

G.N. 4342

SECURITIES AND FUTURES ORDINANCE (Chapter 571)

Pursuant to section 240(9b) of the Securities and Futures Ordinance, the audited financial statements of the Investor Compensation Fund for the financial year ended 31 March 2017 are set out on pages 17872 to 17887.

Keith LUI *Chairman of
Investor Compensation Fund Committee*

INVESTOR COMPENSATION FUND
REPORT OF THE INVESTOR COMPENSATION FUND COMMITTEE

The members of the Investor Compensation Fund Committee (the Committee) present their annual report together with the audited financial statements for the year ended 31 March 2017.

Establishment of the Investor Compensation Fund

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

Financial statements

The financial performance of the Fund for the financial year ended 31 March 2017 and the financial position of the Fund as at that date are set out in the financial statements on pages 17875 to 17887.

Members of the Committee

The members of the Committee during the year ended 31 March 2017 and up to the date of this report were:

Mr Keith Lui	(Chairman)
Ms Teresa Ko Yuk-yin, JP	
Mr Lee Kwok Keung	
Mr Thomas Allan Atkinson	(appointed on 28 September 2016)

Interests in contracts

No contract of significance to which the Fund was a party, and in which a Committee member of the Fund had a material interest, subsisted at the end of the financial year or at any time during the financial year.

23 May 2017

By order of the Committee
Keith LUI
Chairman

INDEPENDENT AUDITOR'S REPORT TO THE SECURITIES AND FUTURES COMMISSION

Opinion

We have audited the financial statements of Investor Compensation Fund (the Fund) established under Part XII of the Securities and Futures Ordinance set out on pages 17875 to 17887, which comprise the statement of financial position as at 31 March 2017, the statement of profit or loss and other comprehensive income, the statement of changes in equity and the cash flow statement for the year then ended and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the financial statements give a true and fair view of the financial position of the Fund as at 31 March 2017 and of its financial performance and its cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards (HKFRSs) issued by the Hong Kong Institute of Certified Public Accountants (HKICPA).

Basis for opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing (HKSA) issued by the HKICPA. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the Fund in accordance with the HKICPA's Code of Ethics for Professional Accountants (the Code) and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Information other than the financial statements and auditor's report thereon

The directors of the Securities and Futures Commission (SFC) are responsible for the other information. The other information comprises all the information included in the annual report, other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the directors of the SFC for the financial statements

The directors of the SFC are responsible for the preparation of the financial statements that give a true and fair view in accordance with HKFRSs issued by the HKICPA and for such internal control as the directors of the SFC determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors of the SFC are responsible for assessing the Fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors of the SFC either intend to liquidate the Fund or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. This report is made solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSA will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the

aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with HKSAAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors of the SFC.
- Conclude on the appropriateness of the directors of the SFC's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Fund's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Fund to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the directors of the SFC regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

23 May 2017

KPMG
Certified Public Accountants
8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

INVESTOR COMPENSATION FUND
STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 MARCH 2017

(Expressed in Hong Kong dollars)

	<i>Note</i>	<i>2017</i> \$'000	<i>2016</i> \$'000
Income			
Net investment income	5	77,141	12,938
Exchange difference		3,110	662
Recoveries		1	7
		<u>80,252</u>	<u>13,607</u>
Expenses			
Investor Compensation Company Limited expenses	7	5,574	5,398
Compensation expenses	8	182	7,341
Auditor's remuneration		131	124
Bank charges		967	934
Professional fees		3,871	3,752
		<u>10,725</u>	<u>17,549</u>
Surplus/(loss) and total comprehensive income for the year		<u><u>69,527</u></u>	<u><u>(3,942)</u></u>

The notes on pages 17879 to 17887 form part of these financial statements.

