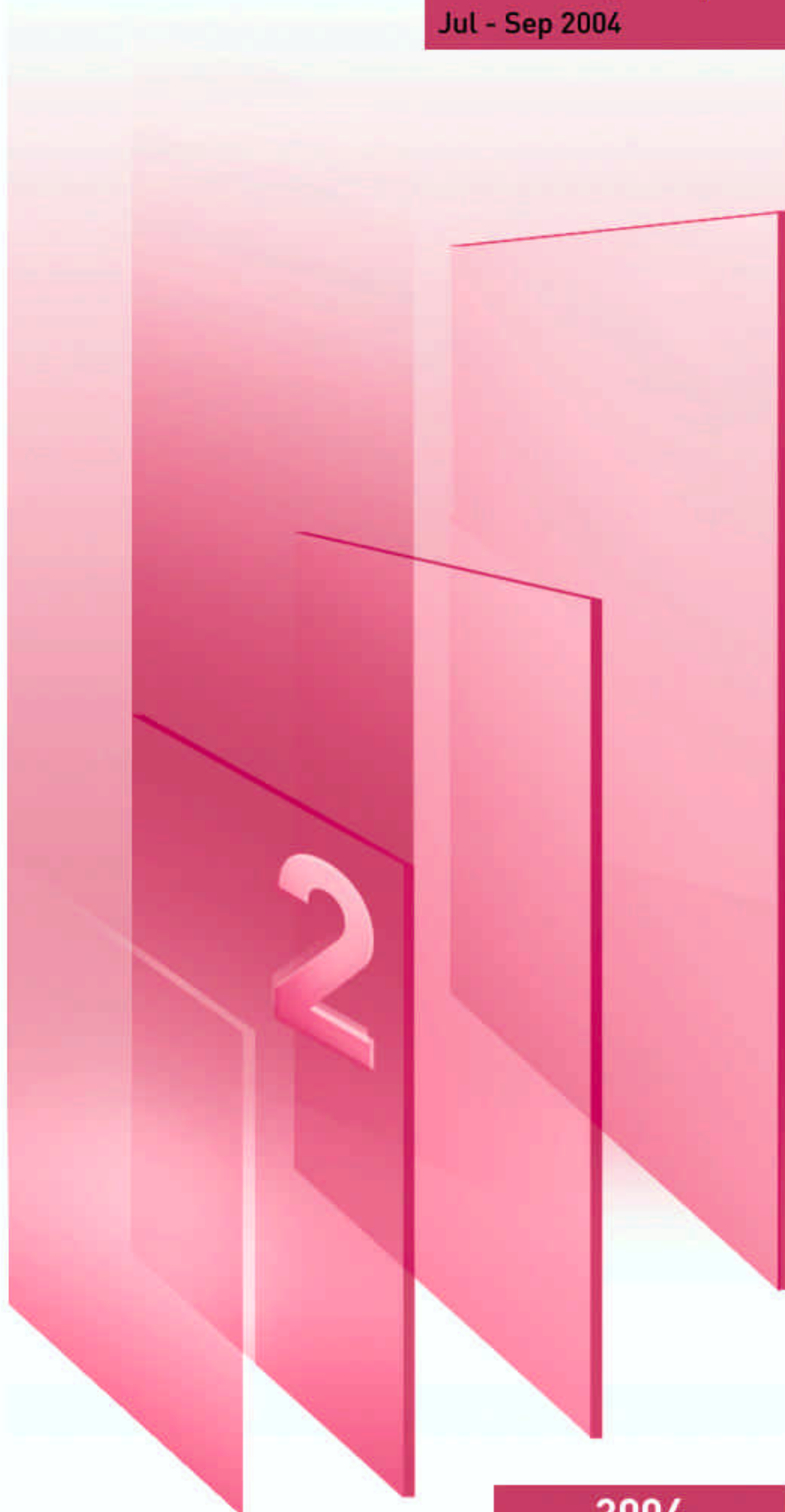




SECURITIES AND  
FUTURES COMMISSION  
證券及期貨事務監察委員會

# Quarterly Report

Jul - Sep 2004



2004

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*This is the Securities and Futures Commission's second Quarterly Report for the financial year from 1 April 2004 to 31 March 2005. The report aims to enhance the transparency and accountability of the Commission.*

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# Operations Highlights

1 July to 30 September 2004

## Financial Position

1. The SFC recorded a \$33.1 million surplus in the quarter. The accumulated surplus for the first six months of the financial year was \$77.3 million, compared with a budgeted surplus of \$1.3 million. On 30 September, reserves stood at \$768.3 million.
2. Total revenue for the six months was \$280.2 million, 27% higher than that in the same period last year due to increased market turnover and activities. Total expenditure (including depreciation) was \$202.9 million, almost the same as last year's.

## Regulatory Developments

3. We are preparing a consultation paper on the overall review of the disclosure of interests regime under Part XV of the Securities and Futures Ordinance.
4. We released a consultation paper on proposed measures to strengthen the regulatory framework for brokerage firms involved in securities margin financing.
5. The SFC and HKEx released the consultation conclusions on the regulation of sponsors and independent financial advisers (IFAs). HKEx has amended the Listing Rules concerning the conduct of sponsors/IFAs; the SFC will consult the market on their eligibility requirements.
6. We have published new guidelines to address analyst conflicts of interest.
7. We published the findings of a Review of the Financial Performance of Category C Stock Exchange Participants since 2001, which showed the overall profitability of smaller brokers had improved significantly.
8. CEPA II was announced. SFC licensees who satisfy the CSRC requirements would be allowed to set up joint venture futures brokerages in the Mainland. The SFC is working with the Mainland authorities on the details.
9. The Taskforce on Overseas Real Estate Investments by REITs had submitted its research findings and recommendations. The SFC is drafting guidelines to regulate overseas property investments by SFC-authorized REITs.
10. We consulted on the proposed repeal of certain class exemptions made under the Companies Ordinance to clarify the legislative framework.
11. The SFC approved HKEx rule amendments to enable the introduction of new features to its Investor Participant (IP) account service.



### Supervisory and Enforcement Actions

12. During the quarter, the SFC had 23 successful prosecutions and disciplined 21 licensees for various regulatory breaches.
13. A listed company and its director were convicted of providing false or misleading information, in the first prosecution under Dual Filing.
14. We settled disciplinary proceedings against an investment adviser by severely reprimanding it. The firm offered ex-gratia payments of \$256 million to over 1,000 investors.
15. We published *Disciplinary Proceedings at a Glance* to explain the SFC's disciplinary process and the procedural rights of persons who are subject to disciplinary proceedings.

### Others

16. We partnered with RTHK and The Salvation Army to tailor-make an investor education radio programme for senior citizens. We worked with Lingnan University to offer a credit-based course on foundations of investing.
17. Mr Ashley Alder has left the Commission at the end of his term as Executive Director of Corporate Finance. His work will be taken over by COO, Mr Peter Au-Yang, for the time being. Mr Alan Linning has been re-appointed Executive Director of Enforcement.



## Review of Operations

1 July to 30 September 2004

This is the Securities and Futures Commission's second Quarterly Report for the financial year starting 1 April 2004.

During the quarter from July to September, interest rate in the US was raised twice by a total of 50 basis points. In addition, investors worldwide were concerned that high oil prices might worsen inflation and slow down economic growth. The Dow, Nasdaq and S&P dropped 3.4%, 7.4% and 2.3% respectively. The performance of the European markets was mixed, with DAX and CAC losing 3.9% and 2.5% respectively and FTSE gaining 2.4%. Nikkei tumbled 8.7% on poor economic data and rising oil prices.

On the other hand, the Hong Kong market shrugged off high oil prices and rising lending rates. This was attributable to the positive reports on inflation and economic growth and better-than-expected corporate results. The HSI closed at 13,120 on 30 September, up 6.8% from the previous quarter. The H-shares and red chips indices also advanced 8.4% and 5.2% respectively.

Despite the index rises, turnover decreased. The average daily turnover on the Main Board dropped 11% from the previous quarter to \$12.2 billion. The average daily turnover of HSI constituent stocks fell 13% to \$5.2 billion, accounting for 42% of the total turnover. The average daily turnover of H-shares dropped 16% to \$3 billion and that of red chips fell 18% to \$1.8 billion.

The average daily turnover on GEM was \$48 million, representing a 31% decrease from the previous quarter. The S&P/HKEx GEM index fell 9% to close at 982 at quarter end.

