



## Table of Contents

Operations Highlights	1
Review of Operations	3
Securities and Futures Commission Condensed Consolidated Financial Statements	13
Investor Compensation Fund Condensed Financial Statements	20
Unified Exchange Compensation Fund Condensed Financial Statements	26
Commodity Exchange Compensation Fund Condensed Financial Statements	33

*This is the Securities and Futures Commission's third 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 October to 31 December 2004

### Financial Position

1. Total revenue in the quarter from October to December 2004 was \$176 million and total expenditure was \$131 million. These resulted in a surplus of \$45 million for the quarter, 34.3% higher than that for July-September 2004.
2. Total revenue for the three quarters from April to December 2004 was \$456 million, 23.5% higher than the same period last year. Total expenditure was 9.9% higher at \$334 million and close to the approved budget of \$333 million. Accumulated surplus for the nine months was \$122 million, bringing reserves at the end of December 2004 to \$813 million.

### Regulatory Developments

3. We issued a consultation paper on proposed amendments to the disclosure of interests regime under Part XV of the Securities and Futures Ordinance.
4. We issued a consultation paper on proposed amendments to the Securities and Futures (Stock Market Listing) Rules to implement the Government's proposal to give statutory backing to the more important requirements in the Listing Rules.
5. We issued a consultation paper on a review of the Codes on Takeovers and Mergers and Share Repurchases to ensure that the Codes take account of market developments and developing market practice.
6. The prospectus-related amendments in the Companies (Amendment) Ordinance 2004 came into force in December to facilitate the public offering of shares and debentures.
7. Guidelines addressing analyst conflicts of interest were introduced in November.
8. We reported to the Legco's Panel on Financial Affairs on the progress of the proposed measures to address risks arising from securities margin financing.
9. We completed an investor survey on the standards of sponsors and on possible measures to enhance the standards. We will conduct a theme inspection on sponsors to check their compliance with the *SFC Corporate Finance Adviser Code of Conduct*.
10. We completed a theme inspection on investment advisers and will report our findings soon.
11. We released guidelines which would enable investors to compare securities-related fees and charges of intermediaries easier.
12. The Academic and Accreditation Advisory Committee approved two re-entry courses as new alternatives to passing licensing examinations, for former practitioners who have left the industry for three to eight years.

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13. We worked on proposed benchmarks for overseas investments by Real Estate Investment Trusts for public consultation.
  14. We worked with the fund industry to facilitate an orderly migration of European funds in Hong Kong to the Undertakings for Collective Investment in Transferable Securities (UCITS) III regime.
  15. We issued a public consultation paper on an automatic levy triggering mechanism of the Investor Compensation Fund.

### **Supervisory and Enforcement Actions**

16. During the quarter, the SFC had 21 successful prosecutions and disciplined 25 licensees for regulatory breaches. We settled disciplinary proceedings with five licensees as it was in the public interest to do so. A licensee was banned for life from the securities industry for poor financial integrity and lying to the SFC.
17. The Takeovers Executive imposed a cold shoulder order on the chairman and an executive director of a listed company, publicly censured both persons, the company and five other directors for failing to issue an offeree document to shareholders.

### **Others**

18. We produced a documentary-drama series, Foundations in Wealth Management. It was rated one of the 10 most popular programmes of Cable TV when it was broadcast.
19. We introduced the new SFC corporate website and Electronic Investor Resources Centre, both with better content and features.
20. We signed a Memorandum of Understanding with the Philippine Securities and Exchange Commission, and a Letter of Intent with Thailand's Securities and Exchange Commission on the establishment of regulatory co-operation relating to investment funds.
21. Mr Eddy Fong, Mr Kenneth Kwok and Professor Liu Pak-wai were appointed with effect from 1 January 2005 as Non-Executive Directors of the Commission to replace Ms Anna Wu, Mr Daniel Fung and Mr Thomas Brian Stevenson, whose terms expired on 31 December 2004.



## Review of Operations

1 October to 31 December 2004

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

During the quarter, markets rebounded as uncertainties regarding the US elections were resolved and oil prices declined. The Fed raised interest rates by a total of 50 basis points, which was within market expectations. During the quarter, the Dow, Nasdaq and S&P increased 7%, 14.7% and 8.7% respectively, buoyed by better corporate earnings. European markets were also higher, with DAX, CAC and FTSE gaining 9.3%, 5% and 5.3% respectively. Nikkei increased 6.1% whilst benchmark indices in other Asian markets advanced, ranging from an increase of 3.5% in the Philippines to 22% in Indonesia. The four markets in the Mainland fell by between 9.2% and 17.7% amid concerns over macro-economic control and credit-tightening measures, as the People's Bank of China also raised interest rates by 27 basis points.

Improving economic conditions supported the local market. The unemployment rate dropped to 6.7% for the three months ended November 2004, while deflation finally ended in October. The continued recovery of the property market and strong land sales boosted market sentiment. In addition, the local lending rate did not move in line with US interest rates due to the ample liquidity in the banking sector. The HSI advanced 8.5% during the quarter to 14,230 on 31 December, while the H-shares and red chips indices also rose 2% and 8.9% respectively.

Trading was very active during the quarter. The average daily turnover on the Main Board rose 46.9% to \$17.9 billion from the previous quarter. The average daily turnover of HSI constituent stocks rose 34.6% to \$7 billion. The average daily turnover of H-shares rose 10.4% to \$3.3 billion and red chips' turnover rose 38.5% to \$2.5 billion.

The average daily turnover on the Growth Enterprise Market (GEM) was \$72 million, a 50.5% increase from the previous quarter. The S&P/HKEX GEM index rose 0.6% to 989 at quarter end.

Initial Public Offering (IPO) activities increased during the quarter with 17 IPOs on the Main Board and one on GEM. Funds raised through IPOs totalled \$37.1 billion during the quarter, about 71.9% of which was for Mainland enterprises.

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

Increase in market turnover boosted revenue in the quarter to \$176 million, 30.3% higher than the previous quarter. Total expenditure (including depreciation) was \$131 million, resulting in a surplus of

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



\$45 million for the quarter, 34.3% higher than the \$33 million surplus for July-September.

The operating results in the three quarters from April to December 2004 were better than expected largely because levy and fees income exceeded original estimates. Total revenue was \$456 million, 23.5% higher than that of the same period last year. Levy income rose 28.1% to \$314 million as the average daily stock market turnover increased to \$15.9 billion<sup>2</sup> from \$12.4 billion in the same period last year. Fees and charges income also rose 13.7% to \$120 million due to increased market activities.

