

# CORPORATE GOVERNANCE REPORT

## CORPORATE GOVERNANCE

The following report comprising three sections: Corporate Governance, Remuneration and Interests, and Corporate and Social Responsibility, serves to outline our effort in promoting corporate governance, and improving our own corporate governance practices.

### PUBLIC RESPONSIBILITY

HKEx is the recognised exchange controller, and has the duty under the SFO to provide an orderly, informed, and fair markets for the trading, clearing, and settlement of securities or futures contracts in Hong Kong.

To help reinforce Hong Kong's role as an international financial centre and also the premier capital formation centre of the Mainland, HKEx accepts a leadership role in setting and articulating corporate governance standards in Hong Kong.

#### Code on Corporate Governance Practices

Following the release of the exposure of draft Code on Corporate Governance Practices and Corporate Governance Report ("Exposure Paper") for public consultation in January 2004, the Stock Exchange published the conclusions on the Exposure Paper on 19 November 2004. The overall responses were supportive of the general direction of the Exposure Paper including the efforts of the Stock Exchange in enhancing the overall standard of corporate governance. The CG Code, which became effective from 1 January 2005 (the internal control section will be effective from 1 July 2005), provides a comprehensive guide for listed issuers to evaluate and improve their corporate governance practices.

Although the general level of corporate governance practices in Hong Kong has improved, continuous refinement and assessment of corporate governance practices against evolving global standards is critical to Hong Kong remaining successful in an increasingly competitive investment market.

#### Enhancement of Regulation of Listing

To further strengthen the listing regulatory functions, the Government published a "Consultation Paper on Proposals to Enhance the Regulation of Listing" in October 2003 seeking market views on improving the listing regulatory structure. The consultation conclusions published in March 2004 recommended, amongst others, to build on the dual filing regime, codifying the important requirements in the Listing Rules into subsidiary legislation, and making the SFC responsible for enforcing statutory listing requirements, while the Stock Exchange would continue to enforce the non-statutory listing requirements as provided in the Listing Rules. The Stock Exchange will also continue to receive listing applications at the frontline, and no securities will be listed on the Stock Exchange unless they are approved by the Listing Committees.

In January 2005, each of the SFC and the Government has published a public consultation paper aiming at giving statutory backing to major listing requirements in order to further enhance the regulation of listed companies. Both consultations will end in March 2005.

## Conflict Management

In discharging its obligations as the recognised Exchange Controller, HKEx has to act in the interests of the public, having particular regard to the interests of the investing public, and ensure that where the interests of the public are in conflict with any other interests, the former shall prevail.

The listing of HKEx is governed by the Memorandum of Understanding (“MOU”) entered into between HKEx, the Stock Exchange, and the SFC, and the Chapter 38 in the Listing Rules. Unlike other listed companies in Hong Kong, the SFC is, pursuant to the MOU, the regulator of HKEx, and shall take all actions and make all decisions in relation to HKEx as a listed company that would normally be taken by the Stock Exchange in respect of other listed companies, including but not limited to the suspension or removal from, listing on the Stock Exchange, and the application for waivers in complying with the Listing Rules.

In addition, HKEx is required, under the MOU, to use its best endeavours to ensure that whenever a conflict or potential conflict of interest exists, the subject matter would be referred to a Conflict Committee comprising the Chief Executive, the Chief Operating Officer, and the Chief Executive of the Stock Exchange or their alternates for consideration. If the Conflict Committee determines that a conflict or potential conflict of interest does or may arise, the case would be referred to the SFC’s representatives who would consider if the Stock Exchange’s regulatory function could be discharged without its intervention. Any disagreement between the Conflict Committee and the SFC’s representatives will be referred to the SFC for resolution.

As noted by Standard & Poor’s (“S&P”) in its annual evaluation on HKEx’s corporate governance practices, there is no evidence, to date, that the results of the Group have been adversely affected through placing the public interests ahead of Shareholders’ interests where the public interests and the financial interests of Shareholders might diverge.

## CORPORATE RESPONSIBILITY

Being a listed company, HKEx is committed to achieving the best corporate governance practices. The Board and the management believe that high standards and appropriately rigorous corporate governance practices are essential for HKEx to improve its accountability and transparency, and achieve a balance of the interests of the public and the interests of its stakeholders, inter alia, Shareholders, EPs, the Government, customers, creditors, and employees. The Board acknowledges its responsibility in ensuring that good corporate governance practices and procedures are established.

### Ongoing Improvements on Corporate Governance Practices

HKEx is dedicated to continue improving its corporate governance practices. The following summarised the measures taken in 2004:

- HKEx has early adopted all HKFRSs, in the preparation of the financial statements for the year ended 31 December 2004. The HKFRSs were developed by the HKICPA in conformity to the IFRSs.

- HKEx has adopted a policy of rotating its engagement partner of the external auditors every 5 years. Should PricewaterhouseCoopers be re-appointed auditors at the 2005 AGM, the first rotation will take effect starting from the audit for 2005.
- The terms of reference of the Audit, Nomination and Remuneration Committees have been reviewed with reference to the CG Code, and they are posted on HKEx's corporate website.
- HKEx revised its organisational structure in May 2004 to reinforce its regulatory function and enhance business operation efficiency. The existing organisational structure is set out on page 94.
- In view of the increasing demand on time and effort for Non-executive Directors to fulfill their responsibilities, the Board has accepted the recommendation of the Remuneration Committee of proposing an increase in Non-executive Directors' remuneration for Shareholders' approval at the 2005 AGM.
- Director's Handbook and the Human Resources Manual are posted on HKEx's corporate website.
- The Board has decided not to seek renewal of the 20 per cent general issue mandate at the 2005 AGM.
- A revamped HKEx website was rolled out in March 2004 featuring enriched content and new design that makes it easy to navigate.

