143
<b>Net cash inflow from investing activities</b>	225,026	4,574
Increase/(decrease) in cash and cash equivalents	163,901	(35,202)
Cash and cash equivalents at beginning of the nine months	107,093	155,439
<b>Cash and cash equivalents at end of the nine months</b>	<u>270,994</u>	<u>120,237</u>
<b>Reconciliation of (deficit)/surplus of income over expenses to net cash (outflow) / inflow from operating activities :</b>		
(Deficit)/surplus	(43,613)	100,538
Investment income	(32,809)	(44,184)
Depreciation	17,891	13,728
(Profit)/loss on sale of fixed assets	(43)	40
Decrease in debtors, deposits and prepayments	10,463	16,825
Decrease in creditors and accrued charges	(10,701)	(21,947)
Increase in fees received in advance	4,231	4,803
<b>Net cash (outflow) / inflow from operating activities</b>	<u>(54,581)</u>	<u>69,803</u>

### Analysis of the balance of cash and cash equivalents :

	Unaudited <u>At 31 Dec 2001</u> \$'000	Unaudited <u>At 31 Dec 2000</u> \$'000
Bank deposits	270,191	119,217
Cash at bank and in hand	803	1,020
	<u>270,994</u>	<u>120,237</u>



## Securities and Futures Commission

### Notes to the Condensed Financial Statements

For the nine months ended 31 December 2001

(Expressed in Hong Kong dollars)

#### 1. Basis of preparation

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

The interim financial report is unaudited and the financial information relating to the financial year ended 31 March 2001 included in this report does not constitute the SFC's statutory accounts for that financial year but is derived from those accounts.

We have applied the same accounting policies adopted in the financial statements for the year ended 31 March 2001 to the interim financial report.

#### 2. Accumulated surplus

Movements of accumulated surplus during the nine months ended 31 December 2001 are as follows:

	<b><u>Unaudited</u></b>
	\$' 000
Balance at 31 March 2001	635,359
Deficits for the period	(43,613)
Balance at 31 December 2001	<u>591,746</u>



## **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 nine-month period ended 31 December 2001.

#### **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 15 to 21.

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

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

Mr. Mark Dickens

Mrs. Alexa Lam (appointed on 1 December 2001)

Mr. Andrew Procter (resigned on 30 November 2001)

Mr. David M. Roberts

Mr. Kwong Ki Chi, GBS

Hon. Bernard Chan (appointed on 1 April 2001 and resigned on 18 November 2001)

Mr Brian Stevenson (appointed on 19 November 2001)

#### **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 nine months.

On behalf of the Committee

Mark Dickens  
Chairman

1 February 2002





## Unified Exchange Compensation Fund

### Income and Expenditure Account

For the nine months ended 31 December 2001

(Expressed in Hong Kong dollars)

	Unaudited		Unaudited	
	Three Months Ended		Nine Months Ended	
	<u>31 Dec 2001</u>	<u>31 Dec 2000</u>	<u>31 Dec 2001</u>	<u>31 Dec 2000</u>
	\$	\$	\$	\$
<b>Income</b>				
Investment Income	8,539,370	10,033,663	28,512,157	22,284,946
	-----	-----	-----	-----
<b>Expenses</b>				
Auditors' remuneration	10,350	9,720	31,050	29,160
Bank charges	82,619	47,136	157,770	157,993
Professional fees	633,027	33,000	760,665	99,000
Sundry expenses	-	-	1,220	680
	-----	-----	-----	-----
	725,996	89,856	950,705	286,833
	-----	-----	-----	-----
<b>Surplus</b>	7,813,374	9,943,807	27,561,452	21,998,113
<b>Accumulated surplus brought forward</b>	211,281,973	171,605,795	191,533,895	159,551,489
	-----	-----	-----	-----
<b>Accumulated surplus carried forward</b>	<u>219,095,347</u>	<u>181,549,602</u>	<u>219,095,347</u>	<u>181,549,602</u>

The notes on pages 19 to 21 form an integral part of the condensed financial statements.



