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*This is the Securities and Futures Commission's first Quarterly Report for the financial year from 1 April 2006 to 31 March 2007. The report aims to enhance the transparency and accountability of the Commission.*

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## Operations Highlights

1 April to 30 June 2006

There were major achievements during the quarter, especially on the enforcement front:

- We took action against a record 38 entities for various breaches.
- We concluded a disciplinary action against an investment adviser for mis-selling of funds. The adviser offered substantial payments to settle claims by eligible investors.
- We took action against a sponsor and its responsible officer over sponsor failures in the second action of this type this year.
- We co-operated with HKMA to reprimand and fine a bank-related licensed corporation for unlicensed activities.
- We took decisive action to issue a restriction notice on a broker firm to protect investors.

On the international front:

- We hosted the 31st Annual Conference of the IOSCO in June with huge success and a record attendance in IOSCO events in recent years.
- We signed a Memorandum of Understanding with the Israel Securities Authority to facilitate regulatory co-operation on enforcement and exchange of information.

Other highlights:

- The amendments to certain rules that aim to address risk from securities margin financing were gazetted. They will come into effect on 1 October.
- We introduced the Guidelines for Sponsors and Compliance Advisers outlining the specific eligibility criteria and ongoing requirements for sponsors and compliance advisers.
- We launched a new TV drama series "Investment Challenge" to explain the features and the risks of investment products.
- Total revenue for the first quarter increased 7% to \$297 million on increased levy income.



**This is the Securities and Futures Commission's first Quarterly Report for the financial year starting 1 April 2006.**

## Market Overview

The US markets were volatile on fluctuations in commodity prices and concerns about interest rate movements. After reaching their five-year highs in early May, benchmark indices slid on rising oil and other commodities prices. However, investor sentiment was lifted in late June as the Fed commented that moderating economic growth could help check inflation. During the quarter, the Dow edged up 0.4% whilst the S&P and NASDAQ retreated 1.9% and 7.2% respectively. European markets retreated amidst concerns over economic growth. The DAX, FTSE and CAC lost 4.8%, 2.2% and 4.9% respectively.

The Mainland markets were buoyant on the back of revised listing rules and the resumption of IPO activities. During the quarter, the Shanghai Composite Index and the Shenzhen Composite Index closed 28.8% and 33.9% higher respectively.

At the start of the period, the Hong Kong market rose on an inflow of capital and strong RMB, pushing the HSI to its six-year high at 17,302 and market cap of Hong Kong securities market to \$10.2 trillion on 8 May. Then the market turned volatile as the HSI dropped significantly. The market closed at 16,268 at the end of June, 2.9% higher from the previous quarter. H-shares index and red chips index respectively rose 1.2% and 5.4%.

Trading remained active during the quarter. The average daily turnover on the Main Board increased 9.3% to \$34.1 billion. Turnover hit a record \$57 billion on 28 April<sup>1</sup>. The average daily turnover of HSI constituent stocks increased 2.4% to \$10.3 billion, while that of H-shares increased 22.1% to \$10.2 billion. The average daily turnover of red chips increased 13.6% to \$4.9 billion.

On the Growth Enterprise Market, the S&P/HKEx GEM index closed 7.2% lower than the previous quarter at 1,178 on 30 June. The average daily turnover was \$194 million, a 5% decrease from the previous quarter.

There were 10 IPOs on the Main Board and one on GEM. While the number was similar to the previous quarter, the total amount of funds raised was \$93.6 billion, compared with \$11.9 billion, as the IPO of Bank of China alone raised \$86.7 billion.

At the end of June, the open interests of HSI futures and HSI options were 109,952 contracts and 213,432 contracts, 5.7% lower and 9.8% higher than the end-March levels respectively. The open interest of H-shares Index futures increased 7.7% from end-March level to 50,145 contracts.

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<sup>1</sup> Excluding turnover during the Government action in August 1998.



## Review of Operations

### Raising Market Standards

During the quarter, we continued to analyse the submissions received in response to the consultation paper on possible reforms to the prospectus regime in the Companies Ordinance. The consultation conclusions setting out which proposals to be pursued, abandoned or revised requiring further consultation are being prepared on the basis of such analysis.

The SFC has analysed the responses to the market consultation on proposed amendments to the Securities and Futures (Stock Market Listing) Rules to give statutory backing to major listing requirements. We are in talks with the Financial Services and Treasury Bureau and HKEx on the approach to amend the rules.

Following the publication of the Consultation Conclusions on Proposed Measures to Address Risks Arising from Securities Margin Financing on 7 April, the amendments to the Securities and Futures (Client Securities) Rules, Securities and Futures (Financial Resources) Rules and Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules were gazetted on 19 May and completed negative vetting on 12 July. The amendments aim to address risk from securities margin financing to give investors better protection. They will come into effect on 1 October.

To strengthen the sponsor regulatory regime, we published the Consultation Conclusions on the Regulation of Sponsors and Compliance Advisers on 10 April. The Consultation Conclusions introduced the Guidelines for Sponsors and Compliance Advisers, which outlined the specific eligibility criteria and ongoing requirements for sponsors and compliance advisers. The guidelines will be incorporated into the Fit and Proper Guidelines and take effect on 1 January 2007.

### Partnership with the Industry

The number of persons licensed by the SFC continued to rise, with a steady growth of 3% from 25,691 as at 31 March to 26,492 as at 30 June. We granted three licences to hedge fund managers and one to a REIT manager.

Following a rigorous tender process, the industry working group comprising representatives from various brokers' associations and brokerage houses, appointed a new insurance broker to arrange and administer the fidelity insurance scheme for the year commenced on 1 April 2006. The insurance scheme covers both stock and futures exchange participants. Overall, exchange participants enjoyed a 12% saving in total premium compared to the previous year as a result of the competitive tender.

