Focus on Offshore Funds used by Hong Kong Fund Managers and an Update on Hong Kong Securities and Futures Ordinance Licensing for Intermediaries

Rising Popularity of Offshore Funds in Hong Kong

There are no readily available statistics for offshore funds being distributed on a private placement basis in Hong Kong. A table showing the net asset value of Securities and Futures Commission (SFC) authorised unit trusts and mutual funds classified into 10 types for the years ended December 2000 to December 2003 according to SFC statistics is as follows:

<table>
<thead>
<tr>
<th>As at</th>
<th>Bond</th>
<th>Equity</th>
<th>Diversified</th>
<th>Money Market</th>
<th>Fund of Funds</th>
<th>Warrant Index¹</th>
<th>Guaranteed²</th>
<th>Hedge</th>
<th>Other Specialised³</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec 2000</td>
<td>44,544</td>
<td>219,934</td>
<td>26,869</td>
<td>15,788</td>
<td>2,529</td>
<td>22</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>1,765</td>
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<tr>
<td></td>
<td>311,451</td>
<td></td>
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<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dec 2001</td>
<td>48,499</td>
<td>181,547</td>
<td>26,123</td>
<td>12,222</td>
<td>2,283</td>
<td>1.3</td>
<td>5,210</td>
<td>5,780</td>
<td>N/A</td>
<td>3,545</td>
</tr>
<tr>
<td></td>
<td>285,210</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dec 2002</td>
<td>77,703</td>
<td>143,290</td>
<td>28,842</td>
<td>69,739</td>
<td>2,375</td>
<td>N/A</td>
<td>7,870</td>
<td>11,734</td>
<td>160</td>
<td>421</td>
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<tr>
<td></td>
<td>342,134</td>
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<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dec 2003</td>
<td>112,048</td>
<td>270,582</td>
<td>41,095</td>
<td>81,472</td>
<td>3,863</td>
<td>N/A</td>
<td>8,139</td>
<td>15,999</td>
<td>405</td>
<td>685</td>
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<tr>
<td></td>
<td>534,288</td>
<td></td>
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<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

It is believed by many in the market that the rise in offshore funds being distributed on a private placement basis in Hong Kong / Asia is just as dramatic.

¹ Part of the figures prior to 2002 are included in Bond Funds and Equity Funds.
² Part of the figures prior to 2002 are included in Other Specialised.
³ Other Specialised includes Futures & Options Funds and Leveraged Funds (Guaranteed Funds up to 2001)

2004 Tricor Seminar will be held in September
See page 7 for details.
THE CLASSIC OFFSHORE FUND STRUCTURE

RATIONALE FOR CLASSIC STRUCTURE

Fund management is a global business. The onshore aspects are being conducted in international financial centres such as London, New York, Tokyo and Hong Kong. The offshore aspects are usually driven by regulatory and taxation issues as well as corporate flexibility, reputation and costs. In Europe, Dublin and Luxemburg have come to dominate. In the United States and Asia, the use of Caribbean centres for the set up of funds and incorporation of fund management vehicles are most popular. In Hong Kong, the classic offshore fund structure may have considerable advantages over the onshore alternative and is relatively less heavily regulated. However, recent scandals involving such funds, one where the manager allegedly misappropriated fund assets and another involving dubious cross trades of small capital stocks between connected funds, will inevitably lead to increased regulatory scrutiny being brought to bear on this sector.

TAXATION OF OFFSHORE FUNDS

The controversy over the taxability or otherwise of offshore funds in Hong Kong continues. To briefly recap on the issue, whilst authorised funds are exempt from profits tax in Hong Kong, private funds are not. There has been much debate on whether the Hong Kong Inland Revenue Department (IRD) may seek to tax the offshore funds that are managed in Hong Kong or are advised by a corporation licensed by the SFC. No decision in this respect has been made and thus there is still a possibility that the IRD may yet seek to tax the offshore funds that are managed in Hong Kong and, perhaps more likely, the offshore fund managers deemed to be doing business in Hong Kong.