Total expenditure (including depreciation) for the nine months was \$334 million, 9.9% higher than the same period last year but marginally higher than the approved budget of \$333 million. The increase was mainly because of provisions for staff variable pay to address, amongst other things, the high staff turnover experienced by the Commission. The staff turnover in 2004 was 11.8%, compared with 6.8% in 2003.

Accumulated surplus for the three quarters was \$122 million, which compared favourably to the nine-month budgeted surplus of \$2 million.

At the end of December, the reserves stood at \$813 million, equivalent to 1.8 times the approved annual operating expenditure (including depreciation) of \$443 million.

The number of staff at the end of the quarter was 426, comprising 384 regular staff and 42 temporary staff.

Meanwhile, at the end of December, the net asset value of the Investor Compensation Fund (ICF) was \$1.46 billion, including the assets of the Unified Exchange Compensation Fund and Commodity Exchange Compensation Fund, which would be ultimately transferred to the ICF.

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


We continued to review the SFO after 21 months of implementation.

A paper consulting the public on proposed amendments to the disclosure of interests regime under Part XV was issued in January 2005. The proposals aim to reduce compliance burden while preserving transparency, and to keep the law in line with developments in the Hong Kong securities market. The proposals address issues including how to make filings easier, disclosure of share pledges by substantial shareholders, the *de minimis* exception, and changes in nature of interests. The consultation will end this month.

Migration to the new licensing regime by intermediaries continued. With three months to go before the end of a two-year transitional period, 83%, or about 14,000, of all those licensees migrating had either migrated or lodged their applications by 31 December 2004. This was up from 78% as at the end of the

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



previous quarter. Those not intending to migrate have been reminded to take early action to return client assets.

### **Improving Market Quality and Investor Protection**

We issued a consultation paper in January 2005 on proposed amendments to the Securities and Futures (Stock Market Listing) Rules to implement the Government's proposal to give statutory backing to the more important requirements of the Listing Rules. This is to enhance the regulation of listing. We proposed new statutory rules to be made under section 36 of the SFO. These rules contain important requirements of the Listing Rules - disclosure of price-sensitive information and specific events; disclosure/publication of annual and periodic reports, including annual and interim accounts; and disclosure of and shareholders' approval for notifiable transactions and connected transactions. Our proposals are related to the Government's proposed amendments to the SFO including empowering the SFC and the Market Misconduct Tribunal to impose civil sanctions on issuers, directors and corporate officers for breaches of the rules.

We released a consultation paper on a review of the Codes on Takeovers and Mergers and Share Repurchases in November. The paper set out proposed changes to keep the Codes up-to-date with market developments and international practice to ensure continued fair treatment for shareholders.

The prospectus-related amendments in the Companies (Amendment) Ordinance 2004 came into force in December. We hope to modernise the public offering regime for shares and debentures under the Companies Ordinance in the final stage of a three-phase overhaul. A public consultation paper is expected to be released this quarter.

Guidelines addressing analyst conflicts of interest were introduced in November after a public consultation. They are scheduled to become effective on 1 April 2005 so that the industry has sufficient time to establish the necessary compliance systems.

In December, we reported to the Legco's Panel on Financial Affairs on the progress of the proposed measures to address risks arising from securities margin financing. Respondents to the public consultation, which ended in October, generally accepted that the rationale behind the proposed reform was to enhance investor protection. Panel members agreed that investors should be afforded better protection, and that the interests of margin clients, in particular those who had not borrowed from their brokers, should be safeguarded. We will continue our dialogue with the industry to identify suitable measures to minimise the risks and allow an appropriate transitional period.

In November, we completed an investor survey on sponsors seeking views from over 1,000 retail investors and 10 multinational fund managers on the standards of sponsors in Hong Kong and on possible measures to enhance the standards. The survey results will be published in early 2005. Meanwhile, we announced in December a plan to conduct a theme inspection on sponsors after the first quarter of 2005 to check their compliance with the *SFC Corporate Finance Adviser Code of Conduct*, especially the due diligence

practice note in the Stock Exchange's Listing Rules which became effective on 1 January 2005.

We have completed a theme inspection of investment advisers who market financial products to the public. Structural and conduct issues of Hong Kong's financial advisory services sector have been identified. We aim to publish our views early this year.

We issued a circular in November to remind brokers to comply with the telephone recording requirements in SFC's *Code of Conduct* and internal control guidelines. We will later conduct a theme inspection on their compliance.

### **Partnership with the Industry**

The number of persons licensed by or registered with us increased steadily from 21,913 as at 30 September to 22,470 as at 31 December 2004.

In relation to mutual recognition of professional qualifications under the first phase of Mainland and Hong Kong Closer Economic Partnership Arrangement, the Hong Kong Securities Institute (HKSI) will hold its first licensing examination for Mainland industry practitioners in Shenzhen in April 2005. The SFC participated in an HKSI seminar in Shenzhen in October to promote the examination.

After a public consultation, new guidelines on disclosure of securities services-related fees and charges were released last November and took effect in January 2005. The guidelines recommend disclosure under six standardised categories. Investors will find it easier to understand what they pay for and compare fees and charges of different intermediaries. We have issued an explanatory leaflet for investors and launched an on-line game on the Electronic Investor Resources Centre (eIRC).

The Academic and Accreditation Advisory Committee approved two re-entry courses of the HKSI and Vocational Training Council as new alternatives to passing licensing examinations, for former practitioners who have left the industry for three to eight years. The Committee also approved Hong Kong Polytechnic University's Management and Executive Development Centre and The Hong Kong Capital Markets Association as new continuous professional training providers.

In view of possible high market volatility in 2005, we issued a circular to licensed corporations in December to remind them to implement prudent risk management policies and procedures.

We also reminded brokers to know their limits when subscribing for shares in IPO on behalf of clients and avoid breaching the Securities and Futures (Financial Resources) Rules. We approved subordinated loans or loan facilities obtained by brokers to enable them to meet the minimum liquid capital requirement under the rules.