IPO activities cooled off during the quarter, with seven IPOs on the Main Board and five on GEM. The total amount of funds raised through IPOs was \$2.9 billion, about one-fifth of which was for Mainland enterprises.


### Financial Highlights<sup>1</sup>

Total revenue for July-September amounted to \$135 million, 7% lower than last quarter's \$145.1 million. This was mainly due to a drop in the average daily stock market turnover from \$14.9 billion in April-June to \$13.3 billion<sup>2</sup>, hence reducing the levy income. Total expenditure (including depreciation) increased 1% to \$101.9 million, from \$101 million in the last quarter. As a result, the SFC recorded a surplus of \$33.1 million for the quarter, 25% lower than the \$44.2 million surplus in April-June.

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<sup>1</sup> We have consolidated the financial results of Investor Compensation Company Limited in this financial report.

<sup>2</sup> For income purpose, the turnover figure includes the amount of new fund raisings, which also attract transaction levy.



By the end of September, total revenue for the first six months of the financial year was \$280.2 million, 27% higher than the \$220.3 million in the same period last year. Of which, levy income rose 34% to \$186.8 million because the average daily stock market turnover increased to \$14.1 billion from \$10.5 billion last year. Fees and charges income also rose 14% to \$78 million due to increased market activities.

Total expenditure (including depreciation) for the six months was \$202.9 million, comparable to the \$203.3 million last year. We continued to exercise stringent cost control and managed to keep total operating expenditure at 9% below the approved budget of \$221.7 million.

The accumulated surplus for the six months was \$77.3 million, which compared favourably to the half-year budgeted surplus of \$1.3 million. The operating results were better than expected largely because levy and fees income had exceeded the original estimates. We also under-spent in all expenditure categories except premises. The premises expenditure was higher due to the leasing of additional office space on the 5th floor of Chater House since July 2004.

At the end of September, our reserves stood at \$768.3 million, equivalent to 1.7 times the approved annual operating expenditure (including depreciation) of \$443.4 million.

The total number of staff at the end of September was 421, comprising 379 regular staff and 42 temporary staff. Increase of staff from last quarter's 412 was largely due to a manager trainee programme which started in the quarter.

Meanwhile, as at the end of the quarter, the net asset value of the Investor Compensation Fund (ICF) totalled about \$1.4 billion, assuming the assets of the Unified Exchange Compensation Fund and Commodity Exchange Compensation Fund would be ultimately transferred to the ICF.

### **The Securities and Futures Ordinance (SFO)**

Maintenance of the SFO continued during the quarter.

We are preparing a consultation paper on the overall review of the disclosure of interests regime under Part XV, which will be released shortly. The paper sets out our proposals to address issues identified and consults on certain other matters, including how to make filings easier, the issue of share pledges, the *de minimis* exception, and changes in nature of interests. After the consultation, we will study the responses before formulating the proposed legislative changes intended for inclusion in the consultation on the Securities and Futures (Amendments) Bill 2005 proposed by the Financial Services and the Treasury Bureau.

Migration to the new licensing regime by intermediaries progressed smoothly. For the first 18 months of the two-year transitional period ending 31 March 2005, about 78% of all those migrating had either migrated or lodged their applications. This was up from 70% as at the end of the previous quarter. Around 3,700 licensees have yet to submit their applications under the new regime.



## Improving Market Quality

Following the theft of some IPO refund cheques in early 2004, the SFC studied with the Hong Kong Association of Banks, the Hong Kong Monetary Authority and the Federation of Share Registrars ways to improve security. In July, we announced that IPO refund cheques would be printed with part of the applicants' identity card numbers to assist banks in verifying the identity of IPO applicants who deposited the refund cheques. The SFC and the other parties will continue to work towards a fully electronic refund process in the long term.

In September, the SFC released a consultation paper on proposed measures to strengthen the regulatory framework for brokerage firms involved in securities margin financing (SMF). To reduce the risks arising from excessive pooling and re-pledging of margin clients' collateral and aggressive lending by SMF providers, we proposed to introduce a per-firm re-pledging limit and to adjust the haircut percentages under the Financial Resources Rules. Supplementary measures were also proposed. The consultation closed in October and we are analysing the responses. We aim to publish the consultation conclusions and finalise the draft rules by early 2005, with a view to implementing the new regime once the draft rules have been negatively vetted by the LegCo, subject however to a transitional period.

In October, the SFC and HKEx released a joint conclusion report on the Consultation Paper on the Regulation of Sponsors and Independent Financial Advisers (IFAs). HKEx has amended the Listing Rules concerning the conduct of sponsors and IFAs, in particular the sponsors' role in advising listed companies and listing applicants and in conducting due diligence. The amendments will become effective in January 2005. Separately, the SFC will consult the market in 2005 on specific eligibility requirements of sponsors and IFAs.

In November, we published the consultation conclusions on proposed measures to address analyst conflicts of interest and the final guidelines, having regard to comments made by the industry. The market in general supports the issuance of clearer and specific guidelines by the SFC to address the analyst conflicts of interest issue and we aim to implement the guidelines in the second quarter of 2005.

## Partnership with the Industry

The number of intermediaries steadily increased from 21,184 as at 30 June to 21,913 as at 30 September amid market recovery.

In August, we published the findings of a Review of the Financial Performance of Category C Stock Exchange Participants since 2001. The overall profitability of these smaller brokers had improved significantly and their aggregate operating profit in the 18 months ended 30 June 2004 had more than covered the aggregate operating losses in 2001 and 2002. Employment by Category C brokers of licensed representatives and staff salary also remained steady over the 12 months ended 30 June 2004.

Also in August, the Administration and the Central People's Government reached an agreement to provide further liberalisation on trades in goods and services under the second phase of the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA II). Under CEPA II, the Mainland has agreed to allow SFC licensees who satisfy the requirements of the China Securities Regulatory Commission (CSRC) to set up joint venture futures brokerage companies in the Mainland. We are working with the Mainland authorities on the details.

A theme inspection of investment advisers that market financial products to the public was almost completed. The exercise examined conduct issues of Hong Kong's financial advisory services sector. We aim to release a report shortly to heighten awareness of the major issues identified and make recommendations.

#### Statistical Information and Financial Position of the Securities Industry (Note 1)

	As at 30 Sep 2004	As at 30 Sep 2003
Total number of securities dealers and securities margin financiers (SMFs)	658	655
Total number of active cash clients (Note 2)	599,763	605,944
Total number of active margin clients (Note 2)	70,335	66,175
<b>Balance Sheet</b>	<b>(\$ Million)</b>	<b>(\$ Million)</b>
Cash in hand and at bank (Notes 3 & 4)	97,864	69,831
Amounts receivable from margin clients (Note 5)	15,775	12,801
Amounts receivable from clients and other dealers arising from dealing in securities (Note 3)	83,372	54,723
Other assets (Note 3)	111,328	40,615
<b>Total assets</b>	<b>308,339</b>	<b>177,970</b>
Amounts payable to clients and other dealers arising from dealing in securities (Note 3)	134,014	90,497
Total borrowings from financial institutions (Note 3)	39,421	6,616
Other liabilities (Note 3)	60,205	26,677
Total shareholders' fund (Notes 3 & 6)	74,699	54,180
<b>Total liabilities and shareholders' fund</b>	<b>308,339</b>	<b>177,970</b>

Note 1: The data were extracted from the monthly Financial Returns (FR) submitted in accordance with the Securities and Futures (Financial Resources) Rules by securities dealers and securities margin financiers. These figures are subject to amendments made by the licensed corporations.

Note 2: Active clients are clients for whom the licensed corporation is required to prepare and deliver monthly statement of accounts in respect of the relevant reporting month in accordance with Securities and Futures (Contracts Notes, Statements of Account and Receipts) Rules.

Note 3: Increases in these items were mainly due to the inclusion of the financial figures of licensed corporations that were exempt dealers before 1 April 2003 and hence were not required to file FR. Such corporations were required to file FR commencing from 1 October 2003 after the expiry of a six-month grace period.

Note 4: Cash in hand and at bank includes trust monies held on behalf of clients amounting to \$42,153 million (30 Sep 2003: \$33,725 million).

Note 5: Average collateral coverage (the number of times the aggregate market value of securities collateral deposited by clients covers the amounts receivable from margin clients on a given date on an industry-wide basis):

<u>As at 30 Sep 2004</u>	<u>As at 30 Sep 2003</u>
4.2	4.1

Note 6: The value of shareholders' fund includes value of redeemable shares.