Licensing and Regulation of BVI Funds

British Virgin Islands (BVI) has recently become more popular in the offshore fund market in particular for US based managers and it is gaining popularity in Hong Kong. Deciding on the jurisdiction for a new fund, a fund manager will consider track record, personal contacts and where comparable funds are domiciled amongst other matters. As of 31 March 2004, there were 2,053 active BVI mutual funds (i.e., net of cancellations) and 453 active managers and / or administrators (again, net of cancellations).

RATIONALULE FOR CLASSIC STRUCTURE

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**THE CLASSIC OFFSHORE FUND STRUCTURE**

**RATIONALE FOR CLASSIC STRUCTURE**

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**TAXATION OF OFFSHORE FUNDS**

The controversy over the taxability or otherwise of offshore funds in Hong Kong continues. To briefly recap on the issue, whilst authorized funds are exempt from profits tax in Hong Kong, private funds are not. There has been much debate on whether the Hong Kong Inland Revenue Department (IRD) may seek to tax funds which could be deemed to be carrying on business through the onshore sub-manager (as an agent) on profits arising in or derived from Hong Kong. Many submissions have been made to the Financial Services and the Treasury Bureau (the Bureau) in response to the Consultation Paper on Exemption of Offshore Funds from Profits Tax issued by the Bureau in January 2004. Many leading practitioners and market participants have recommended that consideration should be given to granting a blanket exemption from the Hong Kong profits tax to genuine and bona-fide offshore funds that are managed in Hong Kong or are advised by a corporation licensed by the SFC. No decision in this respect has been made and thus there is still a possibility that the IRD may yet seek to tax the offshore funds that are managed in Hong Kong and, perhaps more likely, the offshore fund managers deemed to be doing business in Hong Kong.

**Licensing and Regulation of BVI Funds**

British Virgin Islands (BVI) has recently become more popular in the offshore fund market in particular for US based managers and it is gaining popularity in Hong Kong. In deciding on the jurisdiction for a new fund, a fund manager will consider track record, personal contacts and where comparable funds are domiciled amongst other matters. As of 31 March 2004, there were 2,053 active BVI mutual funds (i.e., net of cancellations) and 453 active managers and / or administrators (again, net of cancellations).
<table>
<thead>
<tr>
<th>Currency Accounts</th>
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</thead>
<tbody>
<tr>
<td>Licensing / Registration Requirements</td>
</tr>
<tr>
<td>Regulatory Authority</td>
</tr>
<tr>
<td>Licensing / Registration Requirements</td>
</tr>
<tr>
<td>Accounts</td>
</tr>
<tr>
<td>Currency</td>
</tr>
<tr>
<td>Directors</td>
</tr>
</tbody>
</table>

**Generic Fund Categories**

| Open-ended: |
| i. right to redemption, |
| ii. possible-infinite life, and |
| iii. typically used for stocks, bonds and derivative funds. |
| Closed-ended: |
| i. no right to redemption, |
| ii. finite life, |
| iii. often used for property, venture capital and longer term funds, and |
| iv. no licensing requirements. |

**Fund Categories**

| Private Funds: |
| i. limited by their constitutional documents to no more than fifty investors, and |
| ii. can only solicit investors on a private basis, or |
| iii. designated as private funds by regulations. |
| Professional Funds: |
| i. restricted to professional investors, and |
| ii. the initial investment of which has a minimum subscription size of not less than US$100,000 or its equivalent in any other currency, or |
| iii. designated as professional funds by regulations. |
| Public Funds: |
| i. are not private funds or professional funds. |

**Regulatory Authority**

| Financial Services Commission (FSC) |

**Licensing / Registration Requirements**

| Recognition process for private and professional open-ended funds with FSC |
| Filing of prospectus is only required for public funds |