**INVESTOR COMPENSATION FUND
STATEMENT OF FINANCIAL POSITION
AT 31 MARCH 2017**

(Expressed in Hong Kong dollars)

	Note	2017 \$'000	2016 \$'000
Current assets			
Financial assets designated at fair value through profit or loss			
- Debt securities	9	1,893,248	1,866,404
- Pooled fund	9	330,386	282,860
Interest receivable		13,651	13,367
Due from Investor Compensation Company Limited		75	73
Fixed deposits with banks	10	26,201	7,788
Cash at bank	10	18,770	43,175
		<u>2,282,331</u>	<u>2,213,667</u>
Current liabilities			
Provision for compensation	8	476	1,412
Creditors and accrued charges		1,449	1,376
		<u>1,925</u>	<u>2,788</u>
Net current assets		<u>2,280,406</u>	<u>2,210,879</u>
Net assets		<u>2,280,406</u>	<u>2,210,879</u>
Representing :			
<u>Compensation fund</u>			
Contributions from Unified Exchange Compensation Fund	11	994,718	994,718
Contributions from Commodity Exchange Compensation Fund	11	108,923	108,923
Accumulated surplus		<u>1,176,765</u>	<u>1,107,238</u>
		<u>2,280,406</u>	<u>2,210,879</u>

Approved and authorised for issue by the Securities and Futures Commission on 23 May 2017 and signed on its behalf by

Carlson Tong
Chairman of the SFC

Ashley Alder
Chief Executive Officer of the SFC

The notes on pages 17879 to 17887 form part of these financial statements.

INVESTOR COMPENSATION FUND
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 MARCH 2017

(Expressed in Hong Kong dollars)

	Contributions from Unified Exchange Compensation Fund \$'000	Contributions from Commodity Exchange Compensation Fund \$'000	Accumulated surplus \$'000	Total \$'000
Balance at 1 April 2015	994,718	108,923	1,111,180	2,214,821
Loss and total comprehensive income for the year	-	-	(3,942)	(3,942)
Balance at 31 March 2016 and 1 April 2016	994,718	108,923	1,107,238	2,210,879
Surplus and total comprehensive income for the year	-	-	69,527	69,527
Balance at 31 March 2017	<u>994,718</u>	<u>108,923</u>	<u>1,176,765</u>	<u>2,280,406</u>

The notes on pages 17879 to 17887 form part of these financial statements.

**INVESTOR COMPENSATION FUND
CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 MARCH 2017**

(Expressed in Hong Kong dollars)

	2017 \$'000	2016 \$'000
Cash flows from operating activities		
Surplus / (loss) for the year	69,527	(3,942)
Adjustments for:		
Net investment income	(77,141)	(12,938)
Exchange difference	(3,110)	(662)
	(10,724)	(17,542)
(Increase) / decrease in amount due from Investor Compensation Company Limited	(2)	84
Decrease in provision for compensation	(936)	(42,396)
Increase / (decrease) in creditors and accrued charges	73	(36)
	(11,589)	(59,890)
Net cash used in operating activities		
Cash flows from investing activities		
Debt securities purchased	(536,658)	(505,239)
Debt securities sold or redeemed	494,332	514,675
Equity securities sold	1,455	1,450
Interest received	46,468	45,922
	5,597	56,808
Net cash generated from investing activities		
Net decrease in cash and cash equivalents	(5,992)	(3,082)
Cash and cash equivalents at beginning of the year	50,963	54,045
Cash and cash equivalents at end of the year	44,971	50,963
 Analysis of the balance of cash and cash equivalents		
	2017	2016
	\$'000	\$'000
Fixed deposits with banks	26,201	7,788
Cash at bank	18,770	43,175
	44,971	50,963

The notes on pages 17879 to 17887 form part of these financial statements.

INVESTOR COMPENSATION FUND
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 MARCH 2017

(Expressed in Hong Kong dollars)

1. *Purpose, limitation and principal activity*

The Securities and Futures Ordinance (SFO) provides for the establishment of the Investor Compensation Fund (the Fund) to compensate investors who suffer a loss due to the default of an intermediary in relation to trading of products on Hong Kong Exchanges and Clearing Limited. The defaulting intermediary must be licensed by or registered with the Securities and Futures Commission (SFC) for dealing in securities, futures contracts or securities margin financing.

The SFC is primarily responsible for the administration and management of the Fund in accordance with Section 238 of the SFO, but has transferred some functions to the Investor Compensation Company Limited (ICC) under Section 80 of the SFO. The ICC is thus responsible for receipt, determination and payment of valid claims against the Fund in respect of defaults of intermediaries occurring on or after 1 April 2003. Upon making payment to a claimant, the SFC is subrogated to the claimant's right against the defaulter.