### Achievements

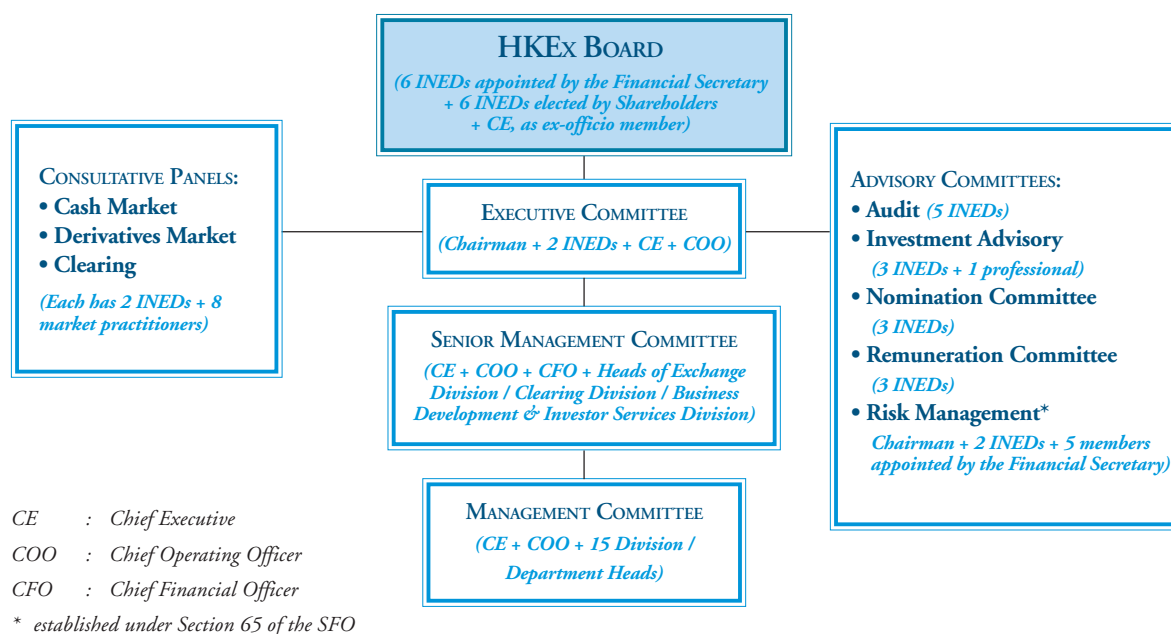
In 2000, HKEx became the first listed company in Hong Kong to have an assessment of its corporate governance standard by an independent third party. S&P had, after the fourth annual evaluation, reaffirmed the same score of 8 out of a possible score of 10 to HKEx for 2004. The score of 8.3 for 2003 had been revised to 8 by S&P due to the adoption of a new rating scale that only shows rating in integers. S&P confirmed that the maintenance of the score at 8 reflects HKEx's strong governance standards on an international basis of comparisons, and demonstrates HKEx's continuing commitment to improving its own corporate governance standards.

In 2004, HKEx was awarded the Significant Improvement Award, and for the second consecutive year, a Diamond Award (top honour) in the Non-Hang Seng Index Category in the Best Corporate Governance Disclosure Awards 2004 organised by the Hong Kong Institute of Certified Public Accountants.

HKEx, as a business entity, a regulator and a public company, would continue to work closely with the Government, the SFC, listed issuers, market participants and users to promote and implement corporate governance reforms in Hong Kong.

## GOVERNANCE STRUCTURE

The overall governance structure of HKEx is set out below –



## REPORT ON CORPORATE GOVERNANCE PRACTICES

HKEx has fully complied with the Code of Best Practice, as set out in Appendix 14 of the Listing Rules throughout 2004.

HKEx applied the principles and complied with all requirements of the newly promulgated CG Code with certain deviations in respect of the service term and rotation of Directors. The following summarises HKEx's corporate governance practices and explains deviations, if any, from the CG Code.

### Key Corporate Governance Principles and HKEx's Practices

#### A. Board of Directors

A balanced board consisting of independent non-executive directors of at least one-third of the board

- HKEx Board includes 12 INEDs, six of them are Government Appointed Directors, and the remaining are Elected Directors. The Chief Executive is an ex-officio member of the Board and is the only Executive Director. The INEDs are explicitly identified in all corporate communications.
- Pursuant to the Listing Rules, every Non-executive Director has confirmed his independence with the SFC. As at 31 December 2004, each Non-executive Directors re-affirmed their independence status, and HKEx, at the advice of the Nomination Committee, considered that they are independent.

Deviation: Nil

The board should have a balance of skills and experience appropriate for the requirements of the business of the company

- Given the nature of HKEx's statutory objectives, and the complexity and breadth of the financial markets in which it operates, the wide range of business, financial, fund management, and securities trading experience of the INEDs provides an appropriate balance of public interests and stakeholders' interests.
- The list of Directors, their respective biographies, and their respective roles in the Board and committees are set out on pages 8 and 22 respectively. The information is also published on HKEx's corporate website.

Deviation: Nil

## Distinctive roles of chairman and chief executive

- Chairman of the Board is an INED, who is responsible for the leadership and effective running of the Board, and ensuring that all key and appropriate issues are discussed by the Board in a timely and constructive manner.
- The Chairman is appointed by the Board, subject to the approval of the Chief Executive of the Government.
- The Chief Executive is delegated with the authority and responsible for running the Group's business, and implementation of the Group's strategy in achieving the overall commercial objectives.
- The Chief Executive is appointed by the Board subject to the approval of the SFC.

Deviation: Nil

## Formal procedures are laid down for the appointment of directors including the establishment of a nomination committee with specific terms of reference

- HKEx has established a Nomination Committee, comprising three INEDs appointed by the Board, which meets at least once a year. List of members of the Nomination Committee is set out in the "Corporate Information" on page 9.
- The terms of reference of the Nomination Committee are posted on HKEx's corporate website. The principal functions include:
  - > to formulate the nomination policy, including the selection criteria of non-Government Appointed Directors;
  - > to develop the procedures for the sourcing and selection of suitable candidates to be nominated to the Board for it to consider and recommend to Shareholders for election at general meetings;
  - > to nominate candidates, where necessary, to fill casual vacancies of Elected Directors;
  - > to assess the independence of INEDs; and
  - > to make recommendations to the Board on succession planning of the Chairman and the Chief Executive.
- The chairman of the Committee will report the findings and recommendations of the Committee to the Board after each meeting.
- In 2004, the Nomination Committee nominated and the Board recommended Messrs John E Strickland and Oscar S H Wong to stand for re-appointment at the 2004 AGM.