Statistical Information and Financial Position of the Securities Industry (Note 1)						
	As at 31 Dec 2004	As at 31 Dec 2003				
Total number of securities dealers and securities margin financiers	663	673				
Total number of active cash clients (Note 2, 3)	609,281	687,802				
Total number of active margin clients (Note 2)	76,546	71,240				
<b>Balance Sheet</b>	<b>(\$ Million)</b>	<b>(\$ Million)</b>				
Cash in hand and at bank (Notes 4, 6)	110,176	88,209				
Amounts receivable from margin clients (Note 5)	17,158	15,327				
Amounts receivable from clients and other dealers arising from dealing in securities (Note 6)	65,357	63,261				
Other assets (Note 7)	138,922	105,003				
<b>Total assets</b>	<b>331,613</b>	<b>271,800</b>				
Amounts payable to clients and other dealers arising from dealing in securities (Note 6)	124,739	109,517				
Total borrowings from financial institutions (Note 6)	56,264	36,786				
Other liabilities (Note 7)	73,620	62,066				
Total shareholders' fund (Note 8)	76,990	63,431				
<b>Total liabilities and shareholders' fund</b>	<b>331,613</b>	<b>271,800</b>				
<p>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.</p> <p>Note 2: Active clients are clients for whom the licensed corporation is required to prepare and deliver monthly statements of account in respect of the relevant reporting month in accordance with Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules.</p> <p>Note 3: The drop in number of active cash clients was mainly due to revocation of the licence of a licensed corporation.</p> <p>Note 4: Cash in hand and at bank includes trust monies held on behalf of clients amounting to \$49,305 million (31/12/2003: \$41,128 million).</p> <p>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):</p> <table border="1"> <thead> <tr> <th><u>As at 31 Dec 2004</u></th> <th><u>As at 31 Dec 2003</u></th> </tr> </thead> <tbody> <tr> <td>4.6</td> <td>4.2</td> </tr> </tbody> </table> <p>Note 6: Increases in these items were mainly due to the increase in trading activities in December 2004 as compared to December 2003.</p> <p>Note 7: Other assets include proprietary positions in securities and other liabilities include short positions in securities held for own account.</p> <p>Note 8: The value of shareholders' fund includes value of redeemable shares.</p>			<u>As at 31 Dec 2004</u>	<u>As at 31 Dec 2003</u>	4.6	4.2
<u>As at 31 Dec 2004</u>	<u>As at 31 Dec 2003</u>					
4.6	4.2					

## Market Developments

Based on recommendations of the Taskforce on Overseas Real Estate Investment by Real Estate Investment Trusts (REITs), we worked on proposed benchmarks for overseas investments by REITs for public consultation in the first quarter this year.

To give greater investment flexibility to funds authorised under Chapter 7 of the Code on Unit Trusts and Mutual Funds, we relaxed in November the prohibition on investment in real estates after consulting the Committee on Unit Trusts. REITs that are authorised by the SFC are permissible investment following the relaxation.



The Link REIT was the first REIT authorised under the Code on REIT, which had sought to raise \$280 billion in its Hong Kong public offering. However, the offering of the Link REIT lapsed, resulting in the cancellation of its proposed listing in December. All application monies under the Hong Kong public offering were refunded to the investors (510,000 investors) in a timely and orderly manner.

To facilitate an orderly migration of European funds in Hong Kong to the Undertakings for Collective Investment in Transferable Securities (UCITS) III regime, we proposed to adopt an interim approach to process the UCITS III fund applications, provided that investors were fully informed of the new features and risks of UCITS III funds. Extensive investor education and market consultation on UCITS III funds will also be conducted.

In November, the SFC approved the first exchange traded fund in Hong Kong to track the performance of an A-share index.

The market for investment-linked assurance products and equity-linked deposits continued to expand. As at 31 December 2004, there were 58 authorised investment-linked deposits (mainly equity-linked deposits) compared to 35 a year ago, representing an increase of 65.7%. The growth in the number and variety of these products will likely continue as banks are focusing on their wealth management business. At the same time, insurance companies launched more products to increase their market share and give investors more choices.


There was continuous interest in capital guaranteed funds (especially funds with variable maturity features), though the pace of introduction has slowed down.

Number of SFC Authorised Collective Investment Schemes			
	31 Dec 2004	30 Sep 2004	31 Dec 2003
Unit trusts and mutual funds	1,933	1,926	1,862
Real estate investment trusts	1	0	0
Investment-linked assurance schemes	175	171	151
Pooled retirement funds	38	38	37
MPF master trust / industry schemes	45	45	46
MPF pooled investment funds (Note 1)	255	253	252
Other schemes (Note 2)	67	57	41
<b>Total</b>	<b>2,514</b>	<b>2,490</b>	<b>2,389</b>
Note 1: There are 109 funds included in this category that are offered both as retail unit trusts as well as pooled investment funds for MPF purpose.			
Note 2: These included equity-linked deposits.			

In December, we consulted the public on an automatic levy triggering mechanism, under which the investor compensation levy will be suspended when the net asset value of the ICF reaches \$1.4 billion. The consultation ended in February and we will publish the conclusions as soon as practicable.

### Supervisory and Enforcement Actions

During the quarter, the SFC successfully prosecuted 21 people and companies - for market manipulation; breaches of disclosure of securities interests law; unlicensed activities; aiding and abetting unlicensed



activities; and issuing unauthorised investment-related advertisements. No evidence was offered against three individuals, resulting in their acquittals.

Three entities appealed to the High Court against their convictions and/or sentences. The appeal by a licensed corporation against its conviction of allowing a person to conduct unlicensed regulated activities was dismissed. A person had his conviction of aiding and abetting unlicensed leveraged foreign exchange trading activities quashed. Another person's sentence of three months' immediate imprisonment for defrauding the SFC was suspended for two years.

We disciplined 25 licensees for misconduct.

- There were 11 suspensions (for one to eight months) and eight reprimands. Among them, one was suspended pursuant to the decision of the Securities and Futures Appeals Tribunal, which reduced the suspension period from the nine months proposed by the SFC to six months. One person and two companies were fined in addition to being reprimanded.
- One licensee was banned for life from the securities industry for poor financial integrity and lying to the SFC.
- We settled disciplinary proceedings against a licensed representative with a payment of \$40,000 in lieu of a proposed three-month suspension. He failed to exercise sufficient due care before accepting trading instructions, thus allowing short selling activities.
- A responsible officer failed to identify potentially suspicious transactions and permitted a person who earned \$5,000 a month to subscribe for \$10 million worth of shares. As a settlement, the licensee agreed not to carry out any regulated activities or act as a responsible officer for one month.
- A responsible officer utilised clients' shares to secure overdraft facilities and provided inaccurate information to the SFC. As a settlement, he agreed to cease business and surrender his licence and undertook never to re-apply for a licence or regulatory approval from the SFC.
- A licensed corporation and its principal supervisor withheld material information from HKEx when acting as sponsor to a listing applicant on Growth Enterprise Market (GEM). As a settlement, the firm was removed from HKEx's approved list of GEM sponsors and agreed not to act as a Main Board sponsor for five months. Its principal supervisor withdrew from the post for nine months, and agreed not to perform or carry out any activities in relation to any listing applicant or listed issuer for the same period.