## Facilitating Market Development

The market for investment-linked assurance products and equity-linked deposits continued to expand during the quarter. This will likely continue as banks are focusing more on their wealth management business.


The number of authorised hedge funds has been increasing steadily. By the end of September, the SFC had authorised 13 retail hedge funds with assets under management of US\$1.13 billion. We would use that experience to review the Guidelines on Hedge Funds within this financial year. The review aims to strengthen the disclosure standards and provide more flexibility in administering the Guidelines, such as accepting a wider range of experience as qualifying experience in respect of management companies of retail hedge funds. The SFC will discuss with market groups and take into account suggestions from the industry before issuing a consultation paper.

We have also announced the formation of a focus team to handle licence applications of hedge fund managers and deal with their enquiries. A designated enquiry e-mail ([hedgefund@sfc.hk](mailto:hedgefund@sfc.hk)) has been set up. This arrangement provides interested market practitioners with a centralised contact point and helps expedite the application process.

On Real Estate Investment Trusts (REITs), the Taskforce on Overseas Real Estate Investments by REITs had submitted its research findings and recommendations on how to set benchmarks for overseas investments. Based on these, the SFC is drafting a set of guidelines to regulate overseas property investments by SFC-authorised REITs. The proposed guidelines will be presented to members of the Taskforce for comments, prior to public consultation.

Number of SFC Authorised Collective Investment Schemes			
	30 Sep 2004	30 Jun 2004	30 Sep 2003
Unit Trusts and Mutual Funds	1,926	1,927	1,947
Investment-Linked Assurance Schemes	171	165	138
Pooled Retirement Funds	38	37	37
MPF Master Trust / Industry Schemes	45	46	46
MPF Pooled Investment Funds (Note1)	253	255	252
Other Schemes (Note 2)	57	47	36
<b>Total</b>	<b>2,490</b>	<b>2,477</b>	<b>2,456</b>
Note 1:	There are 108 funds included in this category that are offered both as retail unit trusts as well as pooled investment funds for MPF purpose.		
Note 2:	The schemes included equity-linked deposits.		

During the quarter, a UK company providing trading facilities for fixed income products was authorised to provide Automated Trading Services (ATS) in Hong Kong. As of 30 September, there were seven authorised ATS providers and the SFC was considering two applications, one from an overseas company and one from a local firm.



In August, the SFC consulted the public on the proposed repeal of certain class exemptions made under the Companies Ordinance as they would become redundant upon commencement of the newly enacted Companies (Amendment) Ordinance 2004 (expected to be in December). A consultation conclusion report would be published shortly.

Following SFC approval of HKEx rule amendments in July, HKEx in August introduced new features to its Investor Participant (IP) account service, including improved communication channels, enhanced system access and simplified procedures for stock transfer. Investors will find it more convenient to use the IP accounts.

Also in August, HKEx consulted the market on its proposal to narrow the trading spreads in two phases, aiming to lower transaction costs and encourage trading interest. In Phase 1, HKEx would reduce the trading spreads of stocks priced over \$30. Subject to the response to Phase 1, HKEx would implement Phase 2 by either reducing the spreads of stocks between \$2 and \$20 or stocks between 25 cents and \$20. The SFC would follow up with HKEx on the results of the consultation, which ended in October.

### **Supervisory and Enforcement Actions**

During the quarter, the SFC successfully prosecuted 23 people and companies - for short selling, market manipulation, breaches of disclosure law, unlicensed investment advising, making unsolicited calls inducing others to trade futures contracts, providing false or misleading information and failing to assist SFC investigations. Summonses were withdrawn against one person and two companies. One person was acquitted after trial.

In one of the successful prosecutions, a listed company and its director were convicted of providing false or misleading information, in the first prosecution under Dual Filing (which came into effect with the SFO). We will enhance the Dual Filing regime through statutory backing to important listing rules, as announced by the Government in March.

During the quarter, we disciplined 21 licensees for a variety of misconduct.

- There were six suspensions (for seven to 15 weeks) and eight reprimands. A licensed corporation was fined in addition to receiving a reprimand.
- We settled disciplinary proceedings against a licensed investment adviser corporation, which had arisen from alleged failings relating to two unauthorised hedge funds, by severely reprimanding it. As a result of SFC negotiations, the corporation offered ex-gratia payments of about \$256 million to over 1,000 investors of the two funds without admission of liability.
- Separately, the SFC settled disciplinary proceeding with a licensed representative, who had been convicted of hawking of futures contracts, with a \$195,000 payment to the SFC in lieu of a six-month suspension.



- In August, the Securities and Futures Appeals Tribunal (SFAT) upheld the SFC's decision to suspend the licence of a former research analyst for frontrunning his research reports. However, it allowed two appeals by licensees, resulting in the reduction of penalty to a one-month suspension and a \$50,000 fine each for a licensed corporation and its responsible officer, and to a reprimand of a responsible officer of another investment adviser.

We also took disciplinary actions against three licensees, which were eventually concluded with no formal sanction imposed.

Following the settlement cases, we explained in August our settlement policy through Dr Wise's Column, an educational column on our website. We reiterated that we would take into account the public interest first and foremost in considering settlements. An offer of monetary payment, however large, would only be acceptable in certain circumstances.

To strengthen communication with the industry and increase the transparency of our enforcement work, we published in September a pamphlet called *Disciplinary Proceedings at a Glance*. Written in plain language, the pamphlet explains the SFC's disciplinary process and the procedural rights of persons who are subject to disciplinary proceedings. We will continue to explain more about the SFC's enforcement work through various channels.

In view of an increase in illegal cold calling of the public, the SFC reminded licensees and registrants that cold calling was illegal and they should have internal control measures in place to prevent their staff from doing so.

During the quarter, we received 33 complaints in relation to boiler room operations. Liaison work with other domestic and overseas enforcement bodies in this regard has continued.

<b>Statistics of Enforcement Actions</b>			
	<b>Jul - Sep 2004</b>	<b>Apr - Jun 2004</b>	<b>Jul - Sep 2003</b>
Successful prosecutions	23	18	20
SFC licensees disciplined	21	15	25
Warning letters issued (Note 1)	63	80	35
Cases under investigation (Notes 2, 3 and 4)	538	519	992
Disciplinary inquiries in progress (Note 3)	105	105	83
Note 1:	The increase from a year ago was mainly related to late submission cases under the disclosure of interests requirements of the SFO.		
Note 2:	Some cases are ongoing investigations from the previous quarter.		
Note 3:	Number of cases as at end of quarters		
Note 4:	The drop from a year ago was due to the conclusion of many late submission cases under the disclosure of interests requirements of the SFO.		



## Strengthening Communication with Investors and Other Stakeholders

For the first time, the SFC joined hands with the Radio Television Hong Kong and The Salvation Army to tailor-make an investor education radio programme for senior citizens. Entitled "Invest Wisely for Seniors", the 12-episode broadcast started in September. It covers a wide range of issues that senior citizens should pay attention to when investing.

Also for the first time, the SFC partnered with Lingnan University to offer a credit-based course on foundations of investing for undergraduates beginning October. "The Craft of Financial Investing" aims to help students acquire fundamental knowledge of market infrastructure and investment risks, and develop a proper attitude towards financial management.

In addition to explaining the SFC's settlement policy, the monthly Dr Wise's Column talked about the common pitfalls of derivative warrants and the enhanced features of IP account service.

During the quarter, we presented another batch of Smart Investor Awards to five winners who reported boiler rooms frauds and internet scams which use emails to entice recipients to disclose their personal financial data (phishing scams). As of 30 September, there were 194 entities of boiler rooms, fake websites and phishing scams on our Alert List.

We published educational materials covering topics like with-profits funds and exotic warrants in view of the increasing number of complaints received on these products. We also explained the drawbacks of nominee arrangements in fund investments.

Statistics of Investor Enquiries and Public Complaints			
	Jul - Sep 2004	Apr - Jun 2004	Jul - Sep 2003
Enquiries (Note 1)	919	1,276	1,376
Complaints	299	342	292

Note 1: The number of enquiries was exceptionally high a year ago because of enquiries made by clients of C.A. Pacific Securities Limited in relation to the allocation of shares in the winding up of the company. The suspected client asset misappropriation case concerning Charles Schmitt & Associates Limited in the last quarter also led to an increase in enquiries.