## Attendance of individual members at Nomination Committee meeting in 2004

<b>Number of meeting</b>	1		
<b>INED</b>			
Charles Y K Lee ( <i>Chairman</i> )	1 / 1		100%
Lo Ka Shui	1 / 1		100%
Oscar S H Wong	1 / 1		100%
<b>Average attendance rate</b>	100%		

Deviation: Nil

## Non-executive directors should be appointed for specific terms and all directors appointed to fill casual vacancy should be subject to election by shareholders at the first general meeting after their appointment

- Only Government Appointed Directors are currently appointed with specific terms. Messrs Fong Hup and Leong Ka Chai were appointed for a term of two years ending after the closure of the 2005 AGM. Mr Charles Y K Lee, Mr Tim Freshwater and Dr Lo Ka Shui were appointed for a term of two years ending after the closure of 2006 AGM. Mr Henry H L Fan was appointed on 15 November 2003 to fill the vacancy after the resignation of Dr Liu Jinbao. Mr Fan's service term lasts until the conclusion of the 2005 AGM.
- According to the Articles of Association, Directors appointed to fill casual vacancy shall hold office only until the next following annual general meeting, and shall be eligible for re-appointment. Mr John E Strickland, being a Director appointed by the Board after the 2003 AGM was elected to the Board by Shareholders at the 2004 AGM.

Deviation:

According to the Articles of Association, only the six Elected Directors are subject to retirement by rotation. At every annual general meeting after the 2003 AGM, one-third of the Elected Directors shall retire and are eligible for re-election. The Directors to retire by rotation shall be those who have been longest in office since their last appointment or re-appointment or those who were appointed by the Board during the year to fill casual vacancy. However, as between persons who became or were last re-appointed on the same day, those to retire shall be determined by drawing of lots (unless they otherwise agree among themselves). As there are six Elected Directors, and one-third of them shall retire subject to rotation, hence barring unforeseen resignation/retirement during a year, each Elected Director is effectively appointed under an average term of 3 years. In addition, Directors appointed to fill casual vacancy shall hold office only until the following annual general meeting, and shall be eligible for re-appointment.

Dr Bill C P Kwok and Vincent K H Lee, two of the six Elected Directors subject to retirement by rotation shall retire at the conclusion of the 2005 AGM, as determined by the draw of lots, and they are both eligible for re-appointment.

To ensure full compliance with the CG Code, the Directors propose to amend the Articles of Association which: (a) specify that all Directors (Government Appointed Directors and Elected Directors), other than the Chief Executive who shall be subject to the term established under his employment contract with HKEx, will be appointed for a specific term of no more than three years, but be eligible for re-appointment upon retirement, and (b) require that any Director appointed by the Board to fill a casual vacancy should be subject to election by Shareholders at the first general meeting of HKEx after such Director's appointment.

The board should assume responsibility for leadership and control of the company and is collectively responsible for promoting the success of the company

- The principal roles of the Board are:
  - > to oversee HKEx's strategic development, and determine the objectives, strategies, and policies, and business plan of the Group; and
  - > to monitor and control operating and financial performance and set appropriate policies to manage risks in pursuit of the Group's strategic objectives.
- Implementation of strategies, and day-to-day operations are delegated to the Chief Executive.
- The Board has separate and independent access to the senior executives for raising enquiries on management information.
- The Board is supported by five committees, a statutory committee, and three consultative panels. Each of them 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 governance structure is set out on page 67 and a list of members of the various committees is set out in the "Corporate Information" on page 9.
- The Listing Committees function totally independently under no influence from the Board.

Deviation: Nil

The board should meet regularly to discharge its duties. Sufficient information is provided to the board and its committees in a timely manner

- The Board meets regularly, normally once a month, and additional meetings would be arranged, if and when required. Regular Board/committees meeting schedules of each year are normally made available to all Directors/committees' members before the start of the year. Directors can attend meetings in person or through other means of electronic communication.
- The Company Secretary assists the Chairman in establishing the meeting agenda, and each Director may request inclusion of items in the agenda.
- The information packages that contain analysis and background material, will be circulated normally four days in advance of Board/committees meetings to Directors/committees' members.
- There exists open atmosphere for Directors to contribute alternative views at meetings and major decisions would only be taken after a full discussion at Board meetings. Directors acknowledge their responsibilities of having to act in the interests of the public, having particular regard to the interests of the investing public, and ensure that where the interests of the public are in conflict with any other interests, the former shall prevail.
- The Chief Operating Officer and the Deputy Chief Operating Officer are invited to attend Board meetings, and other senior executives, will from time to time, be invited to Board meetings for making presentations or answering Board's enquiries.
- Minutes of Board/committees meetings are recorded in detail, and draft minutes are circulated to all Directors/committees' members for comments before being approved by the Board/committees at the immediate following meeting.
- Matters on transactions where Directors are considered having conflict of interests or material interests would not be dealt with by way of written resolutions. The Directors concerned could express views but would not be counted in quorum of meeting and shall abstain from voting of the relevant resolution. According to the Articles of Association, interests of 5 per cent or more is considered material.
- All Directors have access to the Company Secretary who is responsible for ensuring that the Board procedures are complied with, and advising the Board on compliance matters.
- Minutes of the Board/committees meetings are kept by the Company Secretary and are open for inspection by Directors.