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

Separately, the Takeovers Executive imposed a cold shoulder order on the chairman and an executive



director of a listed company, publicly censured both persons, the company and five other directors for failing to issue an offeree document to shareholders on a voluntary conditional cash offer made by an outside party.

In December, we reminded market participants to observe the position limits for futures and options under the law, in light of increased market activities and a number of breaches.

In the quarter, the SFC received 27 complaints in relation to boiler room operations. In this regard, liaison work continued with other domestic and overseas enforcement bodies.

<b>Statistics of Enforcement Actions</b>			
	<b>Oct - Dec 2004</b>	<b>Jul - Sep 2004</b>	<b>Oct - Dec 2003</b>
Successful prosecutions	21	23	14
SFC licensees disciplined	25	21	22
Warning letters issued (Note 1)	82	63	133
Cases under investigation (Notes 1, 2 and 3)	523	538	781
Disciplinary inquiries in progress (Note 3)	122	105	99
Note 1:	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.		
Note 2:	Some cases are ongoing investigations from the previous quarter.		
Note 3:	Number of cases as at end of quarters.		

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


We produced a documentary-drama series, Foundations in Wealth Management, which comprised 10 six-minute episodes on investment advisory services and features of niche products. It was broadcast on Cable TV during prime time slots in November and rated one of the station's 10 most popular programmes during the period.

In the quarter, we organised 11 teachers workshops focusing on stock and fund investments. Over 520 secondary school teachers and student teachers of the Hong Kong Institute of Education participated. Some of them later invited the SFC to talk to their students. In addition, we talked to more than 900 people in investor education seminars.

The educational Dr Wise's column discussed concept stocks, including Macau business-related stocks, viatical settlements, REITs, and fees and charges for holding and trading Hong Kong stocks.

<b>Statistics of Investor Enquiries and Public Complaints</b>			
	<b>Oct - Dec 2004</b>	<b>Jul - Sep 2004</b>	<b>Oct - Dec 2003</b>
Enquiries (Note)	1,219	919	1,465
Complaints	306	299	306
Note:	The number of enquiries was higher than the previous quarter because of many enquiries related to IPO activities and listed companies' corporate actions.		

In November, we introduced the new SFC corporate website ([www.sfc.hk](http://www.sfc.hk)) and eIRC ([www.eirc.hk](http://www.eirc.hk)). They have better content and features. The corporate website is customised for seven groups of users



(investors, intermediaries, compliance officers, issuers, media, academics and regulators) so they can get specific information easily. The overall simple design ensures fast response time. The upgrade has significantly improved the usability of the SFC websites in accordance with industry standards.

SFC's *Annual Report 2003-2004* won two awards - a Platinum Award in the Best Corporate Governance Disclosure Awards 2004 organised by the Hong Kong Institute of Certified Public Accountants, and a Silver Award in the Best Annual Reports Awards 2004 of the Hong Kong Management Association.

We continued to publish our bi-monthly newsletter *SFC Alert*, the monthly *SFC Enforcement Reporter*, and the autumn 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 the quarter, we made significant progress in strengthening co-operation with regional regulators. We signed a Memorandum of Understanding (MOU) with the Philippine Securities and Exchange Commission. It establishes a framework for mutual assistance and facilitates the exchange of information to enable better regulation and enforcement of the securities laws and regulations in both jurisdictions. We also signed a Letter of Intent with Thailand's Securities and Exchange Commission on the establishment of regulatory co-operation. Both sides will strengthen co-operation in matters pertaining to cross-border trading and the supervision of regulated funds. We will work towards a set of common goals including entering into a revised MOU.

In December, the International Organization of Securities Commissions (IOSCO) published its *Code of Conduct Fundamentals for Credit Rating Agencies (CRAs)*. It aims to promote investor protection by safeguarding the integrity of the rating process. The *Code Fundamentals* reflects comments received during a consultation conducted by IOSCO, and CRAs were supportive of and contributed to its development. The SFC actively participated in the Chairmen's Task Force of the IOSCO's Technical Committee which was responsible for developing the *Code Fundamentals*.

Last October, the Technical Committee, which I chair, successfully held its first annual conference in New York to discuss emerging international issues concerning the regulation of global securities market.

The Technical Committee, together with the Committee on Payment and Settlement Systems of the central banks of the Group of Ten countries (CPSS), released a report entitled *Recommendations for Central Counterparties* in November. The report sets out comprehensive standards for risk management of central counterparties for both securities and derivatives markets. The SFC participated in the Task Force on Securities Settlement Systems, jointly established by the Technical Committee and the CPSS to formulate these standards.

On enforcement co-operation, the SFC received 12 requests from overseas regulators: nine sought non-public information, one sought public information and two sought investigatory assistance. We



made one request to an overseas regulator for non-public information.

During the quarter, two staff attended training programmes organised by the US Securities and Exchange Commission and the UK Financial Services Authority respectively. Three were seconded to the China Securities Regulatory Commission (CSRC) for two to four weeks each. On the other hand, we received three secondees from the CSRC for four weeks in mid-November.

During the quarter, the SFC welcomed three overseas and local delegations, and six Mainland and Taiwanese delegations from public and private sectors.

### Looking Ahead

I warmly welcome the appointment of Mr Eddy Fong, Mr Kenneth Kwok and Professor Liu Pak-wai by the Financial Secretary to succeed Mr Thomas Brian Stevenson, Mr Daniel Fung and Ms Anna Wu as our Non-Executive Directors. They will serve for two years until 31 December 2006. I am grateful to Mr Stevenson, Mr Fung and Ms Wu for their expert advice and continuous support over the last six years. They have made significant contribution to the SFC and the Hong Kong financial market.

The Commission is pleased that it was awarded the statuses of Approved Continuing Professional Development (CPD) Employer and Accredited Employer in November by the Association of Chartered Certified Accountants (ACCA) in recognition of our training support to staff. We are the first financial regulator in Asia to receive such awards, and the first employer in Hong Kong to become an Approved CPD Employer. We are also a winner of the Labour Department's Good People Management Award 2004 in recognition of our human resources practice, policy and procedures.