## Statistical Information and Financial Position of the Securities Industry

	As at 30 Jun 2006	As at 30 Jun 2005
Total number of securities dealers and securities margin financiers	640	633
Total number of active cash clients (Note 2)	688,256	629,960
Total number of active margin clients (Note 2)	77,819	76,332
<b>Balance Sheet</b> (Note 3)	<b>(\$ Million)</b>	<b>(\$ Million)</b>
Cash in hand and at bank (Note 4)	120,483	89,500
Amounts receivable from margin clients (Note 5)	17,637	14,961
Amounts receivable from clients and other dealers arising from dealing in securities	165,822	109,547
Proprietary positions	94,807	84,123
Other assets	142,675	72,734
<b>Total assets</b>	<b>541,424</b>	<b>370,865</b>
Amounts payable to clients and other dealers arising from dealing in securities	228,901	154,005
Total borrowings from financial institutions	95,965	59,880
Short positions held for own account	46,737	26,717
Other liabilities	77,051	53,770
Total shareholders' fund (Note 6)	92,770	76,493
<b>Total liabilities and shareholders' fund</b>	<b>541,424</b>	<b>370,865</b>

Note 1: The above data were extracted from the monthly Financial Returns submitted in accordance with the Securities and Futures (Financial Resources) Rules by licensed corporations licensed for dealing in securities or securities margin financing. Figures reported by an overseas incorporated licensed corporation which carries out its principal business activities outside Hong Kong and operates in Hong Kong as a branch office were excluded from the above figures.

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 the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules.

Note 3: The significant increases in various items of the balance sheet are primarily attributable to the rising market turnover over the period.

Note 4: Cash in hand and at bank includes trust monies held on behalf of clients amounting to \$49,283 million (30/6/2005: \$35,145 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 Jun 2006</u>	<u>As at 30 Jun 2005</u>
4.8	4.5

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

### Facilitating Market Development

The Securities and Futures (Reduction of Levy) Order 2006 that provides for the reduction of transaction levy on securities and futures trading was gazetted on 19 June. Subject to negative vetting, investors will pay 20% less in transaction levy starting on 1 December when the Order comes into force.

The SFC continued to monitor the latest developments in the Undertakings for Collective Investment in Transferable Securities (UCITS) III, the regulations issued by the European Union Commission that govern funds domiciled in the EU states. As of the end of June, the SFC had authorised 1,202 UCITS III funds, representing over 91% of the UCITS III fund applications received.

During the quarter, we authorised the first fund in Hong Kong that substantially invested directly in A shares through its Investment Manager's Qualified Foreign Institutional Investor (QFII) quota.

Number of SFC Authorised Collective Investment Schemes			
	30 Jun 2006	31 Mar 2006	30 Jun 2005
Unit trusts and mutual funds	1,968	1,998	1,943
Investment-linked assurance schemes	192	197	182
Pooled retirement funds	37	37	37
MPF master trust / industry schemes	39	44	45
MPF pooled investment funds (Note 1)	281	280	275
Real Estate Investment Trusts	4	3	0
Other schemes (Note 2)	116	108	87
<b>Total</b>	<b>2,637</b>	<b>2,667</b>	<b>2,569</b>
Note 1: This category included funds that were offered both as retail unit trusts as well as pooled investment funds for MPF purposes.			
Note 2: The schemes included equity-linked deposits.			

## Enforcement and Regulatory Actions

In April - June, the SFC successfully prosecuted 22 entities for market manipulation, misleading the SFC, disclosure of interests breaches, unregistered dealing, aiding and abetting others to engage in unlicensed dealing, holding out as carrying on business in regulated activities while unlicensed, issuing a document containing an invitation to the public to enter into an agreement to acquire securities without authorisation, cold calling, short selling and disclosing details of an SFC interview. Two entities charged with eight summonses were acquitted after the SFC withdrew the summonses. Two summonses were withdrawn against an entity who was convicted on other summonses. Another entity was acquitted after trial on one summons, while convicted after trial on other summonses.

On discipline, the SFC took action against 38 entities during the quarter for various breaches:

1. *Settlement* - Four licensed corporations agreed to disciplinary actions, including public reprimands and a fine of \$100,000 for internal control failings and unauthorised issue of promotional documents regarding a collective investment scheme.

Seven licensed representatives, including five responsible officers, agreed to disciplinary actions, including public reprimands and fines ranging from \$4,000 to \$221,000 for breaching the Code of Conduct, internal control failures and breaching internal company policy.

There were several other notable settlement cases:

- We severely reprimanded UKFP (Asia) HK Limited (formerly called Towry Law (Asia) HK Limited) for mis-selling of funds and concerns about the sale of geared products. UKFP also offered to settle claims made by eligible investors.