- All Directors actively participate in HKEx's business. The attendance records of all Board meetings in 2004 are set out below:

Attendance of individual Directors at Board meetings in 2004		
Number of meetings	13	
<b>INED</b>		
Charles Y K Lee ( <i>Chairman</i> )	13 /13	100%
Henry H L Fan	13 /13	100%
Fong Hup	12 /13	92.3%
Tim Freshwater	11 /13	84.6%
Bill C P Kwok	13 /13	100%
Dannis J H Lee	13 /13	100%
Vincent K H Lee	13 /13	100%
Leong Ka Chai	13 /13	100%
Lo Ka Shui	13 /13	100%
John E Strickland	13 /13	100%
David M Webb	13 /13	100%
Oscar S H Wong	13 /13	100%
<b>Executive Director</b>		
Paul M Y Chow ( <i>Chief Executive</i> )	13 /13	100%
<b>Average attendance rate</b>	<b>98.2%</b>	

Deviation: Nil

Every director is required to keep abreast of responsibilities as a director of the company and of the conduct, business activities and development of the company

- Management provides appropriate and sufficient information to Directors and the committee members in a timely manner to keep them apprised of the latest development of the Group and enable them to discharge their responsibilities.
- A Director's Handbook setting out the guidelines on conduct, etc has been provided to every Director, which is updated periodically and is posted on HKEx's corporate website. The Handbook has made reference to the relevant sections of the statutes or the Listing Rules reminding Directors of their responsibilities in making disclosure of their interests, potential conflict of interests, and changes in personal particulars to HKEx in a timely manner.
- Orientation programmes are organised for providing induction to new Directors to help them familiarise with HKEx management, business, and governance practices.
- HKEx also encourages its Directors to participate in continuous professional development seminars and courses organised by qualified institutions to ensure that they continually update their skills and have the knowledge on the latest development or changes in statutes, Listing Rules, corporate governance practices etc. that are required for discharging their responsibilities. The related training expenses are fully reimbursable.

The Board and the committees are provided with sufficient resources to discharge their duties including, inter alia, the retention of outside advisers at HKEx's expense, as they deem necessary. Individual Directors may also retain outside advisers, at HKEx's expense, to provide advice on any specific matter.

Deviation: Nil

The company should arrange appropriate insurance cover in respect of legal action against its directors

- Pursuant to Article 155 of the Articles of Association, every Director/committee members appointed by the Board, and the officers shall be entitled to be indemnified, subject to the provision of the Companies Ordinance, by HKEx against all costs, charges, losses, expenses and liabilities incurred by him in the execution and discharge of his duties or in relation thereto. A Directors' and Officers' liabilities insurance has been arranged for that purpose.

Deviation: Nil

Compliance with the Model Code for Securities Transactions by Directors of Listed Issuers

- HKEx has adopted the Model Code as set out in Appendix 10 to the Listing Rules. All Directors have confirmed, following specific enquiry by HKEx, that they fully complied with the Model Code throughout the year 2004.
- A code of conduct for securities and derivatives transactions of employees, is set out in the Human Resources Manual which is posted on HKEx's corporate website.
- Employees are required to file declarations with the Head of Human Resources Department through the employee's Division/Department Head, the Chief Executive or the Chairman, as the case may be on their investment in securities and derivatives upon joining the Group.

- Before entering into any securities or derivatives transactions, employees shall seek prior written approval from their respective Division/Department Head or the Chief Executive, as the case may be. The Chief Executive and his related person who wish to buy or sell securities and derivatives shall obtain the prior written approval of the Chairman.
- Details of the share interests held by the Directors and Senior Management in HKEx are set out in the “Corporate Governance Report – Remuneration and Interests” on page 76.

Deviation: Nil

## B. Remuneration of Directors and Senior Management

There should be a formal and transparent procedure for setting policy on executive directors’ remuneration and for fixing the remuneration packages for all directors

- The Board has established a Remuneration Committee, comprising three INEDs appointed by the Board, which meets at least once a year. List of members of the Remuneration Committee is set out in the “Corporate Information” on page 9.
- The principal responsibilities of Remuneration Committee include formulation of the remuneration policy, review and recommending to the Board the annual remuneration policy, and determination of the remuneration of the Executive Director and members of the Senior Management. The overriding objective of the remuneration policy is to ensure that HKEx is able to attract, retain, and motivate a high-calibre team which is essential to the success of HKEx.
- No Director and executive can determine his own remuneration.
- The remuneration of Non-executive Directors is subject to Shareholders’ approval.
- The chairman of the Remuneration Committee will report the findings and recommendations to the Board after each meeting.
- The terms of reference of the Remuneration Committee are posted on HKEx’s corporate website.
- A summary of the work performed by the Remuneration Committee during 2004 is set out in the “Remuneration Committee Report” on page 95.
- Details of the remuneration, including the share option benefits of Directors and Senior Management for the year ended 31 December 2004 are set out in the “Corporate Governance Report – Remuneration and Interests” on page 76.

### Attendance of individual members at Remuneration Committee meetings in 2004

Number of meetings	4		
INED			
Lo Ka Shui ( <i>Chairman</i> )	4 / 4		100%
Dannis J H Lee	4 / 4		100%
Vincent K H Lee	4 / 4		100%
Average attendance rate	100%		

Deviation: Nil

## C. Accountability and Audit

The board should present a balanced, clear, and comprehensible assessment of the company’s performance, position, and prospects

- The Directors are responsible for overseeing the preparation of accounts of each financial period, which give a true and fair view of the state of affairs of the Group and of the results and cash flow for that period. In preparing the accounts for the year ended 31 December 2004, the Directors have:
  - > selected suitable accounting policies and applied them consistently;
  - > approved early adoption of all HKFRSs which are in conformity to the IFRSs;
  - > made judgements and estimates that are prudent and reasonable; and have prepared the accounts on the going concern basis.
- Starting from 2003, HKEx publishes its financial results on a quarterly basis to enhance transparency about its performance and to give details of the latest development of the Group in a timely manner.
- HKEx has announced its annual, interim, and quarterly results in a timely manner within the limits of 3 months, 2 months, and 45 days respectively after the end of the relevant periods, as laid down in the Listing Rules.