**Accounts**

| No audit requirements for private and professional funds |
| With public funds, audited financial statements to be prepared and made available to FSC upon request but there is no local (i.e. BVI) auditor requirements |
| No public filing is required |

**Time Frame for Establishment**

| Minimum 1 day for company incorporations |
| Minimum 5 days for recognition with FSC, the normal FSC approval period being 5 to 10 working days (from the time when all of the required paperwork is in order) |

**Transfer of Shares**

| Unless required under the articles of association, transfers are unrestricted |

**Shareholders’ Meetings**

| No mandatory annual meetings requirement |

**Name Reservation**

| Available with on line access for registered agent |

**Taxation**

| The funds and non-BVI investors are exempt from all domestic tax |

**Time Running Out for Licensed Corporations to Migrate to the SFO Licensing Regime in Hong Kong**

In about 8 months’ time, corporations registered as securities dealers, commodities dealers, securities investment advisers and commodities advisers with the SFC under the old Securities Ordinance or Commodities Trading Ordinance which fail to appoint or maintain at least 2 responsible officers for each regulated activity 3 they are licensed for and fail to lodge their migration applications will not be able to carry on the related regulated activity after the expiry of the 2-year transitional period ending 31 March 2005.

It is our understanding that about 50% of the licencees have yet to migrate their licences and speculate that for certain smaller market participants, the need to appoint a second responsible officer may be the stumbling block. Earlier this year, the SFC issued a circular to remind all licensed persons (including corporations and individuals) who have been registered under the old regime but yet to lodge their migration applications to plan ahead of their migration period ending 31 March 2005.

| Filing of prospectus is only required for public funds |

**Update on BVI Insolvency Legislation**

The Insolvency Act 2003 which was passed by the BVI Legislative Council in 2003 and is not yet in force, is arguably the most sophisticated insolvency legislation available in any offshore financial centre.

The new law provides a wide selection of possible corporate insolvency procedures, including liquidation initiated by members voluntarily or by court petition, provisional liquidation as an interim measure in certain circumstances. Under the new law, the BVI Court may request an overseas Court to provide assistance to a BVI insolvency office holder and, conversely, overseas office holders may apply to the BVI Court for assistance with regard to assets located in the BVI or other matters. Under the new law, it is also a requirement for a liquidator to be resident in the BVI.

**9 types of regulated activity stipulated under the SFO are:**

- **Type 1 – Dealing in securities**
- **Type 2 – Dealing in futures contracts**
- **Type 3 – Leveraged foreign exchange trading**
- **Type 4 – Advising on securities**
- **Type 5 – Advising on corporate finance**
- **Type 6 – Advising on commodities contracts**
- **Type 7 – Advising on commodities trading services**
- **Type 8 – Securities margin financing**
- **Type 9 – Asset management**
Generic Fund Categories
Open-ended:
1. right to redemption,
2. possible infinite life, and
3. typically used for stocks, bonds and derivative funds.

Closed-ended:
1. no right to redemption,
2. finite life,
3. often used for property, venture capital and longer term funds, and
4. no licensing requirements.

Fund Categories
Private Funds:
1. limited by their constitutional documents to no more than fifty investors, and
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1. are not private funds or professional funds.

Regulatory Authority
Financial Services Commission (FSC)

Licensing / Registration Requirements
Recognition process for private and professional open-ended funds with FSC.
Filing of prospectus is only required for public funds.

Accounts
No audit requirements for private and professional funds.
With public funds, audited financial statements to be prepared and made available to FSC upon request but there is no local (i.e. BVI) auditor requirements.

No public filing is required.

Currency
Multi-currency funds are permitted.

Directors
No residential qualifications necessary and corporate directors are acceptable.

Name Reservation
Available with on line access for registered agent.

Taxation
The funds and non-BVI investors are exempt from all domestic tax.