We continued to publish our bi-monthly newsletter *SFC Alert*, the monthly *SFC Enforcement Reporter*, and the Summer issue of *Quarterly Bulletin* to keep the market informed of our work and enforcement actions. All these publications are available on the SFC website.



## International Co-operation and External Relations

In early October, the Chairmen's Task Force of the Technical Committee of the International Organization of Securities Commissions (IOSCO) published a Consultation Report on *Code of Conduct Fundamentals for Credit Rating Agencies*. This Report builds on the Statement of Principles Regarding the Activities of Credit Rating Agencies (CRAs) issued by IOSCO in September 2003. It offers more specific and detailed guidance to CRAs on how the objectives of the CRA Principles can be achieved in practice through the development by CRAs of their own code of conduct based on the IOSCO *Code of Conduct Fundamentals*. The consultation closed on 8 November. The SFC actively participates in the Chairmen's Task Force and will continue to be closely involved in the project.

Invited by the US Senate Banking Committee, I testified before the Committee in Washington D.C. in September on the international impact of the Sarbanes-Oxley Act and developments concerning convergence of international securities laws.

On enforcement co-operation, the SFC received 12 requests from overseas regulators: nine sought non-public information and three sought investigatory assistance. Responses were provided to seven requests and we are processing the remaining five. At the same time, we made one request to an overseas regulator for non-public information and investigatory assistance.


To help promote Hong Kong as a financial centre, senior SFC staff met with Mainland media organisations during the quarter. Our Chief Operating Officer was interviewed by a delegation of Shanghai TV and publications in September. They were in Hong Kong to gather stories to coincide with the Trade Development Council's financial services expo in Shanghai, which the SFC sponsored. A Director of Corporate Finance also met several Tianjin journalists to help promote the Tianjin-Hong Kong Week, which was jointly organised by HKSAR Government and Tianjin Municipal Government.

We welcomed and made presentations to two local delegations and six Mainland delegations (four from Shenzhen, Fujian, Tianjin and Hainan, and two from various provinces) from the academic, private and public sectors.

## Looking Ahead

Mr Ashley Alder, who joined the SFC in 2001 as Executive Director of Corporate Finance, has left the Commission at the end of his term. I thank Mr Alder for his significant contributions to the work of the Commission and to improving the quality of the Hong Kong market. Chief Operating Officer, Mr Peter Au-Yang, will double up as Executive Director of Corporate Finance for the time being.

Meanwhile, I warmly welcome the re-appointment of Mr Alan Linning by the Financial Secretary as our Executive Director of Enforcement for two years until October 2006. Mr Linning will continue to lead the enforcement action against corporate misgovernance, market misconduct and serious intermediaries misconduct as our priorities.



While the SFC continues to discharge its responsibilities as a market regulator, we have not forgotten that we are a member of the society. Our volunteers group paid a visit to the Home of Love in Shamshuipo in July, reading books to 40 children. In September, staff visited elderly people in the Eastern District and shared with them moon cakes, fruits and lanterns.

The Hong Kong market has remained active amid economic recovery. Based on current information, and by continuing our tight control on expenditures, we expect to continue to record a surplus in the third quarter.

Andrew Sheng  
Chairman

12 November 2004



# **Independent Review Report**

## **To the Securities and Futures Commission (the SFC)**

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

### **Introduction**

We have been instructed by the SFC to review the interim financial report for the six months ended 30 September 2004 set out on pages 14 to 20. We have not been instructed to review and have not reviewed the financial information for the three months ended 30 September 2004 included on page 14 of the interim financial report.

### **Respective responsibilities of directors and auditors**

The directors are responsible for preparing an interim financial report of the SFC to comply with International Accounting Standard 34 “Interim financial reporting” adopted by the International Accounting Standards Board. The interim financial report is the responsibility of, and has been approved by, the directors.

It is our responsibility to form an independent conclusion, based on our review, on the interim financial report and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

### **Review work performed**

We conducted our review in accordance with Statement of Auditing Standards 700 “Engagements to review interim financial reports” issued by the Hong Kong Institute of Certified Public Accountants. A review consists principally of making enquiries of management and applying analytical procedures to the interim financial report and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the interim financial report.

### **Review conclusion**

On the basis of our review, which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial report for the six months ended 30 September 2004.

KPMG  
Certified Public Accountants  
Hong Kong  
9 November 2004

# Securities and Futures Commission

## Consolidated Income and Expenditure Account

For the six months ended 30 September 2004

(Expressed in Hong Kong dollars)

	Note	Unaudited Three Months Ended		Unaudited Six Months Ended	
		30 Sep 2004	30 Sep 2003	30 Sep 2004	30 Sep 2003
		\$'000	\$'000	\$'000	\$'000
<b>Income</b>					
Levies		90,994	84,592	186,801	139,061
Fees and charges		37,753	35,261	77,983	68,268
Investment income		4,992	5,415	10,156	10,918
Recoveries from the Investor					
Compensation Fund		869	1,171	1,828	1,279
Other income		440	315	3,426	803
		<u>135,048</u>	<u>126,754</u>	<u>280,194</u>	<u>220,329</u>
<b>Expenses</b>					
Staff costs		77,458	78,641	155,639	155,902
Premises					
- rent		5,324	4,467	9,856	9,469
- other		3,336	3,572	6,130	8,652
Other expenses		10,067	8,931	20,820	16,065
		<u>96,185</u>	<u>95,611</u>	<u>192,445</u>	<u>190,088</u>
Depreciation		5,727	6,763	10,455	13,241
		<u>101,912</u>	<u>102,374</u>	<u>202,900</u>	<u>203,329</u>
<b>Surplus</b>	2	<u>33,136</u>	<u>24,380</u>	<u>77,294</u>	<u>17,000</u>

We have not prepared a separate statement of changes in equity as the surplus would be the only component of such a statement.

The notes on pages 18 and 20 form part of the condensed consolidated financial statements.



# Securities and Futures Commission

## Consolidated Balance Sheet

At 30 September 2004

(Expressed in Hong Kong dollars)

	Note	Unaudited At 30 Sep 2004 \$'000	Audited At 31 Mar 2004 \$'000
<b>Non-current assets</b>			
Fixed assets		31,530	34,037
Held-to-maturity debt securities	3	282,636	66,329
<b>Current assets</b>			
Held-to-maturity debt securities	3	471,350	579,802
Bank deposits		64,741	75,781
Debtors, deposits and prepayments		56,647	58,101
Cash at bank and in hand		2,375	2,182
		<u>595,113</u>	<u>715,866</u>
<b>Current liabilities</b>			
Fees received in advance		31,966	34,788
Creditors and accrued charges		34,439	22,198
		<u>66,405</u>	<u>56,986</u>
<b>Net current assets</b>		<u>528,708</u>	<u>658,880</u>
<b>Total assets less current liabilities</b>		842,874	759,246
<b>Non-current liabilities</b>	4	74,556	68,222
<b>Net assets</b>		<u>768,318</u>	<u>691,024</u>
<b>Funding and reserves</b>			
Initial funding by Government		42,840	42,840
Accumulated surplus	2	725,478	648,184
		<u>768,318</u>	<u>691,024</u>

The notes on pages 18 to 20 form part of the condensed consolidated financial statements.

# Securities and Futures Commission

## Balance Sheet

At 30 September 2004

(Expressed in Hong Kong dollars)

	<u>Note</u>	<u>Unaudited</u> <u>At 30 Sep 2004</u> \$'000	<u>Audited</u> <u>At 31 Mar 2004</u> \$'000
<b>Non-current assets</b>			
Fixed assets		31,183	33,597
Held-to-maturity debt securities	3	282,636	66,329
<b>Current assets</b>			
Held-to-maturity debt securities	3	471,350	579,802
Bank deposits		64,741	75,781
Debtors, deposits and prepayments		56,085	57,877
Cash at bank and in hand		1,107	962
		<u>593,283</u>	<u>714,422</u>
<b>Current liabilities</b>			
Fees received in advance		31,966	34,788
Creditors and accrued charges		32,296	20,366
		<u>64,262</u>	<u>55,154</u>
<b>Net current assets</b>		<u>529,021</u>	<u>659,268</u>
<b>Total assets less current liabilities</b>		842,840	759,194
<b>Non-current liabilities</b>	4	74,522	68,170
<b>Net assets</b>		<u>768,318</u>	<u>691,024</u>
<b>Funding and reserves</b>			
<b>Initial funding by Government</b>		42,840	42,840
<b>Accumulated surplus</b>	2	725,478	648,184
		<u>768,318</u>	<u>691,024</u>

The notes on pages 18 to 20 form part of the condensed consolidated financial statements.