## Unified Exchange Compensation Fund

### Balance Sheet

At 31 December 2001

(Expressed in Hong Kong dollars)

	Note	Unaudited At 31 Dec 2001 \$	Audited At 31 Mar 2001 \$
<b>Non-current assets</b>			
Held-to-maturity debt securities		372,963,911	390,060,457
<b>Current assets</b>			
Held-to-maturity debt securities		265,912,394	123,146,790
Contributions receivable		30,000,000	102,347,362
Interest receivable		6,842,297	5,358,046
Levy receivable		5,122,555	-
Bank fixed and call deposits		112,868,014	132,127,801
Cash at bank		99,008	57,360
		420,844,268	363,037,359
<b>Current liabilities</b>			
Accounts payable and accrued charges		2,727,461	585,635
Provision for compensation	3	58,931,324	123,280,031
		61,658,785	123,865,666
<b>Net current assets</b>			
		359,185,483	239,171,693
<b>Net assets</b>			
		732,149,394	629,232,150
Representing:			
<b>Compensation fund</b>			
Contributions from the SEHK		46,450,000	46,450,000
less: Compensation paid	2	(80,581,920)	(72,581,920)
Provision for compensation	3	(12,504,386)	(10,880,262)
Add: Recoveries		9,865,871	9,853,688
Replenishments from the SEHK		16,360,196	16,360,196
		(20,410,239)	(10,798,298)
Excess transaction levy from the SEHK		353,786,882	353,786,882
Special contribution		3,500,000	3,500,000
Additional contributions from the SEHK and the SFC		630,000,000	630,000,000
Special levy surplus		3,002,104	3,002,104
Transaction levy	4	22,993,221	-
Accumulated surplus		219,095,347	191,533,895
		1,232,377,554	1,181,822,881
Less: Compensation paid	2	(433,390,983)	(429,392,664)
Provision for compensation	3	(46,426,938)	(112,399,769)
		752,559,633	640,030,448
		732,149,394	629,232,150

The notes on pages 19 to 21 form an integral part of the condensed financial statements.



## Unified Exchange Compensation Fund

### Statement of Recognised Gains and Losses For the nine months ended 31 December 2001 (Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited Nine Months Ended <u>31 Dec 2001</u> \$	Unaudited Nine Months Ended <u>31 Dec 2000</u> \$
Recoveries		12,183	4,139,246
Replenishments from the SEHK		-	3,627,498
Decrease in provision for compensation		64,348,707	64,937,505
Compensation paid out of the Fund	2	(11,998,319)	(60,704,249)
Additional contributions from the SEHK & the SFC		-	300,000,000
Transaction levy	4	22,993,221	-
Special levy surplus		-	3,002,104
<b>Net gains not recognised in the income and expenditure account</b>		<u>75,355,792</u>	<u>315,002,104</u>
Surplus		27,561,452	21,998,113
<b>Total recognised gains</b>		<u><u>102,917,244</u></u>	<u><u>337,000,217</u></u>

The notes on pages 19 to 21 form an integral part of the condensed financial statements.



## Unified Exchange Compensation Fund

### Cash Flow Statement

For the nine months ended 31 December 2001

(Expressed in Hong Kong dollars)

	Unaudited Nine Months Ended 31 Dec 2001 \$	Unaudited Nine Months Ended 31 Dec 2000 \$
<b>Net cash inflow/(outflow) from operating activities</b>	1,191,121	(885,488)
<b>Returns on investments</b> - interest received	28,920,578	20,097,221
<b>Investing activities</b>		
Held-to-maturity debt securities redeemed	123,000,000	142,000,000
Held-to-maturity debt securities sold	-	24,737,160
Held-to-maturity debt securities bought	(250,561,730)	(516,721,010)
<b>Net cash outflow from investing activities</b>	(127,561,730)	(349,983,850)
<b>Financing</b>		
Recoveries	12,183	4,139,246
Replenishments received from the SEHK	-	3,627,498
Compensation paid	(11,998,319)	(60,704,249)
Additional contribution from the SEHK and the SFC	72,347,362	300,000,000
Special levy received	-	3,002,104
Transaction levy received	17,870,666	-
<b>Net cash inflow from financing</b>	78,231,892	250,064,599
Decrease in cash and cash equivalents	(19,218,139)	(80,707,518)
Cash and cash equivalents at beginning of the nine months	132,185,161	175,877,044
<b>Cash and cash equivalents at end of the nine months</b>	<u>112,967,022</u>	<u>95,169,526</u>
<b>Reconciliation of surplus for the nine-month period to net cash inflow/(outflow) from operating activities:</b>		
Surplus	27,561,452	21,998,113
Investment Income	(28,512,157)	(22,284,946)
Increase/(decrease) in accounts payable and accrued charges	<u>2,141,826</u>	<u>(598,655)</u>
<b>Net cash inflow/(outflow) from operating activities</b>	<u>1,191,121</u>	<u>(885,488)</u>
<b>Analysis of changes in financing:</b>		
	<u>Recoveries</u>	<u>Compensation Paid</u>
	\$	\$
Balance at 1 April 2000	3,530,920	(438,328,748)
Cash inflow/(outflow) from financing	<u>4,139,246</u>	<u>(60,704,249)</u>
Balance at 31 December 2000	<u>7,670,166</u>	<u>(499,032,997)</u>
Balance at 1 April 2001	9,853,688	(501,974,584)
Cash inflow/(outflow) from financing	<u>12,183</u>	<u>(11,998,319)</u>
Balance at 31 December 2001	<u>9,865,871</u>	<u>(513,972,903)</u>
<b>Analysis of the balance of cash and cash equivalents:</b>		
	Unaudited At 31 Dec 2001	Unaudited At 31 Dec 2000
	\$	\$
Cash at bank	99,008	36,757
Bank fixed and call deposits	<u>112,868,014</u>	<u>95,132,769</u>
	<u>112,967,022</u>	<u>95,169,526</u>