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- In a joint action with HKEx, Deloitte & Touche Corporate Finance Limited refrained from acting as sponsors for nine months for failing to properly discharge its responsibilities as a sponsor. Further, its responsible officer refrained from acting as a supervisor for sponsorship mandates for six months for failing to adequately supervise his subordinates.
  - We co-operated with HKMA to reprimand Wing Lung Futures Limited and fine it \$900,000 for aiding and abetting unlicensed dealing in futures contracts. We also suspended its licensed representative for six months for unlicensed dealing, its responsible officer for eight months for aiding and abetting unlicensed dealing, and reprimanded another responsible officer for supervisory failings.
  - Four former securities dealer's representatives settled their disciplinary actions with the SFC. Three were banned from re-entering the industry for four to six months for cold calling and failing to act in his clients' interest, and providing misleading information at an SFC interview. The fourth was reprimanded and fined \$35,000 for breaching staff dealing policy.
2. *Ban from re-entering the industry* - A former licensed representative was prohibited from re-entering the industry for life for stealing clients' securities, giving false information to the SFC and conspiring to pervert the course of public justice.
  3. *Suspensions* - The Securities and Futures Appeals Tribunal (SFAT) upheld an SFC decision to suspend a responsible officer for nine months for breaching the Anti-Money Laundering Guidelines, the Securities and Futures (Financial Resources) Rules and the Code of Conduct, and internal control failures. A licensed representative was suspended for 15 months for manipulating share price, impersonating a client to place orders with another brokerage and failing to obtain written authorisation from clients to conduct discretionary transactions. A former licensed representative was suspended for 11 months for conducting unauthorised trades, forging clients' signatures to open accounts, and making a recommendation to clients without regard to its suitability. One former responsible officer was suspended for six months for breaching the Anti-Money Laundering Guidelines, the Securities and Futures (Financial Resources) Rules and the Code of Conduct, and internal control failures. Two licensed representatives were suspended for 3 1/2 and 12 months for turning a blind eye to possible illegal activities. Another licensed representative and a responsible officer were suspended for six and 10 months for providing inaccurate or misleading information to the SFC. One licensed representative was suspended for five months for aiding and abetting unlicensed activities and failing to assist in the SFC investigations. Three other licensed representatives were suspended for two weeks to three months for making recommendations to clients without regard to its suitability.
  4. *Reprimand and fine* - The SFAT upheld an SFC decision to reprimand and fine a licensed securities firm and its responsible officer for breaching the Code of Conduct and internal control guidelines of the firm regarding telephone recordings and complaints handling.
  5. *Reprimand* - A licensed securities firm was reprimanded for breaching the Code of Conduct and the Anti-Money Laundering Guidance Notes, and inadequate internal control and staff supervision.



<b>Statistics of Enforcement Actions</b>			
	<b>Apr - Jun 2006</b>	<b>Jan - Mar 2006</b>	<b>Apr - Jun 2005</b>
Successful prosecutions	22	17	18
Actions against entities (Note 1)	38	18	14
Warning letters issued (Note 2)	42	30	88
Cases under investigation (Notes 3 and 4)	497	448	494
Disciplinary inquiries in progress (Note 4)	122	122	108
Note 1: Number of entities including settlement cases with or without formal sanctions. The number includes currently and previously licensed entities.			
Note 2: The decrease from the same quarter last year was mainly owing to disclosure of interests breaches.			
Note 3: Some cases are ongoing investigations from the previous quarter.			
Note 4: Number of cases as at end of quarters.			

In May, we issued a restriction notice on Whole Win Securities Limited to preserve the assets of the company and its clients, and to protect the interests of these clients and the investing public. The firm was found to have a liquid capital deficit, pledged the stocks that belonged to some cash clients to its banks without these clients' authorisation, failed to segregate cash clients' money and operated its business almost entirely on financial resources obtained from bank borrowings secured by clients' securities, hence putting its clients at risk. As a result of an SFC application, the Court later appointed Mr John Lees as the Administrator. The Court also empowered him to return certain securities held in Whole Win's CCASS account and trust money held in segregated bank accounts to those clients who are not indebted to Whole Win.

In response to four reports of misappropriation of clients' assets by staff of brokers in early 2006, we monitored these firms closely to ensure that they had adequate financial resources, took appropriate and timely measures to ascertain clients' losses and strengthened their internal controls. A circular and a Dr Wise article were issued to remind the industry to strengthen their relevant internal controls and management supervision to prevent fraud and to urge the investing public to take proactive steps to protect their own interests.

### **Strengthening Communication with Investors and Other Stakeholders**

During the quarter, we introduced several investor education programmes in the media:

- Broadcasted on TV stations a drama series of 10 five-minute episodes entitled "Investment Challenge" to explain the features and the risks of investment products. It was jointly produced with Radio Television Hong Kong.
- Launched with MetroFinance a radio series called "Learn More About Investing" to help investors ask the right questions in different investment activities.
- Introduced a video entitled "Know the Pooling Risk" to explain the pooling risk associated with securities



margin accounts. The video is being broadcasted on TV and 1,200 buses.

In June, we published the findings of the Stock Investor Survey, which showed that about half of all investors referred to financial reports and company announcements when making stock trading decisions, while nearly the same proportions of investors relied on stock commentators' recommendations and media reports. Investors who did not read financial reports suffered a bigger trading loss than those who did.

A new series of 15 investor education workshops for secondary school and vocational education teachers started in May, attracting around 1,900 enrolments. The workshops have been for the first time recognised as Continuing Professional Development courses by the Education and Manpower Bureau. We also spoke to secondary school students and civil servants of retiring age on market operations, IPO investing, personal financial planning and prudent investing after retirement.

During the quarter, Dr Wise's column discussed capital restructuring of listed companies, impact of dividend payments on warrant prices, and auditors' circularisation exercises. We also published FAQs on the components of distributions of a REIT, the mechanism and implications of a "step-up" interest rate swap arrangement, etc.

We published the Annual Report for the financial year 2005/2006 in May. We also published the Fourth Edition of an English-Chinese Glossary of Securities, Futures and Financial Terms, which contains nearly 15,000 entries and an expanded collection of terms commonly used in the Mainland.

We also continued to publish the bi-monthly newsletter SFC Alert, the monthly SFC Enforcement Reporter, and the Spring issue of Quarterly Bulletin to communicate with the public on our work and enforcement actions and to educate the investing public. All these publications are available on the SFC website.

<b>Statistics of Investor Enquiries and Public Complaints</b>			
	<b>Apr - Jun 2006</b>	<b>Jan - Mar 2006</b>	<b>Apr - Jun 2005</b>
Enquiries	1,792*	1,229	1,159
Complaints	294	250	332

\*The surge in the number of enquiries was mainly due to the incident on Whole Win Securities Ltd.

