

Corporate Governance

HKEx believes that good corporate governance is in the interest not only of investors, but also of the company itself. HKEx is committed to the highest standards of corporate governance, and is the first listed company in Hong Kong to have an assessment of its corporate governance by an independent third party. Standard & Poor's (S&P) had, after evaluation, first assigned a corporate governance score of 8.3 out of a possible score of 10 to HKEx in 2001, and affirmed in 2002 the same score after having conducted a thorough review during the year. Although the S&P's scoring standards have been tightened, the overall score for HKEx remains unchanged—a reflection of HKEx's continued efforts in building upon its already strong corporate governance practices.

The Board

The Directors listed on page 6 constituted the Board throughout the year. Among the 15 Board members, eight of them are Public Interest Directors appointed by the Financial Secretary, six of them were elected by shareholders (Elected Directors), and the Chief Executive is an *ex-officio* member of the Board. The Securities and Futures Commission (SFC) had confirmed that the Public Interest Directors and Elected Directors are all independent Directors. The Chief Executive is the only Executive Director who is responsible to the Board for the management of HKEx's business. The roles of the Chairman and the Chief Executive are distinctly segregated. The Chairman is an independent non-

executive, and his appointment was recommended by the Board and approved by the Chief Executive of the HKSAR.

Due to the unique business nature of HKEx as an exchange controller, the Board has to act in the interest of the investing public and give precedence to the public interest should there be a conflict of interest with the company's own commercial interest. A Director's Handbook has been issued to every Board member setting out the guidelines on conduct, under which Directors are required, inter alia, to declare any conflict of interests they may have and where necessary, to withdraw from any consideration of or abstain from voting on a matter in which they have a material interest. All Directors have access to the Company Secretary who is responsible for ensuring the Board procedures are complied with and for advising the Board on compliance matters. The Board has, at all times fully complied with the statutory and Listing Rules requirements governing disclosure of interests, the dealing in securities, and meeting procedures and practices.

The Board is responsible to shareholders for the strategic development of HKEx, and the management of the Group's assets with the objective of maximising long-term shareholders' value. The principal task of the Board is to formulate strategy, lay down policies, monitor and control operating and financial performance in pursuit of the Group's strategic objectives.

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The Board meets regularly, normally once a month, and additional meetings would be arranged, if and when required.

The Board is supported by six committees and three advisory panels, each of which has defined terms of reference covering its duties, powers and functions. The chairmen of the respective committees and panels report regularly to the Board and, as appropriate, make recommendations on matters discussed. The list of members of the various committees are set out in the “Corporate Information” section on page 6.

In accordance with the Articles of Association, the six Elected Directors elected in 2000 shall retire at the conclusion of the annual general meeting to be held on 15 April 2003 (2003 AGM). The term of services of the eight Public Interest Directors will also expire at the conclusion of the 2003 AGM. Shareholders may, at the 2003 AGM, by ordinary resolution elect any person to be a Director, but the total number of Elected Directors must not at any time exceed six. In addition, the Exchanges and Clearing Houses (Merger) Ordinance (Merger Ordinance) provides that the number of Public Interest Directors to be appointed by the Financial Secretary immediately after the 2003 AGM shall not be more than the number of Elected Directors.

At every general meeting after the 2003 AGM, one-third of the Elected Directors shall be subject to retirement by rotation.

None of the Public Interest Directors and the Chief Executive shall, whilst holding office as such, be subject to retirement by rotation.

Committees and Panels

Executive Committee consists of three non-executive Directors, the Chief Executive and the Chief Operating Officer appointed by the Board. It meets regularly, normally twice a month, and serves as an executive arm of the Board, in the formulation of policies for consideration of the Board, and in carrying out and implementing the policies laid down by the Board. The Executive Committee is delegated with the authority from the Board to administer, enforce, interpret and supervise compliance with those parts of the Rules, Regulations and Operational Procedures of its subsidiaries including conducting regular reviews of the same, recommending, advising on appropriate amendments which do not involve policy matters for the approval by the boards of the respective subsidiaries, and as appropriate by the SFC.

Audit Committee, comprising five non-executive Directors appointed by the Board, meets at least four times a year. It examines any matter relating to accounting principles and practices adopted by the Group, and discusses auditing, internal control issues, information systems and financial reporting matters. It also reviews the interim and the final results of the Group prior to recommending them to the Board for approval, recommends the

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application of accounting policies, and changes to financial reporting requirements. Senior representatives of the external auditors, the Chief Executive and senior executives are invited to attend the meetings. The Audit Committee reviews the appointment of HKEx's external auditors, including the audit fees, on an annual basis, and, as a good corporate governance practice, sets restrictions on the employment of HKEx's external auditors for non-audit related activities.

Investment Advisory Committee consists of two non-executive Directors and three market professionals appointed by the Board. It meets at least four times a year, and provides market expertise and advice to the Board on the investments of HKEx, including advice on investment policies, asset allocation and selection of fund managers and custodians.

Nomination Committee, comprising three non-executive Directors appointed by the Board, meets at least once a year, and is responsible for the formulation of the nomination policy, determination of the selection criteria for the nomination of candidates for election to be non-Public Interest Directors, make recommendations to shareholders on new candidates standing for election, provide sufficient biographical details of candidates to enable shareholders to make an informed decision on the election, and where necessary, nominate candidates to fill casual vacancies of Elected Directors.

Remuneration Committee consists of three non-executive Directors appointed by the Board. It meets at least once a year, and formulates the remuneration and succession policies, and the guidelines for the recruitment and the remuneration of Directors, including the Chief Executive who is an Executive Director. The Remuneration Committee ensures that the remuneration offered is appropriate for the duties and in line with market practice. The Board has approved the recommendation of the Remuneration Committee of remunerating non-executive Directors, subject to shareholders' approval at the 2003 AGM. This serves as a recognition of the time and effort contributed by non-executive Directors to HKEx. Appropriate remuneration of non-executive Directors is considered by S&P as a good corporate governance practice.