Deviation: Nil



The board should ensure that the company maintains sound and effective internal controls to safeguard the shareholders' investment and the company's assets

- The Board has the ultimate responsibility for the Group's internal control system and, through the Audit Committee, has reviewed the effectiveness of the system.
- The internal control system which includes a defined management structure with specified limits of authority, is designed to:
  - > help the achievement of business objectives, safeguard assets against unauthorised use or disposition;
  - > ensure the maintenance of proper accounting records for the provision of reliable financial information for internal use or for publication; and
  - > ensure compliance with relevant legislation and regulations.
- The system is designed to provide reasonable, but not absolute, assurance against material misstatement or loss and to manage rather than eliminate risks of failure in operational systems and achievement of the Group's objectives.
- The key procedures that the Board established to provide effective internal controls are as follows:
  - > A distinct organisational structure exists with defined lines of authority and control responsibilities. Division/ Department Heads are involved in preparing the strategic plan which laid down the corporate strategies to be pursued in the next three years for achieving the annual operating plan, the annual operational and financial targets. Both the strategic plan and the annual operating plan laid down the foundation for the preparation of the annual budget by which resources are allocated in accordance with identified and prioritised business opportunities. Other than the strategic plan which was approved by the Board for a three-year period but subject to annual review, the annual operating plan and the annual budget are approved by the Board on an annual basis.
  - > A comprehensive management accounting system is in place providing financial and operational performance measure indicators to the management, and the relevant financial information for reporting and disclosure purpose. Variances against budgets are analysed, and explained, and appropriate actions are taken, if necessary, to rectify deficiencies noted.
  - > System and procedures are in place to identify, measure, manage and control risks including legal, credit, market, concentration, operational, environmental, behavioral and systematic risks that may have an impact on the securities and derivatives markets in Hong Kong. Exposure to these risks is monitored by the Senior Management Committee, the Executive Committee, and the Risk Management Committee as a whole.
  - > Internal Audit Department ("IA") performs independent reviews of the risks and controls identified to provide reasonable assurance to management and the Audit Committee that risks and controls have been adequately addressed.
- The Board, through the Audit Committee, has conducted semi-annual reviews of the effectiveness of HKEx's system of internal control covering all controls, including financial, operational and compliance controls, broad-based risk management processes, and physical and information systems security. No suspected frauds and irregularities, internal control deficiencies or suspected infringement of laws, rules and regulations have come to the Committee's attention to cause the Committee believe that the system of internal controls is inadequate. The Board, through the review of the Audit Committee, is satisfied that the Group has fully complied with the code provisions on internal controls in 2004 as set forth in the CG Code.
- IA plays an important role in monitoring HKEx's internal governance and strives to provide objective assurance to the Board that a sound internal control system is maintained and operated by the management in compliance with agreed processes and standards. To preserve the independence of the internal audit function, the Head of IA reports directly to the Audit Committee on audit matters and to the Chief Executive on administrative matters, and is authorised to communicate directly with the Chairman of the Board and other Board members. For this reason, he attends the Management Committee meetings as an independent observer.
- Using a risk ranking methodology, IA plans its internal audit schedules annually in consultation with, but independent of, management, and the audit plan is submitted to the Audit Committee for approval. Independent reviews of different financial, business and functional operations and activities will be conducted with audit resources being focused on higher risk areas. Ad hoc reviews will also be conducted on areas of concern identified by the Audit Committee and management.
- As HKEx places heavy reliance on Information Technology ("IT") to support its business operations, apart from financial and operational compliance audits, IA also applies special IT audit skills to conduct regular reviews over major application system developmental processes and information systems operations to evaluate the effectiveness of the IT controls and governance processes. IA, in particular, emphasises on the internal control adequacy prior to the system's becoming operational.

- Division/Department Heads will be notified of the deficiencies noted for rectification, and IA will follow up with the implementation of audit recommendations. Significant internal control weaknesses are brought to the attention of the Audit Committee and if necessary to the Board, and to the Senior Management Committee for remedial action.
- To promote corporate governance and provide Shareholders with timely information about HKEx's financial performance, IA conducts quality assurance reviews of the quarterly, interim and final financial reports. These quality assurance reviews provide an addition level of assurance on the overall quality of the financial statements. The quality assurance reports conclude the accuracy and reliability of the financial information prepared by management, and are circulated to the Audit Committee to facility its review prior to making recommendations to the Board for approval.

Deviation: Nil

The board should establish formal and transparent arrangements for considering how it apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors

- The Audit Committee, comprising five INEDs, appointed by the Board who have extensive experience in financial matters, meets at least four times a year. Two members are certified public accountants. None of the Audit Committee members are members of the former or existing auditors of HKEx. List of members of the Audit Committee is set out in the "Corporate Information" on page 9.
- The principal responsibilities of the Audit Committee include:
  - > To serve as a focal point for communication between other Directors, the external auditors and internal auditors in respect of the duties relating to financial and other reporting, internal controls, external and internal audits, and such other matters as the Board determines from time to time.
  - > To assist the Board in fulfilling its responsibility by providing an independent review and supervision of financial reporting, by satisfying themselves as to the effectiveness of the internal controls of the Group and the adequacy of the external and internal audits.
  - > To review the scope and results of internal audit procedures, ensure coordination between the internal and external auditors and ensure that the internal audit function is adequately resourced and has appropriate standing within the Group.
  - > To review the appointment of external auditors on an annual basis including a review of the audit scope and approval of the audit fees.
  - > To review the annual, quarterly and interim financial statements prior to their approval by the Board, and recommend application of accounting policies and changes to financial reporting requirements.
  - > To ensure continuing auditor objectivity and to safeguard independence of HKEx's auditors. The Committee has determined a framework for the type and authorisation of non-audit services for which the external auditors may provide and agreed with the Board on the policy relating to the hiring of employees or former employees of the external auditors.
  - > To review arrangement by which employees, in confidence can raise concerns about possible improprieties in financial reporting, internal control or other matters, and ensure proper arrangement in place for the fair and independent investigation of such concerns and appropriate follow up action.
- Senior representatives of the external auditors, the Chief Executive and senior executives are invited to attend the meetings.
- During 2004, the fees paid to HKEx's external auditors for non-audit related activities amounted to \$3,202,696 (2003: \$1,372,950) comprising taxation services fees of \$1,202,696 (2003: \$673,750), executive secondment to the Listing Division of \$1,800,000 (2003: \$600,000), and other miscellaneous items of \$200,000 (2003: \$99,200).
- The Committee reports its work, findings and recommendations to the Board after each meeting. The terms of reference of the Audit Committee are posted on HKEx's corporate website.
- A summary of the work performed by the Audit Committee during 2004 is set out in "Audit Committee Report" on page 96.