Pursuant to Section 244 of the SFO, the Chief Executive in Council has by order set the maximum amount of compensation at \$150,000 per claimant for a single default in relation to securities traded at The Stock Exchange of Hong Kong Limited (SEHK) or futures contracts traded at Hong Kong Futures Exchange Limited (HKFE).

If amounts owed to claimants against the Fund exceed the Fund's net assets, the SFC would apportion compensation payments to claimants as provided in the Securities and Futures (Investor Compensation-Claims) Rules. The SFC would pay unpaid claim amounts when funds become available in the Fund.

2. *Money constituting the Fund*

The Fund mainly consists of the amounts paid from the two compensation funds, the Unified Exchange Compensation Fund (UECF) and the Commodity Exchange Compensation Fund (CECF) (wound up on 26 May 2006). The SFC will also pay into the Fund any remaining balance in the Securities Dealers' Deposits Fund, the Commodities Dealers' Deposits Fund and the Securities Margin Financiers' Security Fund after repaying the dealers' deposits and any money due to the registered dealers in accordance with Section 76 (11) of Schedule 10 of the SFO though it is not likely that these payments will be made within the coming year.

Other sources of money for the Fund include the levies chargeable on securities traded on SEHK and futures contracts traded on HKFE (see also note 6), and returns earned on the investment of the Fund (see also note 5).

3. *Significant accounting policies*

(a) *Statement of compliance*

These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (HKFRSs), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (HKASs) and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (HKICPA) and accounting principles generally accepted in Hong Kong. A summary of the significant accounting policies adopted by the Fund is set out below.

The HKICPA has issued certain new and revised HKFRSs that are first effective or available for early adoption for the current accounting period of the Fund. Note 3(m) provides information on any changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Fund for the current and prior accounting periods reflected in these financial statements.

The Fund has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 15).

(b) *Basis of preparation*

We have prepared these financial statements using the historical cost basis as the measurement basis, except that we state financial instruments classified as designated at fair value through profit or loss at their fair value (see note 3(e)).

We prepare the financial statements in conformity with HKFRSs which require management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. We make estimates and associated assumptions based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

We review estimates and underlying assumptions on an ongoing basis. We recognise revisions to accounting estimates in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

(c) *Recognition of income*

We recognise income in the statement of profit or loss and other comprehensive income provided it is probable that the economic benefits will flow to the Fund and we can measure reliably the revenue and costs. We record interest income as it accrues using the effective interest method.

(d) *Translation of foreign currencies*

We translate foreign currency transactions during the year into Hong Kong dollars at the foreign exchange rates ruling at the transaction dates. We translate monetary assets and liabilities denominated in foreign currencies that are stated at fair value into Hong Kong dollars at the foreign exchange rates ruling at the end of the reporting period. We record exchange gains and losses on translation in the statement of profit or loss and other comprehensive income.

(e) *Financial instruments*

(i) *Initial recognition*

We classify the financial instruments into different categories at inception, depending on the purpose for which the assets were acquired or the liabilities were incurred. The categories are: fair value through profit or loss, loans and receivables and other financial liabilities.

We initially measure financial instruments at fair value, which normally will be equal to the transaction price, plus, in case of a financial asset or financial liability not held at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. We charge transaction costs on financial assets and financial liabilities at fair value through profit or loss immediately.

We account for financial assets and financial liabilities on the date the Fund becomes a party to the contractual provisions of the instrument. We use settlement date accounting to record regular purchase or sale of financial assets. From this date, we record in our books any gains and losses arising from changes in fair value of the financial assets or financial liabilities at fair value through profit or loss.

The Fund's financial instruments mainly consist of debt and equity securities designated at fair value through profit or loss. We state financial assets and liabilities under this category at fair value and recognise changes in the fair value in the statement of profit or loss and other comprehensive income in the period in which they arise. Upon disposal or repurchase, the difference between the net sale proceeds or the net payment and the carrying value is included in the statement of profit or loss and other comprehensive income.

(ii) *Fair value measurement principles*

We determine the fair value of financial instruments based on their quoted market prices on a recognised stock exchange or a price from a broker/dealer for non-exchange-

traded financial instruments at the end of the reporting period without any deduction for estimated future selling costs. Financial assets are priced at current bid prices, while financial liabilities are priced at current asking prices. Unlisted equity investments are shares in pooled funds. The fair value is determined based on the Fund's share in the net assets of the pooled funds as determined by the custodian.