Risk Management Committee is chaired by the Chairman of the Board, and consists of seven other members of whom five were appointed by the Financial Secretary and two were appointed by the Board. The Risk Management Committee was established under Section 9 of the Merger Ordinance on 3 March 2000 to formulate policies on risk management matters relating to the activities of HKEx and the exchanges and clearing houses of which HKEx is the controller.

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Cash Market Consultative Panel, Clearing Consultative Panel and Derivatives Market Consultative Panel provide market expertise and advice to the Board on international trends, the needs of intermediaries, issuers, investors and other market participants, technological challenges and new product opportunities relating to the Cash market, Clearing business and Derivatives market respectively, and act as sounding boards for policy recommendations, strategic initiatives, and major investments. Each panel consists of two non-executive Directors and eight members from among the respective market participants and industry experts. Executives are invited to attend the panel meetings.

Attendance Record

The following is the attendance record of meetings held by the Board and various committees/panels in 2002:

	Number of meetings held in 2002	Average Attendance
Board	12	86%
Audit Committee	4	80%
Executive Committee	22	92%
Investment Advisory Committee	4	90%
Nomination Committee	1	100%
Remuneration Committee	2	100%
Risk Management Committee	10	90%
Cash Market Consultative Panel	4	68%
Derivatives Market Consultative Panel	5	74%
Clearing Consultative Panel	4	67%

Internal Control

The Board has the ultimate responsibility for the Group's internal control system and for reviewing its effectiveness. The system, which includes a defined management structure with specified limits of authority, is designed to safeguard assets against unauthorised use or disposition, ensure the maintenance of proper accounting records for the provision of reliable financial information, and ensure compliance with relevant legislation and regulations. The Group Internal Audit Functional Unit provides the Board with assurance that the internal control systems of the Group are effective, and assists the Board in the exercise of its governance functions by conducting independent reviews of HKEx's activities. The reviews include financial, operational, compliance and information technology related audits and evaluations. The Group Internal Auditor reports directly to the Audit Committee, and is authorised to communicate directly with the Chairman of the Board and other Board members. The frequency of reviews is scheduled according to an internal audit programme approved by the Audit Committee.

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Shareholders

The Board is committed to providing clear and updated performance information of the Group to all shareholders, as soon as it is available. The Board has, in March 2003, approved the release of quarterly reports in order to provide more up-to-date information to shareholders. Effective from 2003, the first and the third quarter results will be announced in May and November respectively, whilst the interim results will be released in August, and the full year results will be published in March of the following year. In addition to sending circulars, notices, interim and annual reports to shareholders, as required under the Listing Rules, other initiatives undertaken by HKEx to promote shareholders' relations include the setting up of an Investor Relations Corner as part of the HKEx website <www.hkex.com.hk> to provide information to shareholders about the Group, and the quarterly publication of the "Exchange" to provide shareholders and the public with up-to-date information on HKEx's policies, products, and services.

The annual general meeting not only deals with the formal business of HKEx but also acts as a forum for direct dialogue with shareholders at which shareholders may ask questions on HKEx's operations or financial information. The Chairman, the Chief Executive, the Chief Financial Officer and other senior executives maintain a dialogue with institutional investors and analysts, where appropriate.

Guidelines on Conduct

HKEx and its major subsidiaries are designated public bodies listed in the Schedules of the Prevention of Bribery Ordinance. All employees of HKEx, including Directors and committee members, are considered public servants for the purposes of that Ordinance. Guidelines on Conduct for the persons concerned have been worked out in consultation with the Independent Commission Against Corruption, and set out in the Human Resources Manual issued to every employee of the Group.

Succession Policy

The Board has a primary role in ensuring that adequate thought is given to planning for succession to executive director and senior management positions. Management development programmes are in place for staff members, which include staff exchange programmes set up with other exchanges.

Environment

HKEx is committed to conducting its business in a manner which fosters the sustainable use of natural resources, and minimises any adverse impact on the environment. In addition to pursuing environmental protection measures internally, HKEx has, by amending the Listing Rules in February 2002, encouraged listed companies to send or make available corporate communications to holders of securities and to the Stock Exchange by electronic means.

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Changes to the Articles of Association

Pursuant to the changes in the Companies Ordinance and the Listing Rules, HKEx had, with the approval of shareholders at the annual general meeting in April 2002, and the subsequent approval of the SFC, amended Articles 2, 139, 141, 142, 145, 146 and 155 of the Articles of Association.

The amendments to Article 139 permit HKEx to send Summary Financial Reports in place of the Annual Report and Accounts to its shareholders, debenture holders and any other persons entitled for the purpose of a general meeting of the company. HKEx is also allowed to treat the publication of the Annual Report and Accounts and/or the Summary Financial Report on the computer network of the company as discharging its obligation under the Companies Ordinance.

The amendments to Article 2, 141, 142, 145 and 146 allow HKEx to send or otherwise make available corporate communications to holders of securities by electronic means.

In pursuit of better corporate governance, Article 155 was also amended such that the Auditor is excluded as a party entitled to be indemnified by HKEx against all costs, charges, losses, expenses and liabilities incurred by the Auditor in the execution and discharge of its duties.

Compliance with the Code of Best Practice of the Listing Rules

HKEx has fully complied with the Code of Best Practice, as set out in Appendix 14 of the Listing Rules during the year.

By Order of the Board

Joseph Mau

Company Secretary

12 March 2003