Time Frame for Establishment
Minimum 1 day for company incorporations.
Minimum 5 days for recognition with FSC, the normal FSC approval period being 5 to 10 working days (from the time when all of the required paperwork is in order).

Transfer of Shares
Unless required under the articles of association, transfers are unrestricted.

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No mandatory annual meetings requirement.

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It is our understanding that about 50% of the licencees have yet to migrate their licences and speculate that for certain smaller market participants, the need to appoint a second responsible officer may be the stumbling block. Earlier this year, the SFC issued a circular to remind all licensed persons (including corporations and individuals) who have been registered under the old regime but yet to lodge their migration applications to plan ahead of their activity after the expiry of the 2-year transitional period ending 31 March 2005.

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Type 1 – Dealing in securities
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Type 4 – Advising on securities
Type 5 – Advising on corporate finance
Type 6 – Advising on commodities
Type 7 – Providing automated trading services
Type 8 – Asset management
Type 9 – Leveraged foreign exchange trading
MAINTAIN 2 RESPONSIBLE OFFICERS AT ALL TIMES

The SFC issued a circular in May 2004 to licensed corporations reminding those which are licensed under or have migrated to the SFO that they must maintain at all times at least 2 responsible officers for each regulated activity they are licensed for. A licensed corporation (excluding those which have yet to migrate to the new regime) who fail to comply are prohibited from carrying on the related regulated activity. Containment with this requirement, without reasonable excuse, is an offence under the law and if convicted, the licensed corporation is liable to a fine of up to HK$100,000 and to a further fine of HK$1,000 for each day during which the offence continues. In addition, the licensed corporation and its related responsible officer may also be subjected to disciplinary proceedings.

THE SEARCH FOR RESPONSIBLE OFFICERS

Increasingly, licensed corporations are being obliged to adopt an intense sourcing and highly focused approach in the identification of qualified responsible officers locally, regionally and internationally in the securities and fund management sector. Multinational securities businesses establishing themselves in Hong Kong for the first time, frequently have just one resident responsible officer whilst the second in overseas which raises some interesting questions on supervision of representatives.

APPOINTMENT OF RESPONSIBLE OFFICERS SUBJECT TO SFC’S APPROVAL

An individual, who satisfies the competence requirements imposed by the SFC, and is proposed to directly supervise the business of the corporation and its related responsible officer may lodge an application for registration as responsible officer by completing appropriate application form and supplements, providing all supporting documents as required and payment of the required application fee to the SFC.

An individual applicant may lodge an application for registration as responsible officer by completing appropriate application form and supplements, providing all supporting documents as required and payment of the required application fee to the SFC.

The SFC normally takes 10 weeks to process a new responsible officer’s application and takes 2 business days to acknowledge receipt of an application subject to a number of factors as stated in its performance pledges. That being said, recent cases show that the SFC takes more than 2 weeks to acknowledge receipt of applications due to a large number of backlog applications being received by the SFC. Proposed new responsible officers of licensed corporations are therefore recommended to submit their applications to the SFC well in advance to cater for longer processing time or alternatively to seek professional advice if they are not certain about the competence requirements before submission of applications. Representatives transferring between employers have a relatively streamlined application procedure and are usually dealt with in 7 days.

NUMBER OF SFC REGISTRANTS

As at March 2004, the total number of licensed corporations (LC) is 1,298, showing a decrease of approximately 5.7% from that as of June 2003, whereas the total numbers of licensed representatives (LR) and licensed responsible or approved officers (RO/AO)7 are 16,761 and 2,451, showing a slight increase of 1.1% and 2.3% respectively from that as at June 2003, according to statistics published by the SFC. About 8,600 licencees have migrated to the SFO licensing regime.

The table on the right summarises the numbers of LC, LR and RO/AO classified into 9 regulated activities as at June 2003 and March 2004 according to SFC statistics.