(iii) *Derecognition*

We derecognise a financial asset when the contractual rights to receive the cash flows from the financial asset expire, or where the financial asset together with substantially all the risks and rewards of ownership have been transferred.

We derecognise a financial liability when the obligation specified in the contract is discharged, cancelled or expired.

(iv) *Offsetting*

We offset the financial assets and financial liabilities and report the net amount in the statement of financial position where there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(f) *Impairment*

The carrying amount of the Fund's assets are reviewed at each reporting period to determine whether there is objective evidence of impairment. Objective evidence that financial assets are impaired includes observable data that comes to the attention of the Fund about one or more of the following loss events which have an impact on the future cash flows of the assets that can be estimated reliably:

- significant financial difficulty of the issuer or borrower;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- significant changes in the technological, market, economic or legal environment that have an adverse effect on the borrower;
- disappearance of an active market for financial assets because of financial difficulties; and
- a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost.

If any such evidence exists, the carrying amount of financial assets held at amortised cost is reduced to the estimated recoverable amount by means of a charge to the statement of profit or loss and other comprehensive income.

(g) *Cash and cash equivalents*

Cash and cash equivalents comprise cash at bank and in hand and demand deposits with banks and other financial institutions.

(h) *Other receivables*

We state other receivables initially at fair value and thereafter at amortised cost less impairment losses (see note 3(f)), unless the effect of discounting would be immaterial, in which case we state them at cost less impairment losses.

(i) *Provision for compensation*

We make provision for liabilities arising from claims resulting from defaults for which it is probable that the Fund will require an outflow of economic benefits to settle the obligation and the amount can be estimated reliably, independent of whether a notice calling for claims pursuant to Section 3 of the Securities and Futures (Investor Compensation-Claims) Rules has been published. The provision covers all such claims received up to the date on which the financial statements are approved by the SFC. If the effect is material, we determine provisions by discounting the expected future cash flows that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

The maximum liability of the Fund to claims for each default case is set at \$150,000 per claimant.

As the Fund is continually updating information in respect of claims received, it is possible that the recent claim experience is not indicative of future payments that will be required for claims received as at the end of the reporting period. Any increase or decrease in the provision would affect profit and loss in future years.

(j) *Creditors and accrued charges*

We state creditors and accrued charges initially at fair value and thereafter at amortised cost unless the effect of discounting would be immaterial, in which case we state them at cost.

(k) *Provisions and contingent liabilities*

We recognise a provision in the statement of financial position when the Fund has a legal or constructive obligation of uncertain timing or amount as a result of a past event, and it is probable that the Fund will require an outflow of economic benefits to settle the obligation and the amount can be estimated reliably.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, we disclose the obligation as a contingent liability, unless the probability of outflow of economic benefits is remote. We also disclose possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events as contingent liabilities unless the probability of outflow of economic benefits is remote.

(l) *Related parties*

For the purpose of these financial statements, a party is considered to be related to the Fund if:—

- (a) A person, or a close member of that person's family, is related to the Fund if that person:—
 - (i) has control or joint control over the Fund;
 - (ii) has significant influence over the Fund; or
 - (iii) is a member of the key management personnel of the Fund.
- (b) An entity is related to the Fund if any of the following conditions applies:
 - (i) The entity and the Fund are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
 - (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
 - (iii) Both entities are joint ventures of the same third party.
 - (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
 - (v) The entity is a post-employment benefit plan for the benefit of employees of either the group or an entity related to the group.
 - (vi) The entity is controlled or jointly controlled by a person identified in (a).
 - (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).
 - (viii) The entity, or any member of a group of which it is a part, provides key management personnel services to the Fund.

Close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity.

(m) *Changes in accounting policies*

The HKICPA has issued a number of amendments to HKFRSs that are first effective for the current accounting period of the Fund. None of these developments have had a material effect on how the Fund's results and financial position for the current or prior periods have been prepared or presented.

The Fund has not applied any new standard or interpretation that is not yet effective for the current accounting period.