#### Attendance of individual members at Audit Committee meetings in 2004

<b>Number of meetings</b>	6	
<b>INED</b>		
John E Strickland ( <i>Chairman</i> )	6 / 6	100%
Fong Hup* ( <i>Deputy Chairman</i> )	6 / 6	100%
Henry H L Fan	6 / 6	100%
Vincent K H Lee*	6 / 6	100%
David M Webb	6 / 6	100%
<b>Average attendance rate</b>	<b>100%</b>	

\* *Certified Public Accountants*

Deviation: Nil

## D. Delegation by the Board

The company should have a formal schedule of matters specifically reserved to the board and those delegated to management. There should be a clear division of responsibilities amongst committees and each of them should have a specific terms of reference

- The Board is responsible for determining the overall strategy and approving the annual business plan of the Group, and ensuring the business operations are properly planned, authorised, undertaken and monitored. All policy matters of the Group, material transactions or transactions where there is conflict of interests are reserved for the Board's decisions.
- The Board has delegated the day-to-day responsibility to the executive management under the instruction/supervision of various committees, namely, Executive Committee, Senior Management Committee, Investment Advisory Committee. Each of them has specific terms of reference. The Board and the management also seek advice from the Risk Management Committee, the Cash Market Consultative Panel, the Clearing Consultative Panel, and the Derivatives Market Consultative Panel.
- *Executive Committee* consists of the Chairman, two INEDs, appointed by the Board, the Chief Executive and the Chief Operating Officer. 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, other than the Listing Rules, and conduct regular reviews of the same, recommend, and advise 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. The Committee shall report to the Board the work, significant decisions, findings and recommendations of the Committee since the last Board meeting.

### Attendance of individual members at Executive Committee meetings in 2004

<b>Number of meetings</b>	20	
<b>INED</b>		
Charles Y K Lee ( <i>Chairman</i> )	20 / 20	100%
Dannis J H Lee	20 / 20	100%
Leong Ka Chai	20 / 20	100%
<b>Executive Director</b>		
Paul M Y Chow ( <i>Chief Executive</i> )	20 / 20	100%
<b>Chief Operating Officer</b>		
Patrick K Conroy	19 / 20	95%
<b>Average attendance rate</b>	99.0%	

- *Senior Management Committee* comprises the Chief Executive, the Chief Operating Officer, the Chief Financial Officer and Heads of Exchange, Clearing, Business Development & Investor Service Divisions. It meets on a weekly basis to review strategic plan and make recommendations to the Executive Committee on strategic plan, annual operating plan, major projects and initiatives, annual budget, and significant business proposals.
- *Investment Advisory Committee* consists of three INEDs and one market professional 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, and selection of fund managers and custodians. The Investment Advisory Committee will also from time to time approve amendments to the investment guidelines.

### Attendance of individual members at Investment Advisory Committee meetings in 2004

<b>Number of meetings</b>	6	
<b>INED</b>		
Tim Freshwater ( <i>Chairman</i> )	6 / 6	100%
Oscar S H Wong ( <i>Deputy Chairman</i> )	6 / 6	100%
David M Webb	6 / 6	100%
<b>Market Professional</b>		
David Sun	4 / 6	66.7%
<b>Average attendance rate</b>	91.7%	

- *Risk Management Committee* is a statutory committee, 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 65 of the SFO to review and formulate policies on risk management matters relating to the activities of HKEx and the exchanges and clearing houses of which HKEx is the controller, and submit such policies to HKEx for its consideration. The Risk Management Committee is aimed at identifying, measuring, managing and control risks including legal risks, credit risks, market risks, concentration risks, operational risks, environmental risks, behavioral risks, and systemic risks that may have an impact on the securities and derivatives markets in Hong Kong.

- Market-wide rehearsals are conducted periodically in conjunction with a number of Government bureaux, regulatory bodies including, inter alia, the SFC, Hong Kong Monetary Authority, and Financial Services and Treasury Bureau as part of ongoing efforts to ensure an efficient response to emergency market events, and effective communications among the parties concerned.

Attendance of individual members at Risk Management Committee meetings in 2004		
<b>Number of meetings</b>	11	
<b>INED</b>		
Charles Y K Lee ( <i>Chairman</i> )	11 / 11	100%
Henry H L Fan	11 / 11	100%
Bill C P Kwok	11 / 11	100%
<b>Members Appointed by the Financial Secretary under Section 65 of the SFO</b>		
Leong Ka Chai	11 / 11	100%
Mark Dickens	11 / 11	100%
Lam Kin	10 / 11	90.9%
James H Lau ( <i>retired on 30 June 2004</i> )	3 / 6	50%
Peter T S Wong ( <i>retired on 19 January 2004</i> )	0 / 0	–
Raymond Or ( <i>appointed on 20 January 2004</i> )	11 / 11	100%
Eddie Yue ( <i>appointed on 1 July 2004</i> )	5 / 5	100%
<b>Average attendance rate</b>	95.5%	

- *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. Each panel is consisted of two INEDs and eight members who are respective market participants or industry experts. Executives are invited to attend the panel meetings. The average attendance rates of the Cash Market Consultative Panel, the Clearing Consultative Panel and the Derivatives Market Consultative Panel meeting are 70.0%, 76.7% and 72.5% respectively.