## **International Co-operation and External Relations**

The 31st Annual Conference of IOSCO was hosted by the SFC in Hong Kong on 5 - 8 June with huge success. Acting Chief Executive of the HKSAR, the Hon Rafael SY Hui, officiated the Opening Ceremony and Financial Secretary, the Hon Henry Tang, attended the Farewell Gala Dinner. The presence of more than 650 regulators and market practitioners from 135 jurisdictions around the world made the event the largest gathering for an IOSCO Annual Conference in recent years. The event also attracted local, Mainland and international media interest. During the conference, member jurisdictions reached important decisions, including a new resolution that encourages members to examine the legal framework under which they operate and to enable the freezing of assets derived from cross-border securities and



derivatives violations. A final communiqué was issued at the Closing Press Conference, which was attended by the Chairs of the four key committees and the Secretary General of IOSCO.

The SFC signed a Memorandum of Understanding with the Israel Securities Authority on 12 April 2006 to facilitate co-operation on enforcement of securities laws and exchange of information.

During the quarter, we received 82 requests from overseas regulators, 56 relating to licensing status and history, 18 seeking non-public information, two seeking public information, five seeking investigatory assistance and one seeking other assistance. Responses have been provided to 71 requests and the remaining 11 requests were being processed. During the period, we made nine requests to overseas regulators for investigatory assistance.

We received during the quarter 13 complaints in relation to boiler room operations and acted upon eight of them. Liaison work with other domestic and overseas enforcement bodies in this regard has continued.

We welcomed one Singaporean delegation, two Korean delegations and five Mainland delegations during the quarter.

## Corporate Affairs and Financial Review<sup>2</sup>

The LegCo passed the Securities and Futures (Amendment) Bill 2005 on 14 June to amend the Securities and Futures Ordinance to provide for the separation of the role of the Chairman of the SFC from that of the executive arm of the SFC and to create a Chief Executive Officer post. The Securities and Futures (Amendment) Ordinance 2006 was gazetted on 23 June and came into effect immediately. I have since then assumed the title of Chief Executive Officer.

In line with a similar move by the HKSAR Government, we introduced a five-day week for the majority of the SFC's operations starting from 1 July. We believe this would facilitate work-life balance and boost morale. Documents (such as licensing applications) and mails delivered to the SFC on Saturdays will be received and the SFC's Investor Hotline for enquiries about investor protection issues will continue to operate on Saturdays. We will keep the new arrangement under review although we do not expect any material impact on the investing public or market practitioners.

Total revenue for April - June increased 7% from \$277 million in the previous quarter to \$297 million. Levy income increased 9% to \$230 million from \$211 million as the average daily stock market turnover rose from \$32 billion to \$37 billion<sup>3</sup>. Expenditure (including depreciation) was \$126 million, 8% lower than the last quarter mainly due to lower staff costs. As a result, the SFC recorded a surplus of \$171

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<sup>2</sup> We have consolidated the financial results of Investor Compensation Company Limited in this financial report.

<sup>3</sup> For income purpose, the turnover figure includes the amount of new fund raisings, which also attract transaction levy.



million for the quarter, compared with the \$139 million recorded for the previous quarter. Our reserves stood at \$1.4 billion at the end of June.

Based on the current information and by managing our budget prudently, we continue to expect a surplus in the next quarter.

The total number of staff at the end of June was 438, comprising 397 regular staff and 41 temporary staff. There were 436 staff a year ago.

### **Summary and Looking Ahead**

There were major achievements in April - June. The 31st IOSCO Annual Conference was successfully concluded on 8 June with one of the highest attendance in IOSCO record. This indicated a high level of support for the ongoing work of regulators of global capital and securities markets. Again, I would like to thank the HKSAR Government, the industry, our sponsors and staff for their great support and effort in making the event a remarkable one.

During the quarter, we successfully concluded several significant disciplinary actions, and took action against a record 38 entities on a quarterly basis. Among them, we severely reprimanded an investment adviser for mis-selling of funds. The adviser also offered substantial amounts of payments to settle claims made by eligible investors. Further, in our joint action with HKEx, a sponsor had voluntarily refrained from acting as sponsor. This was our second action against sponsor failures during the year. We also co-operated with HKMA for the first time to reprimand and fine a bank-related licensed corporation for unlicensed activities. We took decisive action by issuing a restriction notice on a broker firm to protect investors.

As set out in our Regulatory Challenges and Responses document, improving industry standards, regulation of complex products sold to the public and broker failures are some of the key challenges facing the SFC in the next three years. We will continue to enforce our regulation vigorously and work closely with other regulatory organisations to sanction firms, their staff and management who are guilty of misconduct.

Martin Wheatley  
Chief Executive Officer

14 August 2006

## Securities and Futures Commission

### Consolidated Income and Expenditure Account

For the quarter ended 30 June 2006

(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited Quarter Ended 30 Jun 2006 \$'000	Unaudited Quarter Ended 30 Jun 2005 \$'000
<b>Income</b>			
Levies		230,368	109,665
Fees and charges		47,725	45,859
Investment income		13,222	6,890
Recoveries from Investor Compensation Fund		765	789
Other income		5,558	1,369
		<u>297,638</u>	<u>164,572</u>
<b>Expenses</b>			
Staff costs and directors' emoluments		96,681	91,558
Premises			
rent		5,358	5,358
other		3,788	3,439
Other expenses		17,835	11,118
Depreciation		2,600	4,539
		<u>126,262</u>	<u>116,012</u>
<b>Surplus</b>	2	<u>171,376</u>	<u>48,560</u>

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

The notes on pages 15 to 17 form part of the condensed consolidated financial statements.