4. *Taxation*

The interest and profits on investments earned by the Fund are not subject to Hong Kong Profits Tax under Section 14 of the Inland Revenue Ordinance.

5. *Net investment income*

	2017 \$'000	2016 \$'000
Interest income from bank deposits	84	58
Interest income on financial assets designated at fair value through profit or loss	41,923	42,269
Realised gain/(loss) on disposal of equity securities	4	(38)
Realised loss on redemption/disposal of debt securities	(1,615)	(2,862)
Gain/(loss) on revaluation of equity securities	48,362	(20,655)
Loss on revaluation of debt securities	(11,617)	(5,834)
Net investment income	<u>77,141</u>	<u>12,938</u>

6. *Levy from SEHK and HKFE*

From 1 April 2003, the Fund received a levy chargeable on leviable SEHK transactions and leviable HKFE contracts pursuant to Part 2 and Part 3 of the Securities and Futures (Investor Compensation—Levy) Rules.

After the Securities and Futures (Investor Compensation—Levy) (Amendment) Rules 2005 came into effect on 28 October 2005, a levy suspension and re-instatement mechanism was established whereby the investor compensation levies can be suspended when the net asset value of the Fund exceeds \$1.4 billion, and subsequently reinstated when the net asset value of the Fund falls below \$1 billion. Pursuant to the Securities and Futures (Investor Compensation—Levy) (Amendment) Rules 2005 and the Gazette on 11 November 2005, no person is required to pay any levy to the Fund in respect of a sale and purchase transaction of securities and futures contract with effect from 19 December 2005.

7. *ICC expenses*

The SFC formed the 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 SFO. The Fund is responsible for funding the establishment and operation of the ICC. For the year ended 31 March 2017, the ICC incurred costs of \$5,574,000 for its operations (2016: \$5,398,000) which were reimbursed by the Fund.

8. *Provision for compensation*

	\$'000
Balance as at 1 April 2015	43,808
Add : compensation expenses during the year ended 31 March 2016	11,142
Less : compensation write-backs during the year ended 31 March 2016	(3,801)
Less : compensation paid during the year ended 31 March 2016	<u>(49,737)</u>
Balance as at 31 March 2016 and 1 April 2016	1,412
Add : compensation expenses during the year ended 31 March 2017	476
Less : compensation write-backs during the year ended 31 March 2017	(294)
Less : compensation paid during the year ended 31 March 2017	<u>(1,118)</u>
Balance as at 31 March 2017	<u>476</u>

As at 31 March 2017, the provision for compensation relates to a number of claims received in respect of two default cases. The maximum liability of the Fund to claims for these cases are set at \$150,000 per claimant. The provision for compensation at 31 March 2017 was \$476,000 (31 March 2016: \$1,412,000). As at 31 March 2017, all provisions were expected to be paid within one year.

9. *Financial assets designated at fair value through profit or loss*

	2017 \$'000	2016 \$'000
(a) Debt securities		
(i) Listing status		
Listed - outside Hong Kong	977,432	842,327
Listed - in Hong Kong	490,715	487,379
Unlisted	<u>425,101</u>	<u>536,698</u>
	<u>1,893,248</u>	<u>1,866,404</u>
(ii) Maturity profile		
Within one year	856,310	268,269
After one year but within two years	361,785	892,544
After two years but within five years	635,207	663,757
After five years	<u>39,946</u>	<u>41,834</u>
	<u>1,893,248</u>	<u>1,866,404</u>
(iii) The weighted average effective interest rate of debt securities on 31 March 2017 was 2.1% (2016: 1.8%).		
(b) Pooled fund - Unlisted	<u>330,386</u>	<u>282,860</u>

The pooled fund comprises mainly listed equity securities.

10. *Deposits with banks and cash at bank*

The effective interest rate on deposits with banks and cash at bank at 31 March 2017 ranged from 0.50% to 1.26% (2016: 0.25% to 0.70%). The balances of deposits at both 31 March 2017 and 31 March 2016 mature within one year.

11. *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 UECF and the CECF as it considers appropriate after 1 April 2003. Up to 31 March 2017, the SFC had \$994,718,000 (2016: \$994,718,000) and \$108,923,000 (2016: \$108,923,000) paid into the Fund from the UECF and the CECF respectively.

The Fund defines 'capital' as including contributions from the UECF and the CECF and the accumulated surplus.