We care for those around us, both locally and overseas. We made an appeal to staff for donations to help the victims and others affected by the earthquake and tsunamis in South Asia on 26 December. By the end of January, more than \$350,000 in staff donations were forwarded to the Hong Kong Red Cross, Medecins Sans Frontieres Hong Kong, Salvation Army, World Vision, UNICEF and Oxfam Hong Kong.

In Hong Kong, our volunteers team, the Commission Possible Volunteers Group, organised a Fun Fun Christmas Day for 35 children and parents of a centre for single parent families.

Based on current information and by keeping a tight rein on expenditure, we expect to continue to have a surplus in the final quarter to 31 March 2005.

Andrew Sheng  
Chairman

14 February 2005

# Securities and Futures Commission

## Consolidated Income and Expenditure Account

For the nine months ended 31 December 2004

(Expressed in Hong Kong dollars)

	Note	Unaudited Three Months Ended		Unaudited Nine Months Ended	
		31 Dec 2004	31 Dec 2003	31 Dec 2004	31 Dec 2003
		\$'000	\$'000	\$'000	\$'000
<b>Income</b>					
Levies		127,165	105,952	313,966	245,013
Fees and charges		41,635	36,965	119,618	105,233
Investment income		5,786	5,054	15,942	15,971
Recoveries from the Investor					
Compensation Fund		956	857	2,784	2,136
Other income		404	209	3,831	1,011
		<u>175,946</u>	<u>149,037</u>	<u>456,141</u>	<u>369,364</u>
<b>Expenses</b>					
Staff costs		105,913	79,064	261,552	234,966
Premises					
- rent		5,358	4,559	15,215	14,028
- other		3,397	2,836	9,528	11,487
Other expenses		10,839	7,319	31,659	23,384
		<u>125,507</u>	<u>93,778</u>	<u>317,954</u>	<u>283,865</u>
Depreciation		5,934	7,074	16,388	20,315
		<u>131,441</u>	<u>100,852</u>	<u>334,342</u>	<u>304,180</u>
<b>Surplus</b>	2	<u>44,505</u>	<u>48,185</u>	<u>121,799</u>	<u>65,184</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 17 to 19 form part of the condensed consolidated financial statements.

# Securities and Futures Commission

## Consolidated Balance Sheet

At 31 December 2004

(Expressed in Hong Kong dollars)

	Note	Unaudited At 31 Dec 2004 \$'000	Audited At 31 Mar 2004 \$'000
<b>Non-current assets</b>			
Fixed assets		28,848	34,037
Held-to-maturity debt securities	3	295,329	66,329
<b>Current assets</b>			
Held-to-maturity debt securities	3	527,340	579,802
Bank deposits		59,678	75,781
Debtors, deposits and prepayments		64,861	58,101
Cash at bank and in hand		1,844	2,182
		<u>653,723</u>	<u>715,866</u>
<b>Current liabilities</b>			
Fees received in advance		33,745	34,788
Creditors and accrued charges		56,914	22,198
		<u>90,659</u>	<u>56,986</u>
<b>Net current assets</b>		<u>563,064</u>	<u>658,880</u>
<b>Total assets less current liabilities</b>		887,241	759,246
<b>Non-current liabilities</b>	4	74,418	68,222
<b>Net assets</b>		<u>812,823</u>	<u>691,024</u>
<b>Funding and reserves</b>			
Initial funding by Government		42,840	42,840
Accumulated surplus	2	769,983	648,184
		<u>812,823</u>	<u>691,024</u>

The notes on pages 17 to 19 form part of the condensed consolidated financial statements.

# Securities and Futures Commission

## Balance Sheet

At 31 December 2004

(Expressed in Hong Kong dollars)

	<u>Note</u>	<u>Unaudited</u> <u>At 31 Dec 2004</u> \$'000	<u>Audited</u> <u>At 31 Mar 2004</u> \$'000
<b>Non-current assets</b>			
Fixed assets		28,556	33,597
Held-to-maturity debt securities	3	295,329	66,329
<b>Current assets</b>			
Held-to-maturity debt securities	3	527,340	579,802
Bank deposits		59,678	75,781
Debtors, deposits and prepayments		64,436	57,877
Cash at bank and in hand		342	962
		<u>651,796</u>	<u>714,422</u>
<b>Current liabilities</b>			
Fees received in advance		33,745	34,788
Creditors and accrued charges		54,738	20,366
		<u>88,483</u>	<u>55,154</u>
<b>Net current assets</b>		<u>563,313</u>	<u>659,268</u>
<b>Total assets less current liabilities</b>		887,198	759,194
<b>Non-current liabilities</b>	4	74,375	68,170
<b>Net assets</b>		<u>812,823</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	769,983	648,184
		<u>812,823</u>	<u>691,024</u>

The notes on pages 17 to 19 form part of the condensed consolidated financial statements.



# Securities and Futures Commission

## Consolidated Cash Flow Statement For the nine months ended 31 December 2004

(Expressed in Hong Kong dollars)

	Unaudited Nine months ended 31 Dec 2004 \$'000	Unaudited Nine months ended 31 Dec 2003 \$'000
<b>Cash flows from operating activities</b>		
Surplus	121,799	65,184
Adjustments for:		
Depreciation	16,388	20,315
Investment income	(15,942)	(15,971)
Profit on sale of fixed assets	(27)	(8)
	<u>122,218</u>	<u>69,520</u>
Increase in debtors, deposits and prepayments	(8,750)	(23,389)
Increase in creditors and accrued charges	34,400	1,487
(Decrease) / increase in fees received in advance	(1,043)	1,012
Increase in non-current liabilities	6,196	14,245
	<u>153,021</u>	<u>62,875</u>
<b>Net cash generated from operating activities</b>	-----	-----
<b>Cash flows from investing activities</b>		
Interest received	28,107	17,491
Held-to-maturity debt securities bought	(543,212)	(193,018)
Held-to-maturity debt securities redeemed	356,500	25,000
Fixed assets bought	(10,900)	(27,847)
Fixed assets sold	43	8
	<u>(169,462)</u>	<u>(178,366)</u>
<b>Net cash used in investing activities</b>	-----	-----
<b>Net decrease in cash and cash equivalents</b>	(16,441)	(115,491)
<b>Cash and cash equivalents at beginning of the nine months</b>	<u>77,963</u>	<u>178,792</u>
<b>Cash and cash equivalents at end of the nine months</b>	<u>61,522</u>	<u>63,301</u>
<b>Analysis of the balance of cash and cash equivalents :</b>		
	Unaudited At 31 Dec 2004 \$'000	Unaudited At 31 Dec 2003 \$'000
Bank deposits	59,678	59,129
Cash at bank and in hand	1,844	4,172
	<u>61,522</u>	<u>63,301</u>

# Securities and Futures Commission

## Notes to the Condensed Consolidated Financial Statements

For the nine months ended 31 December 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 financial statements 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 31 December 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 nine months ended 31 December 2004.