# Securities and Futures Commission

## Consolidated Balance Sheet

At 30 June 2006

(Expressed in Hong Kong Dollars)

	Note	Unaudited At 30 Jun 2006 \$'000	Audited At 31 Mar 2006 \$'000
<b>Non-current assets</b>			
Fixed assets		16,999	17,934
Held-to-maturity debt securities	3	<u>774,195</u>	<u>580,962</u>
		<u>791,194</u>	<u>598,896</u>
<b>Current assets</b>			
Held-to-maturity debt securities	3	569,360	617,931
Bank deposits		55,871	47,505
Debtors, deposits and prepayments		112,912	96,562
Cash at bank and in hand		<u>2,644</u>	<u>2,378</u>
		<u>740,787</u>	<u>764,376</u>
<b>Current liabilities</b>			
Fees received in advance		44,502	52,195
Creditors and accrued charges		<u>40,597</u>	<u>33,343</u>
		<u>85,099</u>	<u>85,538</u>
<b>Net current assets</b>			
		<u>655,688</u>	<u>678,838</u>
<b>Total assets less current liabilities</b>			
		1,446,882	1,277,734
<b>Non-current liabilities</b>	4	<u>60,912</u>	<u>63,140</u>
<b>Net assets</b>		<u>1,385,970</u>	<u>1,214,594</u>
<b>Funding and reserves</b>			
<b>Initial funding by Government</b>		42,840	42,840
<b>Accumulated surplus</b>	2	<u>1,343,130</u>	<u>1,171,754</u>
		<u>1,385,970</u>	<u>1,214,594</u>

The notes on pages 15 to 17 form part of the condensed consolidated financial statements.

# Securities and Futures Commission

## Balance Sheet

At 30 June 2006

(Expressed in Hong Kong Dollars)

	Note	Unaudited At 30 Jun 2006 \$'000	Audited At 31 Mar 2006 \$'000
<b>Non-current assets</b>			
Fixed assets		16,942	17,866
Held-to-maturity debt securities	3	<u>774,195</u>	<u>580,962</u>
		<u>791,137</u>	<u>598,828</u>
<b>Current assets</b>			
Held-to-maturity debt securities	3	569,360	617,931
Bank deposits		55,871	47,505
Debtors, deposits and prepayments		112,466	96,223
Cash at bank and in hand		<u>1,417</u>	<u>1,014</u>
		<u>739,114</u>	<u>762,673</u>
<b>Current liabilities</b>			
Fees received in advance		44,502	52,195
Creditors and accrued charges		<u>38,867</u>	<u>31,572</u>
		<u>83,369</u>	<u>83,767</u>
<b>Net current assets</b>		<u>655,745</u>	<u>678,906</u>
<b>Total assets less current liabilities</b>		1,446,882	1,277,734
<b>Non-current liabilities</b>	4	<u>60,912</u>	<u>63,140</u>
<b>Net assets</b>		<u>1,385,970</u>	<u>1,214,594</u>
<b>Funding and reserves</b>			
Initial funding by Government		42,840	42,840
Accumulated surplus	2	<u>1,343,130</u>	<u>1,171,754</u>
		<u>1,385,970</u>	<u>1,214,594</u>

The notes on pages 15 to 17 form part of the condensed consolidated financial statements.

# Securities and Futures Commission

## Consolidated Cash Flow Statement For the quarter ended 30 June 2006 (Expressed in Hong Kong dollars)

	Unaudited Quarter Ended 30 Jun 2006 \$'000	Unaudited Quarter Ended 30 Jun 2005 \$'000
<b>Cash flows from operating activities</b>		
Surplus	171,376	48,560
Adjustments for :		
Depreciation	2,600	4,539
Investment income	<u>(13,222)</u>	<u>(6,890)</u>
	160,754	46,209
Increase in debtors, deposits and prepayments	(13,543)	(8,049)
Increase in creditors and accrued charges	7,394	7,112
Decrease in fees received in advance	(7,693)	(769)
Decrease in non-current liabilities	<u>(2,228)</u>	<u>(2,237)</u>
<b>Net cash generated from operating activities</b>	<u>144,684</u>	<u>42,266</u>
<b>Cash flows from investing activities</b>		
Interest received	10,137	7,655
Held-to-maturity debt securities bought	(311,984)	(134,377)
Held-to-maturity debt securities redeemed	167,600	71,604
Fixed assets bought	<u>(1,805)</u>	<u>(4,157)</u>
<b>Net cash used in investing activities</b>	<u>(136,052)</u>	<u>(59,275)</u>
<b>Net increase / (decrease) in cash and cash equivalents</b>	8,632	(17,009)
<b>Cash and cash equivalents at beginning of the quarter</b>	<u>49,883</u>	<u>71,348</u>
<b>Cash and cash equivalents at end of the quarter</b>	<u>58,515</u>	<u>54,339</u>
<b>Analysis of the balance of cash and cash equivalents :</b>		
	Unaudited At 30 Jun 2006 \$'000	Unaudited At 30 Jun 2005 \$'000
Bank deposits	55,871	52,202
Cash at bank and in hand	<u>2,644</u>	<u>2,137</u>
	<u>58,515</u>	<u>54,339</u>

# Securities and Futures Commission

## Notes to the Condensed Consolidated Financial Statements

For the quarter ended 30 June 2006

(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 2006 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 June 2006. 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 2006 to the interim financial report.

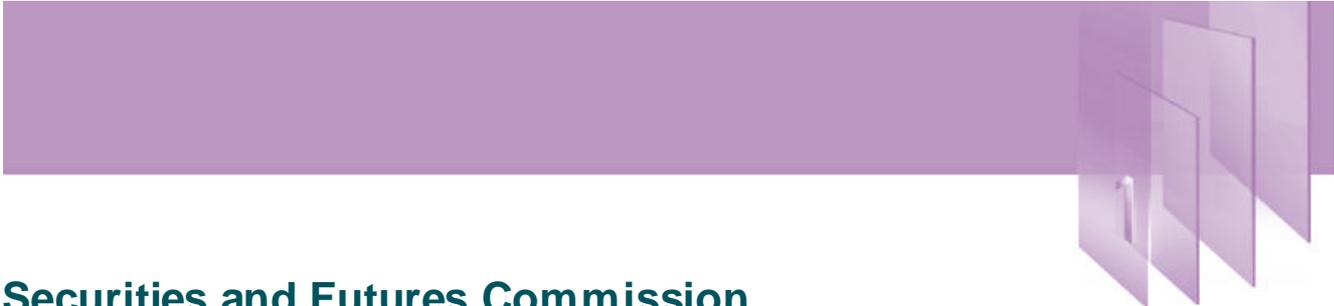
There were no significant changes in the operation of the SFC for the quarter ended 30 June 2006.