## Securities and Futures Commission

Consolidated Cash Flow Statement  
For the six months ended 30 September 2004

(Expressed in Hong Kong dollars)

	Unaudited Six months ended <u>30 Sep 2004</u> \$'000	Unaudited Six months ended <u>30 Sep 2003</u> \$'000
<b>Cash flows from operating activities</b>		
Surplus for the period	77,294	17,000
Adjustments for:		
Depreciation	10,455	13,241
Investment income	(10,156)	(10,918)
Gain on sale of fixed assets	(27)	-
	<u>77,566</u>	<u>19,323</u>
Decrease / (increase) in debtors, deposits and prepayments	5,429	(21,531)
Decrease in creditors and accrued charges	7,973	(220)
Decrease in fees received in advance	(2,822)	(375)
Increase in non-current liabilities	6,334	9,896
	<u>94,480</u>	<u>7,093</u>
<b>Net cash generated from operating activities</b>	-----	-----
<b>Cash flows from investing activities</b>		
Interest received	13,369	13,842
Held-to-maturity debt securities bought	(415,773)	(82,799)
Held-to-maturity debt securities redeemed	300,730	-
Fixed assets bought	(3,696)	(24,220)
Fixed assets sold	43	-
	<u>(105,327)</u>	<u>(93,177)</u>
<b>Net cash used in investing activities</b>	-----	-----
<b>Net decrease in cash and cash equivalents</b>	(10,847)	(86,084)
<b>Cash and cash equivalents at beginning of the six months</b>	<u>77,963</u>	<u>178,792</u>
<b>Cash and cash equivalents at end of the six months</b>	<u>67,116</u>	<u>92,708</u>
<b>Analysis of the balance of cash and cash equivalents :</b>		
	Unaudited <u>At 30 Sep 2004</u> \$'000	Unaudited <u>At 30 Sep 2003</u> \$'000
Bank deposits	64,741	91,477
Cash at bank and in hand	2,375	1,231
	<u>67,116</u>	<u>92,708</u>

# Securities and Futures Commission

## Notes to the Condensed Consolidated Financial Statements

For the six months ended 30 September 2004

(Expressed in Hong Kong dollars)

### 1. Basis of preparation

We have prepared the interim financial report in accordance 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 2004 included in this report does not constitute the SFC's statutory accounts for that financial year but is derived from those financial statements.

We consolidated the financial results of Investor Compensation Company Limited in the SFC's condensed financial statements made up to 30 September 2004. We eliminate all material intragroup balances and transactions in preparing the condensed consolidated financial statements. We have applied the same accounting policies adopted in the consolidated financial statements for the year ended 31 March 2004 to the interim financial report.

There were no significant changes in the operation of the SFC for the six months ended 30 September 2004.

### 2. Accumulated surplus

#### The Group and the SFC

Movements of accumulated surplus during the six months ended 30 September 2004 are as follows :

	\$'000
Balance at 31 March 2004	648,184
Surplus	77,294
	<hr/>
Balance at 30 September 2004	<u>725,478</u>

### 3. Held-to-maturity debt securities

As of 30 September 2004, the total market value of held-to-maturity debt securities amounted to \$757,145,000 (31 March 2004 : \$655,104,000), which was above the total carrying cost of \$753,986,000 (31 March 2004 : \$646,131,000).



## Securities and Futures Commission

Notes to the Condensed Consolidated Financial Statements

For the six months ended 30 September 2004

*(Expressed in Hong Kong dollars)*

### 4. Non-current liabilities

#### The Group and the SFC

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

### 5. Ageing analysis of debtors and creditors

There was no material debtor balance and creditor balance included in "debtors, deposits and prepayments" and "creditors and accrued charges" respectively as at 30 September 2004. Therefore we do not provide an ageing analysis on debtors and creditors.

### 6. Exchange fluctuation

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

### 7. Investments in subsidiaries

The SFC formed FinNet Limited (FinNet) on 6 November 2000 with an authorised share capital of \$10,000 and issued share capital of \$2 and Investor Compensation Company Limited (ICC) on 11 September 2002 with an authorised share capital of \$1,000 and issued share capital of \$0.2. Both FinNet and ICC are incorporated in Hong Kong.

The objective of FinNet is to operate an electronic network to facilitate payment and delivery transactions and interconnection of all financial institutions and financial entities in Hong Kong.

The objective of ICC is to facilitate the administration and management of the Investor Compensation Fund established under the Securities and Futures Ordinance.



## Securities and Futures Commission

Notes to the Condensed Consolidated Financial Statements

For the six months ended 30 September 2004

*(Expressed in Hong Kong dollars)*

### 7. Investments in subsidiaries - Cont'd

Both companies are wholly owned subsidiaries of the SFC. As at 30 September 2004, the investment in subsidiaries, which is stated at cost less any impairment losses, amounted to \$2.2. The balance was too small to appear on the balance sheet which was expressed in thousands of dollars.

FinNet has not commenced operations. The balance sheet of FinNet as at 30 September 2004 and the income and expenditure account for the period then ended were immaterial. Therefore, we have not accounted for its result in the condensed consolidated financial statements.

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

### 8. Related party transactions

We have related party relationships with the Unified Exchange Compensation Fund, the Commodity Exchange Compensation Fund, the Investor Compensation Fund, the Securities Ordinance (Chapter 333) - Dealers' Deposits Fund, the Commodities Trading Ordinance (Chapter 250) - Dealers' Deposits Fund and the Securities Ordinance (Chapter 333) - Securities Margin Financiers' Security Fund. During the period, we received reimbursement from the ICF for all the ICC's expenses, which is in accordance with section 242(1) of the SFO.



# Investor Compensation Fund (the Fund)

## Report of the Investor Compensation Fund Committee (the Committee)

The members of the Committee present their quarterly report and the unaudited condensed financial statements for the six months ended 30 September 2004.

### 1. ESTABLISHMENT OF THE FUND

Part XII of the Securities and Futures Ordinance (Chapter 571) established the Fund on 1 April 2003.

### 2. FINANCIAL RESULTS

The Committee presents the financial results which are set out in the condensed financial statements on pages 23 to 27.

### 3. MEMBERS OF THE COMMITTEE

The members of the Committee during the six months ended 30 September 2004 and up to the date of this report were:-

Mr. Mark Dickens, JP	
Mr. Paul Chow Man Yiu, JP	[resigned on 20 September 2004]
Mr. Gerald Greiner	[appointed on 20 September 2004]
Mrs. Alexa Lam	
Ms. Anna H. Y. Wu, SBS, JP	


### 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 six months.

On behalf of the Committee

Mark Dickens, JP  
Chairman

9 November 2004



# Independent review report to the board of directors of the Securities and Futures Commission (the SFC)

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

## Introduction

We have been instructed by the SFC to review the interim financial report for the six months ended 30 September 2004 of the Investor Compensation Fund (the Fund), established under Part XII of the Securities and Futures Ordinance, set out on pages 23 to 27. We have not been instructed to review and have not reviewed the financial information for the three months ended 30 September 2004 included on page 23 of the interim financial report.

## Respective responsibilities of directors and auditors

The SFC is responsible for preparing an interim report of the Fund to comply with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board. The interim financial report is the responsibility of the SFC and has been approved by the Securities and Futures Commission.

It is our responsibility to form an independent conclusion, based on our review, on the interim financial report and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

## Review work performed

We conducted our review in accordance with Statement of Auditing Standards 700 "Engagements to review interim financial reports" issued by the Hong Kong Institute of Certified Public Accountants. A review consists principally of making enquiries of management and applying analytical procedures to the interim financial report and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the interim financial report.

## Review conclusion

On the basis of our review, which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial report for the six months ended 30 September 2004.