Deviation: Nil

## E. Corporate Communication

The board should endeavour to maintain an on-going dialogue with shareholders, in particular, use annual general meetings to communicate with shareholders

- HKEx establishes and maintains different communication channels with its Shareholders through the publication of annual, interim and quarterly reports, press release and the quarterly newsletter - *Exchange*. To promote effective communication, Shareholders may choose to receive shareholder corporate communication electronically. Shareholders' communications are also available on HKEx's corporate website.
- The annual general meeting provides a useful forum for Shareholders to exchange views with the Board. The Chairman as well as chairmen of the Audit, Nomination, and Remuneration Committees, or in their absence, members of the Committees are available to answer Shareholders' questions.
- Separate resolutions are proposed at general meetings on each substantially separate issue, including the election of individual Directors.
- Details of the poll voting procedures and the rights of shareholders to demand a poll are included in the circular to Shareholders despatched together with the annual report. The circular also includes details of the procedures and the timetable of proposing appropriate candidates to stand for election as Directors at annual general meetings, and relevant details of proposed resolutions, including biographies of each candidates standing for re-election and whether such candidates are considered to be independent.
- The results of the poll are published in the newspapers and on HKEx's corporate website.
- The Articles of Association have been revised in 2004 to reflect changes brought by the new Listing Rules effective 31 March 2004.
- A summary of the top 10 largest registered Shareholders and analysis of shareholding by type and public float capitalisation as at 31 December 2004 are set out in the "Shareholding Analysis" on page 98.
- Shareholders may refer to the "Information for Shareholders – Financial Calendar" on page 198 for important dates in 2004.
- Financial and other information such as Articles of Association, minutes of annual general meetings, and all shareholder corporate communications of HKEx are made available on HKEx's corporate website, [www.hkex.com.hk](http://www.hkex.com.hk), which is updated regularly.

Deviation: Nil

## REMUNERATION AND INTERESTS

### REMUNERATION POLICY

As the frontline regulator, HKEx recognises the importance of formal and transparent remuneration policy, in particular, for determining the remuneration packages for the Executive Director and the Senior Management. HKEx's remuneration policy for Non-executive Directors is to ensure that they are sufficiently but not excessively compensated for their efforts and time dedicated to HKEx, and that for the employees, including the Executive Director and the Senior Management is to ensure that the remuneration offered is appropriate for the duties and in line with market practice. No individual Director and executive would be involved in deciding his own remuneration.

The Board has established a Remuneration Committee comprising three INEDs. It considers and recommends to the Board the Group's remuneration policy and has a delegated authority to review and determine the remuneration packages of the Executive Director and the Senior Management. Where necessary, the Remuneration Committee will engage external professional advisers to assist and/or advise the Committee on relevant issues.

A summary of work performed by the Remuneration Committee during 2004 is set out in the "Remuneration Committee Report" on page 95.

#### **Executive Director and the Senior Management**

The Remuneration Committee is responsible for establishing policies, and reviewing and determining the remuneration of the Chief Executive who is the only Executive Director, and the Senior Management on an annual basis. It will consult with the Chairman and the Chief Executive in respect of their recommendations on determining the remuneration of the Chief Executive and that of the Senior Management respectively. Factors such as market competitiveness, job responsibilities, performance of the Company and the individuals will be taken into consideration. The recommended remuneration packages comprise salaries, bonus, long term incentives, benefits in kind, etc.

#### **Non-executive Directors**

The Remuneration Committee has made reference to the survey report on the remuneration of non-executive directors among over 100 Main Board listed companies published by a leading human resources consulting company, and the remuneration survey of the Hang Sang Index companies as well as the regulatory bodies in the financial sector, in recommending the remuneration of Non-executive Directors, which is subject to Shareholders' approval at general meetings.

At the 2004 AGM, Shareholders approved a remuneration equivalent to \$100,000 (2003: \$100,000) for each Non-executive Directors, which is payable in proportional to the period of service during the period from the conclusion of the 2004 AGM to the conclusion of the 2005 AGM. During 2004, a review on the



adequacy of the Non-executive Directors' remuneration was conducted by the Company with reference to companies of comparable business or scale, with an aim to fairly remunerate the Non-executive Directors in view of their public accountability and time and effort spent on the Board and various committees and/or panels' meetings. The Remuneration Committee has proposed to raise the annual remuneration of each Non-executive Director to \$240,000 which will be subject to the approval of Shareholders at the 2005 AGM.

Details of the remuneration of the Non-executive Directors, the Chief Executive, and the Senior Management for year 2004 are set out in the latter part of this statement.

## Employees

The Remuneration Committee has referred to the remuneration packages in the financial services sector in determining the annual remuneration policy of employees. The remuneration policy is to ensure that the pay levels are competitive and effective in attracting, retaining and motivating employees. In recognition of the contributions made by staff to the achievements and success of HKEx in 2004, the Board had approved a bonus pool equivalent to \$50 million to be granted to good performers as well as the key employees. For the 2005 salary review, the Board also approved an average salary increase of 2.5 per cent up to a maximum of 4 per cent including adjustment for promotions.

The key components of HKEx's employees' remuneration package, including that of the Chief Executive who is the only Executive Director, and the Senior Management are:

### (a) *Base Salary*

Base salary will be reviewed annually taking into consideration the competitive market position, market practice, the Company's and individual's performance.

### (b) *Incentives*

Incentives which included cash bonus and share options are offered to reward good performers and key employees as recognition of the employees' contribution to HKEx, and with the aim at motivating and incentivising employees in continued pursuit of HKEx's business goals and objectives.

### (c) *Employee Benefits*

- Retirement Scheme

HKEx provides provident fund benefits to all full-time employees through the Hong Kong Exchanges and Clearing Provident Fund which is a registered scheme under the Occupational Retirement Schemes Ordinance ("ORSO") with Mandatory Provident Fund ("MPF") exemption. The ORSO scheme is a defined contribution scheme providing employees with investment choices.