### 2. ACCUMULATED SURPLUS

#### The Group and the SFC

Movements of accumulated surplus during the quarter ended 30 June 2006 are as follows :

	<u>Unaudited</u> \$'000
Balance at 31 March 2006	1,171,754
Surplus for the quarter	171,376
	<hr/>
Balance at 30 June 2006	1,343,130
	<hr/> <hr/>



## Securities and Futures Commission

Notes to the Condensed Consolidated Financial Statements

For the quarter ended 30 June 2006

*(Expressed in Hong Kong dollars)*

### 3. HELD-TO-MATURITY DEBT SECURITIES

#### The Group and the SFC

As of 30 June 2006, the total market value of held-to-maturity debt securities amounted to \$1,330,428,000 (31 March 2006 : \$1,187,471,000), which was below the total carrying cost of \$1,343,555,000 (31 March 2006 : \$1,198,893,000).

### 4. NON-CURRENT LIABILITIES

#### The Group and the SFC

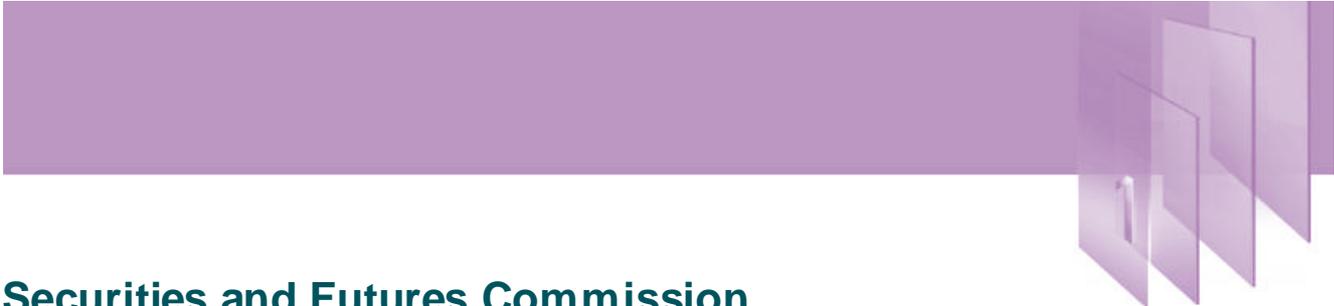
Non-current liabilities represent deferred lease incentives and provision for premises reinstatement cost. Deferred lease incentives consist of incentives granted by our landlord in connection with the lease of our office premises. We recognise the deferred lease incentives in our income and expenditure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

### 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 June 2006. Therefore we do not provide an ageing analysis of 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.



## Securities and Futures Commission

Notes to the Condensed Consolidated Financial Statements

For the quarter ended 30 June 2006

*(Expressed in Hong Kong dollars)*

### 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.

Both companies are wholly owned subsidiaries of the SFC. As at 30 June 2006, the investments in subsidiaries, which is stated at cost less any impairment losses, amounted to \$2.2. The balance is too small to appear on the balance sheet which is expressed in thousands of dollars.

FinNet has not commenced operation. The balance sheet of FinNet as at 30 June 2006 and the income and expenditure account for the quarter 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 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 did not have significant related party transactions except we received reimbursement from the Investor Compensation Fund for all the ICC's expenses, which is in accordance with section 242(1) of the Securities and Futures Ordinance.



# 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 quarter ended 30 June 2006.

### 1. ESTABLISHMENT OF THE FUND

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

### 2. FINANCIAL RESULTS

The Committee presents the financial results which are set out in the financial statements on pages 19 to 23.

### 3. MEMBERS OF THE COMMITTEE

The members of the Committee during the quarter ended 30 June 2006 and up to the date of this report were:-

Mr. Martin Wheatley (Chairman)  
Mr. Gerald Greiner  
Mrs. Alexa Lam  
Ms. Anna H.Y. Wu, SBS, JP  
Mr. Eddy Fong, 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 quarter.

On behalf of the Committee

Martin Wheatley  
Chairman

8 August 2006

## Investor Compensation Fund

### Income and Expenditure Account

For the quarter ended 30 June 2006

(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited Quarter Ended 30 Jun 2006 \$'000	Unaudited Quarter Ended 30 Jun 2005 \$'000
<b>Income</b>			
Net investment income		11,194	23,661
Levy - from the SEHK		-	41,004
Levy - from the HKFE		-	3,559
		<u>11,194</u>	<u>68,224</u>
		-----	-----
<b>Expenses</b>			
ICC expenses	2	765	789
Auditors' remuneration		18	15
Bank charges		185	428
Professional fees		641	560
Exchange difference		(587)	3,033
Sundry expenses		1	1
		<u>1,023</u>	<u>4,826</u>
		-----	-----
<b>Surplus</b>		10,171	63,398
<b>Accumulated surplus brought forward</b>		571,528	353,479
		<u>581,699</u>	<u>416,877</u>
<b>Accumulated surplus carried forward</b>		<u>581,699</u>	<u>416,877</u>

The notes on page 23 form part of the condensed financial statements.