KPMG  
Certified Public Accountants  
Hong Kong  
9 November 2004



## Investor Compensation Fund

### Income and Expenditure Account

For the six months ended 30 September 2004

(Expressed in Hong Kong dollars)

	Note	Unaudited Three Months Ended		Unaudited Six Months Ended	
		30 Sep 2004	30 Sep 2003	30 Sep 2004	30 Sep 2003
		\$'000	\$'000	\$'000	\$'000
<b>Income</b>					
Net investment income		11,189	1,475	11,591	2,350
Transaction levy from the SEHK		33,839	31,744	69,731	51,699
Contract levy from the HKFE		3,234	2,615	6,656	4,911
		<u>48,262</u>	<u>35,834</u>	<u>87,978</u>	<u>58,960</u>
<b>Expenses</b>					
ICC expenses	2	869	1,313	1,828	2,699
Auditors' remuneration		12	-	18	-
Bank charges		386	5	412	5
Professional fees		478	12	483	12
Exchange difference		350	-	355	-
Sundry expenses		-	-	1	-
		<u>2,095</u>	<u>1,330</u>	<u>3,097</u>	<u>2,716</u>
<b>Surplus</b>		46,167	34,504	84,881	56,244
<b>Accumulated surplus brought forward</b>		<u>193,323</u>	<u>21,740</u>	<u>154,609</u>	<u>-</u>
<b>Accumulated surplus carried forward</b>		<u>239,490</u>	<u>56,244</u>	<u>239,490</u>	<u>56,244</u>

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

## Investor Compensation Fund

### Balance Sheet

At 30 September 2004

(Expressed in Hong Kong dollars)

	<u>Note</u>	<u>Unaudited</u> <u>At 30 Sep 2004</u> \$'000	<u>Audited</u> <u>At 31 Mar 2004</u> \$'000
<b>Current assets</b>			
Debt securities		1,084,660	174,286
Equity securities		105,966	-
Other receivable		83	-
Interest receivable		10,573	1,656
Due from ICC		2,106	1,778
Levy receivable from the SEHK		12,856	16,415
Levy receivable from the HKFE		1,099	1,163
Fixed and call deposits with banks		71,043	766,964
Cash at bank		8,429	13
		<u>1,296,815</u>	<u>962,275</u>
<b>Current liabilities</b>			
Accounts payable and accrued charges		647	66
		<u>647</u>	<u>66</u>
<b>Net current assets</b>		<u>1,296,168</u>	<u>962,209</u>
<b>Net assets</b>		<u>1,296,168</u>	<u>962,209</u>
Representing:			
<b><u>Compensation fund</u></b>			
Contributions from UECF	3	948,718	699,640
Contributions from CECF	3	107,960	107,960
Accumulated surplus		239,490	154,609
		<u>1,296,168</u>	<u>962,209</u>

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

**Investor Compensation Fund**  
**Statement of Changes in Equity**  
**For the six months ended 30 September 2004**  
*(Expressed in Hong Kong dollars)*

	<u>Note</u>	Unaudited Six Months Ended <u>30 Sep 2004</u> \$'000	Unaudited Six Months Ended <u>30 Sep 2003</u> \$'000
Compensation Fund balance as at 1 April		962,209	-
Surplus for the period		84,881	56,244
Contributions from UECF	3	249,078	588,040
Contributions from CECF	3	-	105,990
<b>Compensation Fund balance as at 30 September</b>		<u><u>1,296,168</u></u>	<u><u>750,274</u></u>

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

## Investor Compensation Fund

### Cash Flow Statement

For the six months ended 30 September 2004  
(Expressed in Hong Kong dollars)

	Unaudited Six Months Ended 30 Sep 2004 \$'000	Unaudited Six Months Ended 30 Sep 2003 \$'000
<b>Cash flows from operating activities</b>		
Surplus for the period	84,881	56,244
Net investment income	(11,591)	(2,350)
Exchange difference	355	-
Decrease / (increase) in levies receivable	3,623	(13,118)
Increase in amount due from ICC	(328)	-
Increase in other receivable	(83)	-
Increase in accounts payable and accrued charges	581	1,330
	<hr/>	<hr/>
<b>Net cash generated from operating activities</b>	<u>77,438</u>	<u>42,106</u>
<b>Cash flows from investing activities</b>		
Purchase of debt securities	(1,567,680)	(218,379)
Purchase of equity securities	(99,990)	-
Sale or maturity of debt securities	653,407	-
Interest received	242	1,068
	<hr/>	<hr/>
<b>Net cash used in investing activities</b>	<u>(1,014,021)</u>	<u>(217,311)</u>
<b>Cash flows from financing activities</b>		
Contributions received from UECF	249,078	588,040
Contributions received from CECF	-	105,990
	<hr/>	<hr/>
<b>Net cash generated from financing activities</b>	<u>249,078</u>	<u>694,030</u>
<b>Net (decrease) / increase in cash and cash equivalents</b>	(687,505)	518,825
<b>Cash and cash equivalents at beginning of the six months</b>	766,977	-
	<hr/>	<hr/>
<b>Cash and cash equivalents at end of the six months</b>	<u>79,472</u>	<u>518,825</u>
<b>Analysis of the balance of cash and cash equivalents:</b>		
	Unaudited At 30 Sep 2004 \$'000	Unaudited At 30 Sep 2003 \$'000
Cash at bank	8,429	26
Fixed and call deposits with banks	71,043	518,799
	<hr/>	<hr/>
	<u>79,472</u>	<u>518,825</u>



## **Investor Compensation Fund**

**Notes to the Condensed Financial Statements**  
**For the six months ended to 30 September 2004**  
*(Expressed in Hong Kong dollars)*

### **1. BASIS OF PREPARATION**

The Fund prepares the interim financial report in accordance 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 2004 included in this report does not constitute the Fund's statutory accounts for that financial year but is derived from those accounts.

We applied the same accounting policies adopted in the financial statements for the year ended 31 March 2004 to the interim financial report.

### **2. ICC EXPENSES**

The SFC formed the Investor Compensation Company Limited (ICC) in September 2002 to perform functions on behalf of the Fund in relation to the compensation to investors and other functions under Part III and Part XII of the Securities and Futures Ordinance (SFO). The Fund is responsible for funding the establishment and operation of ICC. For the six months ended 30 September 2004, ICC incurred \$1,828,000 for its operation (For the six months ended 30 September 2003 : \$2,699,000).

### **3. CONTRIBUTIONS FROM UECF AND CECF**

Under Sections 74(2) and 75(2) of Schedule 10 of the SFO, the SFC may pay into the Fund such sum of money from the Unified Exchange Compensation Fund (UECF) and the Commodity Exchange Compensation Fund (CECF) respectively as it considers appropriate after 1 April 2003. Up to 30 September 2004, the SFC has paid \$948,718,000 and \$107,960,000 into the Fund from the UECF and the CECF respectively.

### **4. MATERIAL RELATED PARTY TRANSACTIONS**

During the period, the Fund purchased from the UECF debt securities of total nominal value of HK\$61 million at market prices.

### **5. CONTINGENT LIABILITIES**

As at the date of this report, the Fund has received claims against four intermediaries. The validity of these claims is under investigation. We have not made any provision for these claims. The maximum contingent liability of the Fund to these claims is \$900,000 (As at 31 March 2004 : \$450,000).



# 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 six months ended 30 September 2004.

### 1. ESTABLISHMENT OF THE FUND

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

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

### 2. FINANCIAL RESULTS

The Committee presents the financial results which are set out in the condensed financial statements on pages 30 to 35.

### 3. MEMBERS OF THE COMMITTEE

The members of the Committee during the six months ended 30 September 2004 and up to the date of this report were : -

Mr. Mark Dickens, JP  
Mr. Paul Chow Man Yiu, JP  
Mrs. Alexa Lam  
Mr. David M. Roberts  
Mr. T. Brian Stevenson, SBS


### 4. INTERESTS IN CONTRACTS

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

On behalf of the Committee

Mark Dickens, JP  
Chairman

9 November 2004



# Independent review report to the board of directors of the Securities and Futures Commission (the SFC)

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

## Introduction

We have been instructed by the SFC to review the interim financial report for the six months ended 30 September 2004 of the Unified Exchange Compensation Fund (the Fund) set out on pages 30 to 35. We have not been instructed to review and have not reviewed the financial information for the three months ended 30 September 2004 included on page 30 of the interim financial report.

## Respective responsibilities of directors and auditors

The SFC is responsible for preparing an interim report of the Fund to comply with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board. The interim financial report is the responsibility of the SFC and has been approved by the Securities Compensation Fund Committee on behalf of the Securities and Futures Commission.

It is our responsibility to form an independent conclusion, based on our review, on the interim financial report and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

## Review work performed

We conducted our review in accordance with Statement of Auditing Standards 700 "Engagements to review interim financial reports" issued by the Hong Kong Institute of Certified Public Accountants. A review consists principally of making enquiries of management and applying analytical procedures to the interim financial report and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the interim financial report.