### 2. Accumulated surplus

Movements of accumulated surplus during the nine months ended 31 December 2004 are as follows :

	\$'000
Balance at 31 March 2004	648,184
Surplus	121,799
	<hr/>
Balance at 31 December 2004	<u>769,983</u>

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

As of 31 December 2004, the total market value of held-to-maturity debt securities amounted to \$822,917,000 (31 March 2004 : \$655,104,000), which was above the total carrying cost of \$822,669,000 (31 March 2004 : \$646,131,000).



## Securities and Futures Commission

Notes to the Condensed Consolidated Financial Statements  
For the nine months ended 31 December 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 31 December 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 nine months ended 31 December 2004

*(Expressed in Hong Kong dollars)*

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

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

FinNet has not commenced operations. The balance sheet of FinNet as at 31 December 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 nine months ended 31 December 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 21 to 25.

### 3. MEMBERS OF THE COMMITTEE

The members of the Committee during the nine months ended 31 December 2004 and up to the date of this report were:-

Mr. Mark Dickens, JP

Mrs. Alexa Lam

Ms. Anna H. Y. Wu, SBS, JP

Mr. Paul Chow Man Yiu, JP [resigned on 20 September 2004]

Mr. Gerald Greiner [appointed on 20 September 2004]

### 4. INTERESTS IN CONTRACTS

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

On behalf of the Committee

Mark Dickens, JP  
Chairman

28 January 2005

## Investor Compensation Fund

### Income and Expenditure Account

For the nine months ended 31 December 2004

(Expressed in Hong Kong dollars)

	Note	Unaudited Three Months Ended		Unaudited Nine Months Ended	
		31 Dec 2004	31 Dec 2003	31 Dec 2004	31 Dec 2003
		\$'000	\$'000	\$'000	\$'000
<b>Income</b>					
Net investment income		23,117	1,150	34,708	3,500
Transaction levy from the SEHK		48,348	40,432	118,079	92,131
Contract levy from the HKFE		3,179	2,436	9,835	7,347
		<u>74,644</u>	<u>44,018</u>	<u>162,622</u>	<u>102,978</u>
<b>Expenses</b>					
ICC expenses	2	956	710	2,784	3,409
Auditors' remuneration		11	-	29	-
Bank charges		226	24	638	29
Professional fees		514	-	997	12
Exchange difference		3,677	-	4,032	-
Sundry expenses		-	-	1	-
		<u>5,384</u>	<u>734</u>	<u>8,481</u>	<u>3,450</u>
<b>Surplus</b>		69,260	43,284	154,141	99,528
<b>Accumulated surplus brought forward</b>		<u>239,490</u>	<u>56,244</u>	<u>154,609</u>	<u>-</u>
<b>Accumulated surplus carried forward</b>		<u><u>308,750</u></u>	<u><u>99,528</u></u>	<u><u>308,750</u></u>	<u><u>99,528</u></u>

The notes on page 25 form part of the condensed financial statements.

## Investor Compensation Fund

### Balance Sheet

At 31 December 2004

(Expressed in Hong Kong dollars)

	<u>Note</u>	<u>Unaudited</u> <u>At 31 Dec 2004</u> \$'000	<u>Audited</u> <u>At 31 Mar 2004</u> \$'000
<b>Current assets</b>			
Debt securities		1,213,621	174,286
Equity securities		121,132	-
Interest receivable		14,020	1,656
Due from ICC		2,142	1,778
Levy receivable from the SEHK		17,284	16,415
Levy receivable from the HKFE		1,085	1,163
Fixed and call deposits with banks		42,543	766,964
Cash at bank		356	13
		<u>1,412,183</u>	<u>962,275</u>
<b>Current liabilities</b>			
Accounts payable and accrued charges		755	66
		<u>755</u>	<u>66</u>
<b>Net current assets</b>		<u>1,411,428</u>	<u>962,209</u>
<b>Net assets</b>		<u>1,411,428</u>	<u>962,209</u>
Representing:			
<b><u>Compensation fund</u></b>			
Contributions from UECF	3	994,718	699,640
Contributions from CECF	3	107,960	107,960
Accumulated surplus		308,750	154,609
		<u>1,411,428</u>	<u>962,209</u>

The notes on page 25 form part of the condensed financial statements.

**Investor Compensation Fund**  
**Statement of Changes in Equity**  
**For the nine months ended 31 December 2004**  
*(Expressed in Hong Kong dollars)*

	<u>Note</u>	Unaudited Nine Months Ended <u>31 Dec 2004</u> \$'000	Unaudited Nine Months Ended <u>31 Dec 2003</u> \$'000
<b>Compensation Fund balance as at 1 April</b>		962,209	-
<b>Surplus for the period</b>		154,141	99,528
<b>Contributions from UECF</b>	3	295,078	588,040
<b>Contributions from CECF</b>	3	-	105,990
<b>Compensation Fund balance as at 31 December</b>		<u>1,411,428</u>	<u>793,558</u>

The notes on page 25 form part of the condensed financial statements.



## Investor Compensation Fund

### Cash Flow Statement

For the nine months ended 31 December 2004

(Expressed in Hong Kong dollars)

	Unaudited Nine Months Ended 31 Dec 2004 \$'000	Unaudited Nine Months Ended 31 Dec 2003 \$'000
<b>Cash flows from operating activities</b>		
Surplus for the period	154,141	99,528
Net investment income	(34,708)	(3,500)
Exchange difference	3,702	-
Increase in levies receivable	(791)	(14,529)
Increase in amount due from ICC	(364)	(1,812)
Increase in accounts payable and accrued charges	689	4
	<hr/>	<hr/>
<b>Net cash generated from operating activities</b>	<b>122,669</b>	<b>79,691</b>
	<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
<b>Cash flows from investing activities</b>		
Purchase of debt securities	(2,033,676)	(218,379)
Purchase of equity securities	(99,990)	-
Sale or maturity of debt securities	983,263	17,000
Sale of equity securities	136	-
Interest received	8,442	3,001
	<hr/>	<hr/>
<b>Net cash used in investing activities</b>	<b>(1,141,825)</b>	<b>(198,378)</b>
	<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
<b>Cash flows from financing activities</b>		
Contributions received from UECF	295,078	588,040
Contributions received from CECF	-	105,990
	<hr/>	<hr/>
<b>Net cash generated from financing activities</b>	<b>295,078</b>	<b>694,030</b>
	<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
<b>Net (decrease) / increase in cash and cash equivalents</b>	<b>(724,078)</b>	<b>575,343</b>
<b>Cash and cash equivalents at beginning of the nine months</b>	<b>766,977</b>	<b>-</b>
	<hr/>	<hr/>
<b>Cash and cash equivalents at end of the nine months</b>	<b>42,899</b>	<b>575,343</b>
	<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
<b>Analysis of the balance of cash and cash equivalents:</b>		
	Unaudited At 31 Dec 2004 \$'000	Unaudited At 31 Dec 2003 \$'000
Cash at bank	356	17
Fixed and call deposits with banks	42,543	575,326
	<hr/>	<hr/>
	<b>42,899</b>	<b>575,343</b>
	<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>