# Investor Compensation Fund

## Balance Sheet

At 30 June 2006

(Expressed in Hong Kong dollars)

	Unaudited At 30 Jun 2006 \$'000	Audited At 31 Mar 2006 \$'000
<b>Current assets</b>		
Financial assets designated at fair value through profit or loss		
- Debt securities	1,441,580	1,357,440
- Equity securities	142,996	145,608
Interest receivable	16,616	17,848
Due from ICC	1,707	1,726
Fixed and call deposits with banks	83,152	152,341
Cash at bank	<u>10</u>	<u>9</u>
	1,686,061	1,674,972
<b>Current liabilities</b>		
Accounts payable and accrued charges	<u>721</u>	<u>766</u>
<b>Net current assets</b>	<u>1,685,340</u>	<u>1,674,206</u>
<b>Net assets</b>	<u>1,685,340</u>	<u>1,674,206</u>
Representing:		
<b><u>Compensation fund</u></b>		
Contributions from UECF	994,718	994,718
Contributions from CECF	108,923	107,960
Accumulated surplus	<u>581,699</u>	<u>571,528</u>
	<u>1,685,340</u>	<u>1,674,206</u>

The notes on page 23 form part of the condensed financial statements.

## Investor Compensation Fund

### Statement of Changes in Equity

For the quarter ended 30 June 2006

*(Expressed in Hong Kong dollars)*

	Unaudited Quarter Ended <u>30 Jun 2006</u> \$'000	Unaudited Quarter Ended <u>30 Jun 2005</u> \$'000
Compensation fund balance as at 1 April	1,674,206	1,456,157
Surplus for the quarter	10,171	63,398
Contributions from CECF	<u>963</u>	<u>-</u>
Compensation fund balance as at 30 June	<u><u>1,685,340</u></u>	<u><u>1,519,555</u></u>

The notes on page 23 form part of the condensed financial statements.

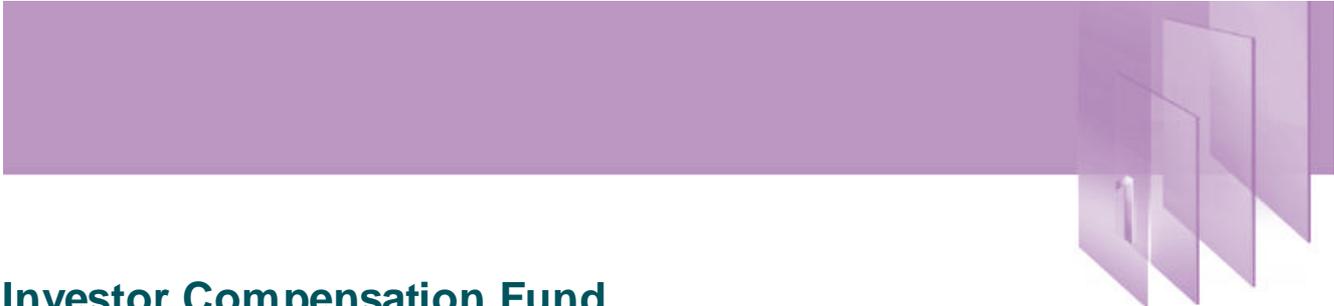
## Investor Compensation Fund

### Cash Flow Statement

For the quarter ended 30 June 2006

(Expressed in Hong Kong dollars)

	Unaudited Quarter Ended 30 Jun 2006 \$'000	Unaudited Quarter Ended 30 Jun 2005 \$'000
<b>Cash flows from operating activities</b>		
Surplus for the quarter	10,171	63,398
Net investment income	(11,194)	(23,661)
Exchange difference	(587)	3,033
Increase in levies receivable	-	(305)
Decrease / (increase) in amount due from ICC (Decrease) / increase in accounts payable and accrued charges	19	(484)
	<u>(45)</u>	<u>59</u>
<b>Net cash (used in) / generated from operating activities</b>	<u>(1,636)</u>	<u>42,040</u>
<b>Cash flows from investing activities</b>		
Purchase of debt securities	(533,951)	(979,836)
Sale or maturity of debt securities	448,124	895,124
Sale of equity securities	179	153
Interest received	17,133	12,910
<b>Net cash used in investing activities</b>	<u>(68,515)</u>	<u>(71,649)</u>
<b>Cash flows from financing activities</b>		
Contributions received from CECF	963	-
<b>Net cash generated from financing activities</b>	<u>963</u>	<u>-</u>
<b>Net decrease in cash and cash equivalents</b>	(69,188)	(29,609)
<b>Cash and cash equivalents at beginning of the quarter</b>	<u>152,350</u>	<u>118,958</u>
<b>Cash and cash equivalents at end of the quarter</b>	<u>83,162</u>	<u>89,349</u>
<b>Analysis of the balance of cash and cash equivalents:</b>		
	Unaudited At 30 Jun 2006 \$'000	Unaudited At 30 Jun 2005 \$'000
Fixed and call deposits with banks	83,152	89,117
Cash at bank	<u>10</u>	<u>232</u>
	<u>83,162</u>	<u>89,349</u>



# Investor Compensation Fund

## Notes to the Condensed Financial Statements

For the quarter ended 30 June 2006

*(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 2006 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 2006 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 quarter ended 30 June 2006, ICC incurred \$765,000 for its operation (For the quarter ended 30 June 2005 : \$789,000).

### 3. CONTINGENT LIABILITIES

As at the date of this report, the Fund has 75 outstanding claims in respect of four intermediaries. The validity of these claims is under investigation. SFC or ICC has not yet published any notice calling for claims pursuant to Section 3 of the Securities & Futures (Investor Compensation-Claims) Rules in respect of these cases. We have not made any provision for these claims. The maximum contingent liability of the Fund to these claims is \$11,250,000 (As at 31 March 2006 : \$900,000).