## Review conclusion

On the basis of our review, which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial report for the six months ended 30 September 2004.

KPMG  
Certified Public Accountants  
Hong Kong  
9 November 2004

## Unified Exchange Compensation Fund

### Income and Expenditure Account

For the six months ended 30 September 2004

(Expressed in Hong Kong dollars)

	Note	Unaudited Three Months Ended		Unaudited Six Months Ended	
		30 Sep 2004 \$'000	30 Sep 2003 \$'000	30 Sep 2004 \$'000	30 Sep 2003 \$'000
<b>Income</b>					
Net investment income		1,744	1,232	766	5,514
Transaction levy		-	-	-	(4)
Compensation refund from claimants		-	27,560	-	28,180
Recoveries	2	738	19,585	10,771	19,585
Provision for compensation reversed		2,608	1,049	3,531	2,971
		<u>5,090</u>	<u>49,426</u>	<u>15,068</u>	<u>56,246</u>
<b>Expenses</b>					
Auditors' remuneration		9	11	18	21
Bank charges		13	34	29	76
Professional fees		10	44	23	87
Sundry expenses		-	(15)	1	49
		<u>32</u>	<u>74</u>	<u>71</u>	<u>233</u>
<b>Surplus</b>		5,058	49,352	14,997	56,013
<b>Accumulated deficit brought forward</b>		<u>(3,345)</u>	<u>(158,475)</u>	<u>(13,284)</u>	<u>(165,136)</u>
<b>Accumulated surplus / (deficit) carried forward</b>		<u>1,713</u>	<u>(109,123)</u>	<u>1,713</u>	<u>(109,123)</u>

The notes on pages 34 to 35 form part of the condensed financial statements.



## Unified Exchange Compensation Fund

### Balance Sheet

At 30 September 2004

(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited At 30 Sep 2004 \$'000	Audited At 31 Mar 2004 \$'000
<b>Current assets</b>			
Debt securities		-	160,985
Equity securities received under subrogation	2	6,857	7,251
Interest receivable		13	2,024
Fixed and call deposits with banks		90,321	167,407
Cash at bank		503	215
		<u>97,694</u>	<u>337,882</u>
<b>Current liabilities</b>			
Accounts payable and accrued charges		4,257	4,522
Provision for compensation	3	3,953	9,545
		<u>8,210</u>	<u>14,067</u>
<b>Net current assets</b>		<u>89,484</u>	<u>323,815</u>
<b>Net assets</b>		<u>89,484</u>	<u>323,815</u>
Representing:			
<b><u>Compensation fund</u></b>			
Contributions from the SEHK	4	46,200	46,450
Excess transaction levy from the SEHK		353,787	353,787
Special contribution		3,500	3,500
Additional contribution from the SEHK		300,000	300,000
Additional contribution from the SFC		330,000	330,000
Special levy surplus		3,002	3,002
Accumulated surplus / (deficit)		1,713	(13,284)
		<u>1,038,202</u>	<u>1,023,455</u>
Contributions to Investor Compensation Fund	5	(948,718)	(699,640)
		<u>89,484</u>	<u>323,815</u>

The notes on pages 34 to 35 form part of the condensed financial statements.

**Unified Exchange Compensation Fund**  
**Statement of Changes in Equity**  
**For the six months ended 30 September 2004**  
*(Expressed in Hong Kong dollars)*

	<u>Note</u>	Unaudited Six Months Ended <u>30 Sep 2004</u> \$'000	Unaudited Six Months Ended <u>30 Sep 2003</u> \$'000
<b>Compensation Fund balance as at 1 April</b>		323,815	871,603
<b>Surplus for the period</b>		14,997	56,013
<b>Contributions refunded to the SEHK</b>	4	(250)	-
<b>Contributions to Investor Compensation Fund</b>	5	(249,078)	(588,040)
<b>Compensation Fund balance as at 30 September</b>		<u>89,484</u>	<u>339,576</u>

The notes on pages 34 to 35 form part of the condensed financial statements.

**Unified Exchange Compensation Fund**  
**Cash Flow Statement**  
**For the six months ended 30 September 2004**  
*(Expressed in Hong Kong dollars)*

	Unaudited Six Months Ended 30 Sep 2004 \$'000	Unaudited Six Months Ended 30 Sep 2003 \$'000
<b>Cash flows from operating activities</b>		
Surplus for the period	14,997	56,013
Net investment income	(766)	(5,514)
Decrease in levy receivable	-	5,607
Decrease / (increase) in equity securities received under subrogation	394	(22,746)
Decrease in provision for compensation	(5,592)	(15,344)
(Decrease) / increase in accounts payable and accrued charges	<u>(265)</u>	<u>132</u>
<b>Net cash generated from operating activities</b>	<u>8,768</u>	<u>18,148</u>
<b>Cash flows from investing activities</b>		
Debt securities redeemed	90,500	120,000
Debt securities sold	67,763	166,824
Interest received	<u>5,499</u>	<u>14,567</u>
<b>Net cash generated from investing activities</b>	<u>163,762</u>	<u>301,391</u>
<b>Cash flows from financing activities</b>		
Contributions refunded to the SEHK	(250)	-
Contributions to Investor Compensation Fund	<u>(249,078)</u>	<u>(588,040)</u>
<b>Net cash used in financing activities</b>	<u>(249,328)</u>	<u>(588,040)</u>
<b>Net decrease in cash and cash equivalents</b>	(76,798)	(268,501)
<b>Cash and cash equivalents at beginning of the six months</b>	<u>167,622</u>	<u>339,704</u>
<b>Cash and cash equivalents at end of the six months</b>	<u>90,824</u>	<u>71,203</u>
<b>Analysis of the balance of cash and cash equivalents:</b>		
	Unaudited At 30 Sep 2004 \$'000	Unaudited At 30 Sep 2003 \$'000
Cash at bank	503	28,800
Fixed and call deposits with banks	<u>90,321</u>	<u>42,403</u>
	<u>90,824</u>	<u>71,203</u>



**Unified Exchange Compensation Fund**  
**Notes to the Condensed Financial Statements**  
**For the six months ended 30 September 2004**  
*(Expressed in Hong Kong dollars)*

**1. BASIS OF PREPARATION**

The Fund prepares the interim financial report in accordance with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board. As the Fund will eventually cease operation as a result of the Securities and Futures Ordinance (SFO) which came into effect from 1 April 2003, the Fund prepares the interim financial report on a break-up basis with assets stated at recoverable amounts.

The interim financial report is unaudited and the financial information relating to the financial year ended 31 March 2004 included in this report does not constitute the Fund's statutory accounts for that financial year but is derived from those accounts.

We applied the same accounting policies adopted in the financial statements for the year ended 31 March 2004 to the interim financial report.


**2. EQUITY SECURITIES AND RECOVERIES**

In relation to the share distribution from C.A. Pacific Securities Ltd. and C.A. Pacific Finance Ltd., the liquidators had advised the Securities and Futures Commission (SFC) that shares were allocated to the Fund under its subrogation rights, subject to paying a processing fee to the liquidators. The Fund arranged to pay processing fees and to liquidate the shares as far as possible. The Fund recognised as recoveries the sale proceeds and the remaining shares at market value as of 30 September 2004 after deducting relevant processing fees and charges for collecting and selling the securities received.

**3. PROVISION FOR COMPENSATION**

	Unaudited \$'000
Balance as at 1 April 2003	30,628
Less: amount paid during the year ended 31 March 2004	(17,284)
Less: unused provision reversed during the year ended 31 March 2004	<u>(3,799)</u>
Balance as at 31 March 2004	9,545
Less: amount paid during the six months ended 30 September 2004	(2,061)
Less: unused provision reversed during the six months ended 30 September 2004	<u>(3,531)</u>
Balance as at 30 September 2004	<u><u>3,953</u></u>

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



**Unified Exchange Compensation Fund**  
**Notes to the Condensed Financial Statements**  
**For the six months ended 30 September 2004**  
*(Expressed in Hong Kong dollars)*

**4. CONTRIBUTIONS FROM THE SEHK**

The SEHK advised the SFC of five trading rights having been relinquished in November 2003. The deposits of \$250,000 in respect of these five trading rights were refunded to the SEHK during the six months ended 30 September 2004. The SEHK also advised the SFC of two trading rights having been relinquished in July 2004. The SFC should refund to the SEHK the deposit of \$100,000 in respect of these two trading rights at the end of a six-month period after the relinquishment took effect.