## **Investor Compensation Fund**

### **Notes to the Condensed Financial Statements**

**For the nine months ended 31 December 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 nine months ended 31 December 2004, ICC incurred \$2,784,000 for its operation (For the nine months ended 31 December 2003 : \$3,409,000).

#### **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 31 December 2004, the SFC has paid \$994,718,000 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 nine months ended 31 December 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 27 to 32.

### 3. MEMBERS OF THE COMMITTEE

The members of the Committee during the nine months ended 31 December 2004 and up to the date of this report were : -

Mr. Mark Dickens, JP  
Mrs. Alexa Lam  
Mr. David M. Roberts  
Mr. Paul Chow Man Yiu, JP  
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 nine months.

On behalf of the Committee

Mark Dickens, JP  
Chairman

28 January 2005

# Unified Exchange Compensation Fund

## Income and Expenditure Account

For the nine months ended 31 December 2004

(Expressed in Hong Kong dollars)

	Note	Unaudited Three Months Ended		Unaudited Nine Months Ended	
		31 Dec 2004 \$'000	31 Dec 2003 \$'000	31 Dec 2004 \$'000	31 Dec 2003 \$'000
<b>Income</b>					
Net investment income		87	1,478	853	6,992
Transaction levy		-	-	-	(4)
Compensation refund from claimants		-	3,630	-	31,810
Recoveries	2	4,236	20,284	15,007	39,869
Provision for compensation reversed		1,232	812	4,763	3,783
		<u>5,555</u>	<u>26,204</u>	<u>20,623</u>	<u>82,450</u>
<b>Expenses</b>					
Auditors' remuneration		10	10	28	31
Bank charges		-	21	29	97
Professional fees		-	25	23	112
Sundry expenses		-	-	1	49
		<u>10</u>	<u>56</u>	<u>81</u>	<u>289</u>
<b>Surplus</b>		<b>5,545</b>	<b>26,148</b>	<b>20,542</b>	<b>82,161</b>
<b>Accumulated surplus / (deficit) brought forward</b>		<b>1,713</b>	<b>(109,123)</b>	<b>(13,284)</b>	<b>(165,136)</b>
<b>Accumulated surplus / (deficit) carried forward</b>		<b>7,258</b>	<b>(82,975)</b>	<b>7,258</b>	<b>(82,975)</b>

The notes on pages 31 and 32 form part of the condensed financial statements.

## Unified Exchange Compensation Fund

### Balance Sheet

At 31 December 2004

(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited <u>At 31 Dec 2004</u> \$'000	Audited <u>At 31 Mar 2004</u> \$'000
<b>Current assets</b>			
Debt securities		-	160,985
Equity securities received under subrogation	2	8,132	7,251
Interest receivable		4	2,024
Fixed and call deposits with banks		47,347	167,407
Cash at bank		83	215
		<u>55,566</u>	<u>337,882</u>
<b>Current liabilities</b>			
Accounts payable and accrued charges		4,261	4,522
Provision for compensation	3	2,276	9,545
		<u>6,537</u>	<u>14,067</u>
<b>Net current assets</b>		<u>49,029</u>	<u>323,815</u>
<b>Net assets</b>		<u>49,029</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)		7,258	(13,284)
		<u>1,043,747</u>	<u>1,023,455</u>
Contributions to Investor Compensation Fund	5	(994,718)	(699,640)
		<u>49,029</u>	<u>323,815</u>

The notes on pages 31 and 32 form part of the condensed financial statements.

**Unified Exchange Compensation Fund**  
**Statement of Changes in Equity**  
**For the nine months ended 31 December 2004**  
*(Expressed in Hong Kong dollars)*

	<u>Note</u>	Unaudited Nine Months Ended <u>31 Dec 2004</u> \$'000	Unaudited Nine Months Ended <u>31 Dec 2003</u> \$'000
<b>Compensation Fund balance as at 1 April</b>		323,815	871,603
<b>Surplus for the period</b>		20,542	82,161
<b>Contributions refunded to the SEHK</b>	4	(250)	-
<b>Contributions to Investor Compensation Fund</b>	5	(295,078)	(588,040)
<b>Compensation Fund balance as at 31 December</b>		<u>49,029</u>	<u>365,724</u>

The notes on pages 31 and 32 form part of the condensed financial statements.

**Unified Exchange Compensation Fund**  
**Cash Flow Statement**  
**For the nine months ended 31 December 2004**  
*(Expressed in Hong Kong dollars)*

	Unaudited Nine Months Ended 31 Dec 2004 \$'000	Unaudited Nine Months Ended 31 Dec 2003 \$'000
<b>Cash flows from operating activities</b>		
Surplus for the period	20,542	82,161
Net investment income	(853)	(6,992)
Decrease in levy receivable	-	5,607
Increase in equity securities received under subrogation	(881)	(4,936)
Decrease in provision for compensation (Decrease) / increase in accounts payable and accrued charges	(7,269)	(17,897)
	<u>(261)</u>	<u>77</u>
<b>Net cash generated from operating activities</b>	<u>11,278</u>	<u>58,020</u>
<b>Cash flows from investing activities</b>		
Debt securities redeemed	90,500	205,000
Debt securities sold	67,763	166,824
Interest received	5,595	18,188
<b>Net cash generated from investing activities</b>	<u>163,858</u>	<u>390,012</u>
<b>Cash flows from financing activities</b>		
Contributions refunded to the SEHK	(250)	-
Contributions to Investor Compensation Fund	(295,078)	(588,040)
<b>Net cash used in financing activities</b>	<u>(295,328)</u>	<u>(588,040)</u>
<b>Net decrease in cash and cash equivalents</b>	(120,192)	(140,008)
<b>Cash and cash equivalents at beginning of the nine months</b>	<u>167,622</u>	<u>339,704</u>
<b>Cash and cash equivalents at end of the nine months</b>	<u>47,430</u>	<u>199,696</u>
<b>Analysis of the balance of cash and cash equivalents:</b>		
	Unaudited At 31 Dec 2004 \$'000	Unaudited At 31 Dec 2003 \$'000
Cash at bank	83	594
Fixed and call deposits with banks	<u>47,347</u>	<u>199,102</u>
	<u>47,430</u>	<u>199,696</u>