There has been a clear decline in numbers since the commencement of the SFO and we expect consolidation in the industry. Furthermore, whilst not separately reflected in the statistics, there have been many newly licensed corporations since June 2003 and hence the actual fall out is even more pronounced.

ENFORCEMENT ACTIONS

In recent years, the key enforcement areas prioritised by the SFC are corporate mis-governance, serious misconduct by intermediaries involving dishonesty, market misconduct, listed company crime and misconduct, etc., while the key disciplinary priorities are dishonesty, conflicts of interests, control supervision failures, etc.

In May 2004, a person who pleaded guilty to defrauding the SFC for compliance with the requirements of the Financial Resources Rules was sentenced to 3 months’ imprisonment, the first time that a jail sentence has been imposed on a person for such matters, according to the SFC Enforcement Report for June 2004.

Nevertheless, articles published by the press indicate that recent scandals in relation to unauthorised funds supposedly distributed on a private placement basis in Hong Kong causes the SFC a great deal concern. “The SFC will continue its vigilance programme to detect incidences of suspected fraud”, an official of the SFC recently quoted as saying.

Update on CEPA: Certificate of Hong Kong Service Supplier (the Certificate)

In late May 2004, the Hong Kong Trade & Industry Department announced to have the following revisions in the requirements relating to the Certificate:

1. Streamlining documentation requirements:-
   In particular, written reports for office premises and local employment are no longer required. Nevertheless, applicants are still required to submit copies of documents evidencing the use of office premises and the employment of local staff duly certified by a Designated Professional.

2. Application procedures in relation to a group of companies:-
   There are flexible treatments to the applications involving a group of companies. Business operation, lease of office premises as well as employment of local staff can now be performed by different companies within a group. As defined in the Hong Kong Companies Ordinance, “group of companies” means any 2 or more companies or bodies corporate of which is the holding company of the other or others.

2004 Tricor Seminar: Enhancing Corporate Governance for Hong Kong Listed Companies

We are pleased to invite our valuable clients and business partners to our 2004 Tricor Seminar. The Seminar will provide a platform for us and our guests to share experiences of implementing the new rules and the consequent implications for listed companies. We will also give an insight into potential new code provisions which we believe are on the way. Please refer to the 2004 Tricor Seminar leaflet sent to you or visit our website at http://www.tricor.com.hk/2004seminar for more details.

NUMBERS OF LC, LR AND RO/AO CLASSIFIED INTO 9 REGULATED ACTIVITIES (RA) AS AT JUNE 2003 AND MARCH 2004

<table>
<thead>
<tr>
<th>RA</th>
<th>LC As at Jun 03</th>
<th>LC As at Mar 04</th>
<th>LR As at Jun 03</th>
<th>LR As at Mar 04</th>
<th>RO/AO As at Jun 03</th>
<th>RO/AO As at Mar 04</th>
</tr>
</thead>
<tbody>
<tr>
<td>RA1</td>
<td>714</td>
<td>148</td>
<td>11</td>
<td>1,119</td>
<td>245</td>
<td>986</td>
</tr>
<tr>
<td>RA2</td>
<td>668</td>
<td>153</td>
<td>16</td>
<td>980</td>
<td>217</td>
<td>839</td>
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<tr>
<td>RA3</td>
<td>11,855</td>
<td>3,416</td>
<td>899</td>
<td>14,458</td>
<td>3,039</td>
<td>13,620</td>
</tr>
<tr>
<td>RA4</td>
<td>12,326</td>
<td>3,733</td>
<td>975</td>
<td>9,574</td>
<td>1,472</td>
<td>7,651</td>
</tr>
<tr>
<td>RA5</td>
<td>1,461</td>
<td>340</td>
<td>45</td>
<td>1,532</td>
<td>372</td>
<td>1,570</td>
</tr>
<tr>
<td>RA6</td>
<td>1,321</td>
<td>340</td>
<td>45</td>
<td>1,532</td>
<td>372</td>
<td>1,570</td>
</tr>
</tbody>
</table>

As at Jun 03 1,461 340 45 1,532 372 1,570 296 14 1,696 7,518
As at Mar 04 1,461 340 45 1,532 372 1,570 296 14 1,696 7,518
The search for responsible officers

Increasingly, licensed corporations are being obliged to adopt an intense sourcing and highly focused approach in the identification of qualified responsible officers locally, regionally and internationally in the securities and fund management sector.