**Unified Exchange Compensation Fund**  
**Notes to the Condensed Financial Statements**  
**For the nine months ended 31 December 2001**  
*(Expressed in Hong Kong dollars)*

**1. ACCOUNTING POLICIES**

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

The interim financial report is unaudited and the financial information relating to the financial year ended 31 March 2001 included in this report does not constitute the Fund's statutory accounts for that financial year but is derived from those accounts.

We have applied the same accounting policies adopted in the financial statements for the year ended 31 March 2001 to the interim financial report.

**2. COMPENSATION PAID**

	\$
Compensation paid up to the \$8 million limit as set out in Section 109(3) of the Securities Ordinance	
Balance as at 1 April 2000	68,815,176
Add: compensation paid during the year ended 31 March 2001	3,766,744
	<hr/>
Balance as at 31 March 2001	72,581,920
Add: compensation paid during the nine months ended 31 December 2001	8,000,000
	<hr/>
Balance as at 31 December 2001	<u>80,581,920</u>
Compensation paid in excess of the \$8 million limit pursuant to Section 113(5A) of the Securities Ordinance	
Balance as at 1 April 2000	369,513,572
Add: compensation paid during the year ended 31 March 2001	59,879,092
	<hr/>
Balance as at 31 March 2001	429,392,664
Add: compensation paid during the nine months ended 31 December 2001	3,998,319
	<hr/>
Balance as at 31 December 2001	<u>433,390,983</u>



**Unified Exchange Compensation Fund**  
**Notes to the Condensed Financial Statements**  
**For the nine months ended 31 December 2001**  
*(Expressed in Hong Kong dollars)*

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

Total compensation paid as at 31 March 2001 \$501,974,584

Total compensation paid as at 31 December 2001 \$513,972,903

In five 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 nine months ended 31 December 2001 were:

C.A. Pacific Securities Ltd.	\$1,713,036
Chark Fung Securities Co. Ltd.	\$1,641,656
Win Successful Securities Ltd.	\$8,643,627

**3. PROVISION FOR COMPENSATION**

	\$
Provision for compensation to be paid up to the \$8 million limit	
Balance as at 1 April 2000	26,658,386
Less: amount paid during the year ended 31 March 2001	(3,766,744)
unused provision reversed during the year	
ended 31 March 2001	(12,011,380)
Balance as at 31 March 2001	<u>10,880,262</u>
Add: additional provision made during the nine months	
ended 31 December 2001	9,624,124
Less: amount paid during the nine months ended 31 December 2001	(8,000,000)
Balance as at 31 December 2001	<u><u>12,504,386</u></u>



**Unified Exchange Compensation Fund**  
**Notes to the Condensed Financial Statements**  
**For the nine months ended 31 December 2001**  
**(Expressed in Hong Kong dollars)**