**Unified Exchange Compensation Fund**  
**Notes to the Condensed Financial Statements**  
**For the nine months ended 31 December 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 31 December 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 nine months ended 31 December 2004	(2,506)
Less: unused provision reversed during the nine months ended 31 December 2004	<u>(4,763)</u>
Balance as at 31 December 2004	<u><u>2,276</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 nine months ended 31 December 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 nine months ended 31 December 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 \$295,078,000 into the ICF from the Fund. Total contributions paid into the ICF upto 31 December 2004 amounted to \$994,718,000.

**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 nine months ended 31 December 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 34 to 38.

### 3. MEMBERS OF THE COMMITTEE

The members of the Committee during the nine months ended 31 December 2004 and up to the date of this report were :-

Mr. Mark Dickens, JP

Mrs. Alexa Lam

Mr. Calvin Tai

Mr. Lawrence Fok [resigned on 31 May 2004]

Mr. Gerald Greiner [appointed on 21 June 2004]

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 nine months.

On behalf of the Committee

Mark Dickens, JP

Chairman

28 January 2005

## Commodity Exchange Compensation Fund

### Income and Expenditure Account

For the nine months ended 31 December 2004

(Expressed in Hong Kong dollars)

	Unaudited Three Months Ended		Unaudited Nine Months Ended	
	31 Dec 2004	31 Dec 2003	31 Dec 2004	31 Dec 2003
	\$'000	\$'000	\$'000	\$'000
<b>Income</b>				
Net investment income	1	12	1	730
<b>Expenses</b>				
Auditors' remuneration	10	10	28	31
Bank charges	1	3	1	21
Professional fees	-	3	9	22
Sundry expenses	-	-	1	1
	11	16	39	75
<b>(Deficit) / Surplus</b>	(10)	(4)	(38)	655
<b>Accumulated surplus brought forward</b>	108,234	108,272	108,262	107,613
<b>Accumulated surplus carried forward</b>	108,224	108,268	108,224	108,268

The note on page 38 forms part of the condensed financial statements.

## Commodity Exchange Compensation Fund

### Balance Sheet

At 31 December 2004

(Expressed in Hong Kong dollars)

	Unaudited At 31 Dec 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
	<hr/>	<hr/>
	491	529
<b>Current liabilities</b>		
Accounts payable and accrued charges	227	227
	<hr/>	<hr/>
<b>Net current assets</b>	264	302
	<hr/> <hr/>	<hr/> <hr/>
<b>Net assets</b>	264	302
	<hr/> <hr/>	<hr/> <hr/>
Representing:		
<b><u>Compensation fund</u></b>		
Accumulated surplus	108,224	108,262
Contributions to Investor Compensation Fund	(107,960)	(107,960)
	<hr/>	<hr/>
	264	302
	<hr/> <hr/>	<hr/> <hr/>

The note on page 38 forms part of the condensed financial statements.

**Commodity Exchange Compensation Fund**  
**Statement of Changes in Equity**  
**For the nine months ended 31 December 2004**  
*(Expressed in Hong Kong dollars)*

	Unaudited Nine Months Ended <u>31 Dec 2004</u> \$'000	Unaudited Nine Months Ended <u>31 Dec 2003</u> \$'000
Compensation Fund balance as at 1 April	302	129,013
(Deficit) / Surplus for the period	(38)	655
Net contributions reimbursed to the HKFE	-	(21,400)
Contributions to Investor Compensation Fund	-	(105,990)
Compensation Fund balance as at 31 December	<u>264</u>	<u>2,278</u>

The note on page 38 forms part of the condensed financial statements.

## Commodity Exchange Compensation Fund

### Cash Flow Statement

For the nine months ended 31 December 2004

(Expressed in Hong Kong dollars)

	Unaudited Nine Months Ended 31 Dec 2004 \$'000	Unaudited Nine Months Ended 31 Dec 2003 \$'000
<b>Cash flows from operating activities</b>		
(Deficit) / Surplus for the period	(38)	655
Net investment income	-	(730)
Decrease in levy receivable	-	772
Decrease in accounts payable and accrued charges	-	(24)
	<hr/>	<hr/>
<b>Net cash (used in) / generated from operating activities</b>	<b>(38)</b>	<b>673</b>
	<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
<b>Cash flows from investing activities</b>		
Debt securities redeemed	-	23,000
Debt securities sold	-	51,554
Interest received	-	2,766
	<hr/>	<hr/>
<b>Net cash generated from investing activities</b>	<b>-</b>	<b>77,320</b>
	<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
<b>Cash flows from financing activities</b>		
Contributions reimbursed to HKFE	-	(21,400)
Contributions to Investor Compensation Fund	-	(105,990)
	<hr/>	<hr/>
<b>Net cash used in financing activities</b>	<b>-</b>	<b>(127,390)</b>
	<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
<b>Net decrease in cash and cash equivalents</b>	<b>(38)</b>	<b>(49,397)</b>
<b>Cash and cash equivalents at beginning of the nine months</b>	<b>529</b>	<b>51,903</b>
	<hr/>	<hr/>
<b>Cash and cash equivalents at end of the nine months</b>	<b>491</b>	<b>2,506</b>
	<hr style="border-top: 3px double black;"/>	<hr style="border-top: 3px double black;"/>
<b>Analysis of the balance of cash and cash equivalents:</b>		
	Unaudited At 31 Dec 2004 \$'000	Unaudited At 31 Dec 2003 \$'000
Cash at bank	4	10
Fixed and call deposits with banks	487	2,496
	<hr/>	<hr/>
	<b>491</b>	<b>2,506</b>
	<hr style="border-top: 3px double black;"/>	<hr style="border-top: 3px double black;"/>



## Commodity Exchange Compensation Fund

### Notes to the Condensed Financial Statements

For the nine months ended 31 December 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.