# 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 quarter ended 30 June 2006.

### 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 25 to 30.

### 3. MEMBERS OF THE COMMITTEE

The members of the Committee during the quarter ended 30 June 2006 and up to the date of this report were: -

Mr. Martin Wheatley (Chairman)

Mrs. Alexa Lam

Mr. Eddy C. Fong, SBS, JP

Mr. Gerald Greiner

Mr. Roger Lee

[appointed on 1 April 2006]

### 4. INTERESTS IN CONTRACTS

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

On behalf of the Committee

Martin Wheatley  
Chairman

31 July 2006

## Unified Exchange Compensation Fund

### Income and Expenditure Account

For the quarter ended 30 June 2006

(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited Quarter Ended 30 Jun 2006 \$'000	Unaudited Quarter Ended 30 Jun 2005 \$'000
<b>Income</b>			
Net investment income		626	292
Recoveries	2	2,447	164
Replenishments from SEHK		-	1
		<u>3,073</u>	<u>457</u>
		-----	-----
<b>Expenses</b>			
Provision for compensation made		-	876
Auditors' remuneration		8	9
Bank charges		-	1
Sundry expenses		1	1
		<u>9</u>	<u>887</u>
		-----	-----
<b>Surplus / (Deficit)</b>		3,064	(430)
<b>Accumulated surplus brought forward</b>		9,584	7,455
		<u>12,648</u>	<u>7,025</u>
		=====	=====

The notes on pages 29 and 30 form part of the condensed financial statements.

# Unified Exchange Compensation Fund

## Balance Sheet

At 30 June 2006

(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited <u>At 30 Jun 2006</u> \$'000	Audited <u>At 31 Mar 2006</u> \$'000
<b>Current assets</b>			
Equity securities received under subrogation	2	589	721
Interest receivable		89	91
Fixed and call deposits with banks		60,411	57,236
Cash at bank		<u>15</u>	<u>14</u>
		61,104	58,062
		-----	-----
<b>Current liabilities</b>			
Accounts payable and accrued charges		4,232	4,254
Provision for compensation	3	<u>2,553</u>	<u>2,553</u>
		6,785	6,807
		-----	-----
<b>Net current assets</b>		<u>54,319</u>	<u>51,255</u>
		-----	-----
<b>Net assets</b>		<u>54,319</u>	<u>51,255</u>
		-----	-----
Representing:			
<b><u>Compensation fund</u></b>			
Contributions from the SEHK		46,100	46,100
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		<u>12,648</u>	<u>9,584</u>
		1,049,037	1,045,973
Contributions to Investor Compensation Fund		<u>(994,718)</u>	<u>(994,718)</u>
		<u>54,319</u>	<u>51,255</u>
		-----	-----

The notes on pages 29 and 30 form part of the condensed financial statements.

## Unified Exchange Compensation Fund

### Statement of Changes in Equity

For the quarter ended 30 June 2006

*(Expressed in Hong Kong dollars)*

	Unaudited Quarter Ended <u>30 Jun 2006</u> \$'000	Unaudited Quarter Ended <u>30 Jun 2005</u> \$'000
Compensation fund balance as at 1 April	51,255	49,126
Surplus / (deficit) for the quarter	<u>3,064</u>	<u>(430)</u>
Compensation fund balance as at 30 June	<u><u>54,319</u></u>	<u><u>48,696</u></u>

The notes on pages 29 and 30 form part of the condensed financial statements.

# Unified Exchange Compensation Fund

## Cash Flow Statement

For the quarter ended 30 June 2006

(Expressed in Hong Kong dollars)

	Unaudited Quarter Ended 30 Jun 2006 \$'000	Unaudited Quarter Ended 30 Jun 2005 \$'000
<b>Cash flows from operating activities</b>		
Surplus / (deficit) for the quarter	3,064	(430)
Net investment income	(626)	(292)
Decrease in equity securities received under subrogation	132	2,350
Increase in provision for compensation	-	85
Decrease in accounts payable and accrued charges	<u>(22)</u>	<u>-</u>
<b>Net cash generated from operating activities</b>	<u>2,548</u>	<u>1,713</u>
<b>Cash flows from investing activities</b>		
Interest received	<u>628</u>	<u>280</u>
<b>Net cash generated from investing activities</b>	<u>628</u>	<u>280</u>
<b>Net increase in cash and cash equivalents</b>	3,176	1,993
<b>Cash and cash equivalents at beginning of the quarter</b>	<u>57,250</u>	<u>47,080</u>
<b>Cash and cash equivalents at end of the quarter</b>	<u>60,426</u>	<u>49,073</u>

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

	Unaudited At 30 Jun 2006 \$'000	Unaudited At 30 Jun 2005 \$'000
Cash at bank	15	145
Fixed and call deposits with banks	<u>60,411</u>	<u>48,928</u>
	<u>60,426</u>	<u>49,073</u>



# Unified Exchange Compensation Fund

## Notes to the Condensed Financial Statements

For the quarter ended 30 June 2006

*(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 2006 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 2006 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 recognised as recoveries the sale proceeds and the revaluation of the remaining shares at market value as of 30 June 2006 after deducting relevant processing fees and charges for collecting and selling the securities received.

In addition, recoveries of \$2,475,427 were received in respect of Chark Fung case during the quarter.

### 3. PROVISION FOR COMPENSATION

We maintain provision for claims in respect of two SEHK exchange participants for which the SEHK has published a notice calling for claims.



# Unified Exchange Compensation Fund

Notes to the Condensed Financial Statements

For the quarter ended 30 June 2006

*(Expressed in Hong Kong dollars)*

## 4. CONTINGENT LIABILITIES

As at the date of this report, the validity of outstanding claims received against three exchange participants is still under investigation by the SEHK. They are subject to the normal \$8 million ceiling pursuant to section 109 of the repealed Securities Ordinance. We have not made any provision for these claims. The maximum contingent liability of the Fund to these claims is \$24 million (As at 31 March 2006 : \$24 million).