12. *Material related party transactions*

We have related party relationships with the SFC, ICC and the UECF. There were no significant related party transactions other than those disclosed in the financial statements of the Fund for the years ended 31 March 2016 and 2017 (refer to notes 7 and 11).

13. *Financial risk management and fair values*

The financial assets of the Fund mainly comprise debt securities and units in a pooled fund. The underlying investments of the pooled fund mainly comprise equity securities.

The main financial risks of the Fund arise from its investments in debt securities and units in the pooled fund. The SFC appoints external investment managers to manage the Fund's investments and to ensure that the portfolio's investments comply with the Fund's investment policy approved by the SFC which sets control limits on credit risk, market risk, interest rate risk, liquidity risk and foreign currency risk. The external investment managers report thereon to the SFC on a regular basis.

The Fund's exposure to these risks and the financial risk management policies and practices used by the Fund to manage these risks are described below.

(a) *Credit risk*

The Fund's Investment Policy and Administrative Guidelines (the Policy) only allows the Fund to invest in pooled funds, fixed rate dated securities rated A or above or in bank deposits. The Policy further limits the Fund's exposure to each issuer and each country, except for holdings of US Treasuries, any issuances by the Hong Kong Government and the

Government of the People's Republic of China and approved pooled funds. The Fund's investment managers are responsible for managing the portfolio and ensuring the portfolio's investments meet the Policy and restrictions and reports thereon on a monthly basis. During the year, the Fund complied with the above Policy. The maximum exposure to credit risk is the carrying value of the assets in the statement of financial position.

(b) *Liquidity risk*

The Fund's policy is to regularly monitor its liquidity requirement to ensure that it maintains sufficient reserves of cash and readily realisable marketable securities to meet its liquidity requirements in the short and longer term.

All financial liabilities are due within one year or payable on demand.

(c) *Interest rate risk*

The Fund's interest bearing assets mainly comprise fixed interest rate bearing debt securities and bank deposits. The Fund's bank deposits are exposed to short-term bank deposit interest re-pricing risk.

The Fund is subject to the risk that future cash flows of a debt security will fluctuate because of changes in market interest rates. In order to manage the re-pricing risk, the Fund adopts a policy of maintaining duration at no more than five years within its debt securities portfolio. As at 31 March 2017 the duration was 1.55 years (31 March 2016: 1.74 years).

At 31 March 2017, it is estimated that a general increase/decrease of 100 basis points in interest rates, with all other variables held constant, would decrease/increase the Fund's gains on revaluation of debt securities and the accumulated surplus by approximately \$29,659,000 (2016: \$32,475,000). Further, at 31 March 2017, it is estimated that a general increase/decrease of 100 basis points in interest rates, with all other variables held constant, would increase/decrease the Fund's interest income and the accumulated surplus by approximately \$5,031,000 (2016: \$1,076,000). Other components of the accumulated surplus would not be affected (2016: Nil) by the changes in interest rates.

The sensitivity analysis above indicates the instantaneous change in the Fund's accumulated surplus that would arise assuming that the change in interest rates had occurred at the end of the reporting period and had been applied to re-measure those financial instruments held by the Fund which expose the Fund to fair value interest rate risk at the end of the reporting period. The analysis is performed on the same basis for the year ended 31 March 2016.

(d) *Foreign currency risk*

The Fund's investment policy allows the Fund to have US dollars and renminbi foreign exchange exposure. As at 31 March 2017, the Fund has exposure to US dollars, as Hong Kong dollars are pegged with US dollars, the Fund was not exposed to significant foreign exchange risk.

(e) *Market risk*

The investment activities of the Fund expose it to various types of market risks which are associated with the markets in which it invests, to the extent of the amount invested in debt and equity securities. Such risk will be reflected in the price and the carrying value of the financial assets concerned.

The Fund invests in units of a pooled fund, which mainly comprises listed equity securities, the performance of which is measured against the benchmark index MSCI AC Pacific ex Japan. It is estimated that a general increase/decrease of 14.3% in the benchmark index would increase/decrease the Fund's surplus and the accumulated surplus by approximately \$47,245,000 (2016: a general increase/decrease of 16.8% in the benchmark index would increase/decrease the Fund's surplus and the accumulated surplus by approximately \$42,995,000).