Multinational securities businesses establishing themselves in Hong Kong for the first time, frequently have just one resident responsible officer whilst the second in overseas which raises some interesting questions on supervision of representatives.

Appointment of responsible officers subject to SFC's approval

An individual, who satisfies the competence requirements imposed by the SFC, and is proposed to directly supervise the business of the licensed corporation and its related responsible officer may also be subjected to disciplinary proceedings.

The basic elements of the test of competence for responsible officers are:-

1. Academic or industry qualification,
2. Industry experience,
3. Management experience, and
4. Regulatory knowledge.

An individual applicant may lodge an application for registration as responsible officer by completing appropriate application form and supplements, providing all supporting documents as required and payment of the required application fee to the SFC.

The SFC normally takes 10 weeks to process a new responsible officer’s application and takes 2 business days to acknowledge receipt of an application subject to a number of factors as stated in its performance pledges. That being said, recent cases show that the SFC takes more than 2 weeks to acknowledge receipt of applications due to a large number of backlog applications being received by the SFC. Proposed new responsible officers of licensed corporations are therefore recommended to submit their applications to the SFC well in advance to cater for longer processing time or alternatively to seek professional advice if they are not certain about the competence requirements before submission of applications. Representatives transferring between employers have a relatively streamlined application procedure and are usually dealt with in 7 days.

Number of SFC registrants

As at March 2004, the total number of licensed corporations (LC) is 12,126, showing a decrease of approximately 5.7% from that as at June 2003, whereas the total numbers of licensed representatives (LR) is 4,166, indicating a decrease of 7.2% from that as at June 2003. The total numbers of responsible officers and temporary responsible officers (RO/AO) is 15,256, showing a decrease of 5.3% from that at June 2003. LC and RO/AO classified into 9 regulated activities as at June 2003 and March 2004 according to SFC statistics.

There has been a clear decline in numbers since the commencement of the SFO and we expect consolidation in the industry. Furthermore, whilst not separately reflected in the statistics, there have been many newly licensed corporations since June 2003 and hence the actual fall out is even more pronounced.

Enforcement actions

In recent years, the key enforcements areas prioritised by the SFC are corporate mis-governance, serious misconduct by intermediaries involving dishonesty, market misconduct, listed company crime and misconduct, etc., while the key disciplinary priorities are dishonesty, conflicts of interests, control supervision failures, etc.

In May 2004, a person who pleaded guilty to defrauding the SFC has been imposed a jail sentence of 3 months’ imprisonment, the first time that a jail sentence has been imposed on a person for such matters, according to the SFC Enforcement Report for June 2004.

Nevertheless, articles published by the press indicate that recent scandals in relation to unauthorised funds supposedly distributed on a private placement basis in Hong Kong causes the SFC a great deal concern. “The SFC will continue its vigilance programme to detect incidences of suspected fraud”, an official of the SFC recently quoted as saying.

The table on the right summarises the numbers of LC, LR and RO/AO classified into 9 regulated activities as at June 2003 and March 2004 according to SFC statistics.

As at Mar 04 12,126 3,733 975 9,574 1,472 7,651 1,222 22 7,676
As at Jun 03 11,855 3,416 899 14,458 3,039 13,620 3,985 132 13,625

There has been a clear decline in numbers since the commencement of the SFO and we expect consolidation in the industry. Furthermore, whilst not separately reflected in the statistics, there have been many newly licensed corporations since June 2003 and hence the actual fall out is even more pronounced.

Enforcement actions

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