**5. CONTRIBUTIONS TO INVESTOR COMPENSATION FUND**

Under section 74(2) of Schedule 10 of the SFO, the SFC may after 1 April 2003 pay into the Investor Compensation Fund (ICF), which came into operation after 1 April 2003, such sum of money from the Fund as it considers appropriate. During the period, the SFC paid \$249,078,000 into the ICF from the Fund. Total contributions paid into the ICF up to 30 September 2004 amounted to \$948,718,000.

**6. MATERIAL RELATED PARTY TRANSACTIONS**

During the period, the Fund sold debt securities of nominal value HK\$61 million to the ICF at market price. No gain or loss was recognised by the Fund in respect of the disposal of these debt securities.

**7. 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 repealed 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 (As at 31 March 2004 : \$64 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 six months ended 30 September 2004.

### 1. ESTABLISHMENT OF THE FUND

Part VIII of the repealed Commodities Trading Ordinance (Chapter 250) established the Fund. However, when the Securities and Futures Ordinance (SFO) and its subsidiary legislation came into effect from 1 April 2003, a new single investor compensation fund (ICF) was formed to ultimately replace the Fund and the Unified Exchange Compensation Fund. After reserving sufficient money in the Fund to meet claims against it and its other liabilities, the SFC will eventually transfer the remaining balance of the Fund to the ICF.

Part VIII of the repealed Commodities Trading Ordinance remains effective in respect of the operation of the Fund to the extent described in Section 75 of Schedule 10 of the SFO.

### 2. FINANCIAL RESULTS

The Committee presents the financial results which are set out in the condensed financial statements on pages 38 to 42.

### 3. MEMBERS OF THE COMMITTEE

The members of the Committee during the six months ended 30 September 2004 and up to the date of this report were :-

Mr. Mark Dickens, JP

Mr. Lawrence Fok [resigned on 31 May 2004]

Mr. Gerald Greiner [appointed on 21 June 2004]

Mrs. Alexa Lam

Mr. T. Brian Stevenson, SBS

Mr. Calvin Tai

### 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 six months.

On behalf of the Committee

Mark Dickens, JP  
Chairman

9 November 2004



# Independent review report to the board of directors of the Securities and Futures Commission (the SFC)

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

## Introduction

We have been instructed by the SFC to review the interim financial report for the six months ended 30 September 2004 of the Commodity Exchange Compensation Fund (the Fund) set out on pages 38 to 42. We have not been instructed to review and have not reviewed the financial information for the three months ended 30 September 2004 included on page 38 of the interim financial report.

## Respective responsibilities of directors and auditors

The SFC is responsible for preparing an interim report of the Fund to comply with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board. The interim financial report is the responsibility of SFC, and has been approved by the Futures Compensation Fund Committee on behalf of the Securities and Futures Commission.

It is our responsibility to form an independent conclusion, based on our review, on the interim financial report and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

## Review work performed

We conducted our review in accordance with Statement of Auditing Standards 700 "Engagements to review interim financial reports" issued by the Hong Kong Institute of Certified Public Accountants. A review consists principally of making enquiries of management and applying analytical procedures to the interim financial report and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the interim financial report.

## Review conclusion

On the basis of our review, which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial report for the six months ended 30 September 2004.

KPMG  
Certified Public Accountants  
Hong Kong  
9 November 2004

## Commodity Exchange Compensation Fund

### Income and Expenditure Account

For the six months ended 30 September 2004

(Expressed in Hong Kong dollars)

	Unaudited Three Months Ended		Unaudited Six Months Ended	
	<u>30 Sep 2004</u>	<u>30 Sep 2003</u>	<u>30 Sep 2004</u>	<u>30 Sep 2003</u>
	\$'000	\$'000	\$'000	\$'000
<b>Income</b>				
Net investment income	-	226	-	718
	-----	-----	-----	-----
<b>Expenses</b>				
Auditors' remuneration	9	10	18	21
Bank charges	-	10	-	18
Professional fees	9	15	9	19
Sundry expenses	-	-	1	1
	-----	-----	-----	-----
	18	35	28	59
	-----	-----	-----	-----
<b>(Deficit) / Surplus</b>	(18)	191	(28)	659
<b>Accumulated surplus brought forward</b>	<u>108,252</u>	<u>108,081</u>	<u>108,262</u>	<u>107,613</u>
<b>Accumulated surplus carried forward</b>	<u>108,234</u>	<u>108,272</u>	<u>108,234</u>	<u>108,272</u>

The note on page 42 forms part of the condensed financial statements.



## Commodity Exchange Compensation Fund

### Balance Sheet

At 30 September 2004

(Expressed in Hong Kong dollars)

	Unaudited At 30 Sep 2004 \$'000	Audited At 31 Mar 2004 \$'000
<b>Current assets</b>		
Fixed and call deposits with banks	487	524
Cash at bank	4	5
	<u>491</u>	<u>529</u>
<b>Current liabilities</b>		
Accounts payable and accrued charges	217	227
	<u>217</u>	<u>227</u>
<b>Net current assets</b>	274	302
	<u>274</u>	<u>302</u>
<b>Net assets</b>	<u>274</u>	<u>302</u>
Representing:		
<b>Compensation fund</b>		
Accumulated surplus	108,234	108,262
Contributions to Investor Compensation Fund	(107,960)	(107,960)
	<u>274</u>	<u>302</u>

The note on page 42 forms part of the condensed financial statements.

**Commodity Exchange Compensation Fund**  
**Statement of Changes in Equity**  
**For the six months ended 30 September 2004**  
*(Expressed in Hong Kong dollars)*

	Unaudited Six Months Ended <u>30 Sep 2004</u> \$'000	Unaudited Six Months Ended <u>30 Sep 2003</u> \$'000
Compensation Fund balance as at 1 April	302	129,013
(Deficit) / Surplus for the period	(28)	659
Net contributions refunded to the HKFE	-	(300)
Contributions to Investor Compensation Fund	-	(105,990)
Compensation Fund balance as at 30 September	<u>274</u>	<u>23,382</u>

The note on page 42 forms part of the condensed financial statements.


## Commodity Exchange Compensation Fund

### Cash Flow Statement

For the six months ended 30 September 2004

(Expressed in Hong Kong dollars)

	Unaudited Six Months Ended 30 Sep 2004 \$'000	Unaudited Six Months Ended 30 Sep 2003 \$'000
<b>Cash flows from operating activities</b>		
(Deficit) / Surplus for the period	(28)	659
Net investment income	-	(718)
Decrease in levy receivable	-	772
Decrease in accounts payable and accrued charges	(10)	(21)
<b>Net cash (used in) / generated from operating activities</b>	<u>(38)</u>	<u>692</u>
<b>Cash flows from investing activities</b>		
Debt securities redeemed	-	13,000
Debt securities sold	-	51,554
Interest received	-	2,579
<b>Net cash generated from investing activities</b>	<u>-</u>	<u>67,133</u>
<b>Cash flows from financing activities</b>		
Net contribution refunded to the HKFE	-	(300)
Contributions to Investor Compensation Fund	-	(105,990)
<b>Net cash used in financing activities</b>	<u>-</u>	<u>(106,290)</u>
<b>Net decrease in cash and cash equivalents</b>	(38)	(38,465)
<b>Cash and cash equivalents at beginning of the six months</b>	529	51,903
<b>Cash and cash equivalents at end of the six months</b>	<u>491</u>	<u>13,438</u>
<b>Analysis of the balance of cash and cash equivalents:</b>		
	Unaudited At 30 Sep 2004 \$'000	Unaudited At 30 Sep 2003 \$'000
Cash at bank	4	26
Fixed and call deposits with banks	487	13,412
	<u>491</u>	<u>13,438</u>



**Commodity Exchange Compensation Fund**  
**Notes to the Condensed Financial Statements**  
**For the six months ended 30 September 2004**  
*(Expressed in Hong Kong dollars)*

**1. BASIS OF PREPARATION**

The Fund prepares the interim financial report in accordance with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board. As the Fund will eventually cease operation as a result of the Securities and Futures Ordinance (SFO) which came into effect from 1 April 2003, the Fund prepares the interim financial report on a break-up basis with assets stated at recoverable amounts.

The interim financial report is unaudited and the financial information relating to the financial year ended 31 March 2004 included in this report does not constitute the Fund's statutory accounts for that financial year but is derived from those accounts.

We applied the same accounting policies adopted in the financial statements for the year ended 31 March 2004 to the interim financial report.