The sensitivity analysis above indicates the instantaneous change in the Fund's accumulated surplus that would arise assuming that the changes in the benchmark index had occurred at the end of the reporting period and had been applied to re-measure those financial instruments held by the Fund which expose the Fund to equity price risk at the end of the reporting period. It is also assumed that the fair values of the Fund's investment in pooled fund would change in accordance with the historical correlation with the relevant benchmark

index since the portfolio is diversified in terms of industry distribution and that all other variables remain constant. The analysis is performed on the same basis for 2016.

(f) *Fair values of financial instruments*

The following table presents the carrying value of financial instruments measured at fair value at the end of the reporting period across the three levels of the fair value hierarchy defined in HKFRS 13, Fair value measurement, with the fair value of each financial instrument categorised in its entirety based on the lowest level of input that is significant to that fair value measurement. The levels are defined as follows:

- Level 1 (highest level): fair values measured using quoted prices (unadjusted) in active markets for identical financial instruments
- Level 2: fair values measured using quoted prices in active markets for similar financial instruments, or using valuation techniques in which all significant inputs are directly or indirectly based on observable market data
- Level 3 (lowest level): fair values measured using valuation techniques in which any significant input is not based on observable market data

All financial instruments are carried at amounts not materially different from their fair values as at 31 March 2017 and 2016.

The fair value of the debt securities is the quoted market price or based on quotes from bond market-makers.

The fair value of the investment in the unlisted pooled fund is determined based on the Fund's share in the net assets of the pooled fund as determined by the custodian. The majority of the underlying assets of the pooled fund are listed securities.

Changes in the market conditions could materially affect fair value estimates. Any increase or decrease in the fair values of financial instruments would affect profit or loss in future years.

	2017			
	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
Assets				
Debt securities				
- Listed	1,229,343	238,804	-	1,468,147
- Unlisted	61,693	363,408	-	425,101
Pooled fund				
- Unlisted	330,386	-	-	330,386
	<u>1,621,422</u>	<u>602,212</u>	<u>-</u>	<u>2,223,634</u>
	2016			
	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
Assets				
Debt securities				
- Listed	1,180,929	148,777	-	1,329,706
- Unlisted	359,663	177,035	-	536,698
Pooled fund				
- Unlisted	282,860	-	-	282,860
	<u>1,823,452</u>	<u>325,812</u>	<u>-</u>	<u>2,149,264</u>

Since the quoted prices in active markets for certain debt securities were unavailable at the end of the reporting period, debt securities with carrying amount of \$602 million were classified under Level 2 financial instruments, of which \$227 million were classified as Level 1 financial instruments in prior year. Other than that, there were no significant transfers between financial instruments in Level 1 and Level 2.

14. *Contingent liabilities*

As at the date of this report, in addition to the provision made as described in note 8, there are 18 claims received for which currently there is insufficient information to determine the likely level of payment. The maximum liability in respect of these claims is \$2,558,000 (2016:

\$2,619,000). This is determined based on the lower of the maximum compensation limit of \$150,000 per claimant or the amount claimed.

15. *Possible impact of amendments, new standards and interpretations issued but not yet effective for the year ended 31 March 2017*

Up to the date of issue of these financial statements, the HKICPA has issued a number of amendments and new standards which are not yet effective for the year ended 31 March 2017 and which have not been adopted in these financial statements. These include the following which may be relevant to the Fund.

*Effective for
accounting periods
beginning on or after*

HKFRS 9, *Financial instruments*

1 January 2018

The Fund is in the process of making an assessment of what the impact of this amendments is expected to be in the period of initial application. So far it has concluded that the adoption of HKFRS 9 may have an impact on the Fund's results and financial position arising from changes in the Fund's classification and measurement of financial instruments.

HKFRS 9 introduces new requirements for classification and measurement of financial assets, calculation of impairment of financial assets and hedge accounting. Based on the preliminary assessment, the Fund expects that its financial assets currently measured at fair value through profit or loss will continue with their respective classification and measurements upon the adoption of HKFRS 9. The new impairment model in HKFRS 9 may result in an earlier recognition of credit losses on the Fund's financial assets. However, a more detailed analysis is required to determine the extent of this impact.