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

	\$
Provision for compensation to be paid in excess of the \$8 million limit	
Balance as at 1 April 2000	151,291,614
Less: amount paid during the year ended 31 March 2001	(59,879,092)
Add: additional provision made during the year ended 31 March 2001	20,987,247
	<hr/>
Balance as at 31 March 2001	112,399,769
Less: amount paid during the nine months ended 31 December 2001	(3,998,319)
unused provision reversed during the nine months ended 31 December 2001	(61,974,512)
	<hr/>
Balance as at 31 December 2001	<u>46,426,938</u>

We made provision for unprocessed claims in respect of six 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 five of these default cases including Ying Kit Stock Company ("Ying Kit") exceed the normal \$8 million limit. However, the compensation in excess of the \$8 million limit for claims in respect of Ying Kit was subject to the approval of the SEHK and the SFC. Furthermore, in respect of three of these default cases, we revised the provision according to claims being processed. During the period, we also reversed provision for claim against two formerly reported default cases, which had been rejected by the SEHK.

**4. TRANSACTION LEVY**

With effect from 1 September 2001, the Fund would receive transaction levy at 0.002% chargeable for every leviable transaction in the SEHK. During the nine months ended 31 December 2001, the Fund recognised \$22,993,221 transaction levy (nine months ended 31 December 2000: Nil).

**5. CONTINGENT LIABILITIES**

As at the date of this report, the SEHK has received claims against ten 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 \$80 million (As at 31 March 2001: \$96 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 nine-month period ended 31 December 2001.

### 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 23 to 27.

### 3. MEMBERS OF THE COMMITTEE

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

Mr. Mark Dickens

Mrs. Alexa Lam (appointed on 1 December 2001)

Mr. Andrew Procter (resigned on 30 November 2001)

Mr. William D. Grossman

Mr. Mark Ho

Hon. Bernard Chan (appointed on 1 April 2001 and resigned on 18 November 2001)

Mr. Brian Stevenson (appointed on 19 November 2001)

### 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 nine months.

On behalf of the Committee

Mark Dickens  
Chairman

1 February 2002





## Commodity Exchange Compensation Fund

### Income and Expenditure Account

For the nine months ended 31 December 2001

(Expressed in Hong Kong dollars)

	Unaudited Three Months Ended		Unaudited Nine Months Ended	
	<u>31 Dec 2001</u>	<u>31 Dec 2000</u>	<u>31 Dec 2001</u>	<u>31 Dec 2000</u>
	\$	\$	\$	\$
<b>Income</b>				
Investment Income	1,155,522	1,729,024	4,382,962	5,000,252
	-----	-----	-----	-----
<b>Expenses</b>				
Auditors' remuneration	10,350	9,720	31,050	29,160
Bank charges	28,245	11,657	54,012	29,369
Professional fees	4,219	3,000	32,656	9,000
Sundry expenses	-	-	900	600
	-----	-----	-----	-----
	42,814	24,377	118,618	68,129
	-----	-----	-----	-----
<b>Surplus</b>	1,112,708	1,704,647	4,264,344	4,932,123
<b>Accumulated surplus brought forward</b>	38,747,442	32,226,422	35,595,806	28,998,946
	-----	-----	-----	-----
<b>Accumulated surplus carried forward</b>	<u>39,860,150</u>	<u>33,931,069</u>	<u>39,860,150</u>	<u>33,931,069</u>

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



## Commodity Exchange Compensation Fund

### Balance Sheet

At 31 December 2001

(Expressed in Hong Kong dollars)

	Note	Unaudited At 31 Dec 2001 \$	Audited At 31 Mar 2001 \$
<b>Non-current assets</b>			
Held-to-maturity debt securities		73,173,312	43,070,728
		-----	-----
<b>Current assets</b>			
Held-to-maturity debt securities		26,359,141	39,505,457
Interest receivable		804,543	881,261
Levy receivable		431,843	592,856
Bank fixed and call deposits		11,384,551	19,141,475
Cash at bank		24,345	7,710
		-----	-----
		39,004,423	60,128,759
<b>Current liabilities</b>			
Accounts payable and accrued charges		242,796	252,672
		-----	-----
<b>Net current assets</b>		38,761,627	59,876,087
		-----	-----
<b>Net assets</b>		111,934,939	102,946,815
		=====	=====
Representing:			
<b><u>Compensation fund</u></b>			
Contributions from the HKFE	2	21,500,000	21,300,000
Contract levy	3	62,208,428	57,684,648
Accumulated Surplus		39,860,150	35,595,806
		-----	-----
		123,568,578	114,580,454
Deduct: Compensation paid		(24,457,172)	(24,457,172)
Add: Recoveries		12,823,533	12,823,533
		-----	-----
		111,934,939	102,946,815
		=====	=====

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



## Commodity Exchange Compensation Fund

### Statement of Recognised Gains and Losses

For the nine months ended 31 December 2001

(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited Nine Months Ended <u>31 Dec 2001</u> \$	Unaudited Nine Months Ended <u>31 Dec 2000</u> \$
Net contributions from / (refund to) HKFE		200,000	(500,000)
Contract levy	3	4,523,780	3,817,631
<b>Net gains not recognised in the income and expenditure account</b>		<u>4,723,780</u>	<u>3,317,631</u>
Surplus		<u>4,264,344</u>	<u>4,932,123</u>
<b>Total recognised gains</b>		<u><u>8,988,124</u></u>	<u><u>8,249,754</u></u>

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



## Commodity Exchange Compensation Fund

### Cash Flow Statement

For the nine months ended 31 December 2001

(Expressed in Hong Kong dollars)

	Unaudited Nine Months Ended 31 Dec 2001 \$	Unaudited Nine Months Ended 31 Dec 2000 \$
<b>Net cash outflow from operating activities</b>	(128,494)	(88,213)
<b>Returns on investments</b> - interest received	4,754,182	5,257,182
<b>Investing activities</b>		
Held-to-maturity debt securities redeemed	39,500,000	5,500,000
Held-to-maturity debt securities sold	-	8,029,240
Held-to-maturity debt securities bought	(56,750,770)	(18,053,200)
<b>Net cash outflow from investing activities</b>	(17,250,770)	(4,523,960)
<b>Financing</b>		
Net contribution received from / (refunded to) HKFE	200,000	(500,000)
Contract levy received	4,684,793	3,855,212
<b>Net cash inflow from financing</b>	4,884,793	3,355,212
(Decrease) / Increase in cash and cash equivalents	(7,740,289)	4,000,221
Cash and cash equivalents at beginning of the nine months	19,149,185	12,290,428
<b>Cash and cash equivalents at end of the nine months</b>	<u>11,408,896</u>	<u>16,290,649</u>
<b>Reconciliation of surplus for the nine-month period to net cash outflow from operating activities:</b>		
Surplus	4,264,344	4,932,123
Investment income	(4,382,962)	(5,000,252)
Decrease in accounts payable and accrued charges	(9,876)	(20,084)
<b>Net cash outflow from operating activities</b>	<u>(128,494)</u>	<u>(88,213)</u>
<b>Analysis of the balance of cash and cash equivalents:</b>		
	Unaudited At 31 Dec 2001 \$	Unaudited At 31 Dec 2000 \$
Cash at bank	24,345	4,834
Bank fixed and call deposits	11,384,551	16,285,815
	<u>11,408,896</u>	<u>16,290,649</u>



## Commodity Exchange Compensation Fund

### Notes to the Condensed Financial Statements

For the nine months ended 31 December 2001

(Expressed in Hong Kong dollars)

#### 1. ACCOUNTING POLICIES

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

The interim financial report is unaudited and the financial information relating to the financial year ended 31 March 2001 included in this report does not constitute the Fund's statutory accounts for that financial year but is derived from those accounts.

We have applied the same accounting policies adopted in the financial statements for the year ended 31 March 2001 to the interim financial report.

#### 2. CONTRIBUTIONS FROM HKFE

	\$
Balance as at 1 April 2000	21,800,000
Add: Contribution received during the year ended 31 March 2001	200,000
Deduct: Refunds to outgoing shareholders during the year ended 31 March 2001	(700,000)
Balance as at 31 March 2001	<u>21,300,000</u>
Add: Contributions received during the nine months ended 31 December 2001	600,000
Deduct: Refunds to outgoing shareholders during the nine months ended 31 December 2001	(400,000)
Balance as at 31 December 2001	<u><u>21,500,000</u></u>

#### 3. CONTRACT LEVY

During the nine months ended 31 December 2001, the Fund recognised \$4,523,780 contract levy (nine months ended 31 December 2000: \$3,817,631).