Under the ORSO scheme, HKEx contributes 12.5 per cent of the employee's base salary if the employee contributes 5 per cent, or HKEx contributes 10 per cent when the employee chooses not to contribute.

In addition, HKEx has participated in a master trust MPF scheme to provide retirement benefits to all temporary employees and those full-time employees who elect not to join the ORSO scheme.



As for the MPF scheme, HKEx provides contributions up to the statutory limit, i.e. 5 per cent of the employee's relevant income subject to a maximum of \$1,000.

HKEx's total retirement benefit cost charged to the profit and loss account for the year ended 31 December 2004:

MPF scheme	\$324,465
ORSO scheme	\$46,344,570
<hr/>	
Total	\$46,669,035

- Other benefits

Apart from the retirement benefits, HKEx also provides other benefits to employees such as medical insurance, dental insurance, life and personal accident insurance, employee compensation, and business travel insurance.

## SHARE OPTION SCHEMES

HKEx operates two share option schemes, Pre-Listing Scheme and Post-Listing Scheme, under which the Board, may at its discretion, offer any employee (including any Executive Director) of HKEx or its subsidiaries, options to subscribe for shares in HKEx, for the purpose of attracting and retaining high calibre employees. Both of these schemes were approved by Shareholders on 31 May 2000 and have a life of 10 years until 30 May 2010. Amendments to the Post-Listing Scheme were approved by Shareholders on 17 April 2002 so as to comply with the new requirements of Chapter 17 of the Listing Rules which came into effect on 1 September 2001.

A non-refundable remittance of \$1 by way of consideration for the grant of an option is required to be paid by each grantee upon acceptance of the option.

The maximum number of shares in respect of which options may be granted under these schemes shall not in aggregate exceed 10 per cent of the shares of HKEx in issue as at the date of approval of the Schemes, i.e. a total of 104,066,484 shares. The key terms of these two schemes are summarised below.

### Pre-Listing Scheme

Options for the subscription of 34,890,262 shares were granted to employees of HKEx or its subsidiaries on 20 June 2000. The options granted were exercisable subject to a vesting scale which commenced on 6 March 2002 in tranches of 25 per cent and reaching 100 per cent from 6 March 2005, and in any event shall end not later than 30 May 2010, subject to the provisions for early exercise and/or termination contained in the Pre-Listing Scheme. No further options can be, or have been, issued under the Pre-Listing Scheme from 27 June 2000, the date of listing of HKEx on the Stock Exchange.

The maximum entitlement of each participant, when aggregated with shares issued and issuable under all options granted to him, must not exceed 25 per cent of the aggregated number of shares for the time being issued and issuable under the Pre-Listing Scheme.

The subscription price for a share in HKEx in respect of any particular option granted was determined based on a formula:  $P = 80 \text{ per cent } (A \times B)$ , where “P” is the subscription price; “A” is 18.81, a price/earnings multiple determined by reference to the price/earning multiples of various financial companies listed on the Stock Exchange and/or overseas; and “B” is the earnings of the Group based on its audited combined results for the year ended 31 December 1999 as if the current group structure of HKEx had been in existence throughout the year divided by 1,040,664,846 shares in issue.

### Post-Listing Scheme

Unless approved by Shareholders in general meeting, no employee shall be granted an option if the total number of shares issued and to be issued upon exercise of the options granted and to be granted to such employee in any 12-month period up to the date of the latest grant would exceed 1 per cent of the issued share capital of HKEx in issue at the relevant time.

The subscription price of share in respect of any particular option granted shall be at least the higher of (i) the closing price of HKEx shares on the Stock Exchange, as stated in the Stock Exchange’s daily quotations sheet on the relevant offer date in respect of such option; or (ii) the average of the closing prices of HKEx shares on the Stock Exchange, as stated in the Stock Exchange’s daily quotations sheet for the five trading days immediately preceding the relevant offer date in respect of such option; or (iii) the nominal value of a share in HKEx.

An option may be exercised in accordance with the terms of the Post-Listing Scheme at any time during a period to be notified by the Board to each grantee. Such period may commence on the second anniversary of the date on which the option is offered in tranches of 25 per cent and reaching 100 per cent from the fifth anniversary of the date on which the option is offered, and in any event shall end not later than 10 years from the date upon which the option is granted and accepted, subject to the provisions for early exercise and/or termination as contained in the Post-Listing Scheme.

As at the date of annual report, the total number of shares available for issue, save for those granted but yet to be exercised, under the Pre-Listing Scheme and the Post-Listing Scheme aggregated to 62,310,484 shares, which represented 5.9 per cent of the issued share capital of HKEx as at 28 February 2005.

### Accounting Policy adopted for share options granted

The early adoption of HKFRS 2 has resulted in a charge of employee option expenses to the profit and loss account. Under the HKFRS 2, the fair value of share options at grant date is amortised over the relevant vesting periods to the profit and loss account. However, as HKFRS 2 is not applicable to options granted before 7 November 2002, shares granted under the Pre-Listing Scheme is not subject to the requirements of HKFRS 2.

For share options granted under the Post-Listing Scheme, the fair value of the employee services rendered in exchange for the grant of the options is recognised as an expense and credited to an employee share-based compensation reserve under equity. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options at grant date. At each balance sheet date, the Group revises its estimates of the number of options that are expected to become exercisable. Changes of the financial impact, if any, will be adjusted in the profit and loss account, and a corresponding adjustment to the employee share-based compensation reserve over the remaining vesting period.

HKEx has used the Binomial Option Pricing Model for estimating the fair value of options issued under the Post-Listing Scheme. The assumptions used in the model for the following factors are:

- Risk-free rate of return – the yield of 10-year Exchange Fund Notes
- Expected volatility of share price – annualised volatility for 1 year immediately preceding the grant date
- Expected dividend yields – annual dividend (excluding special dividend) of the most recent financial year and the closing price on grant date

The amount written off in the profit and loss account for the year ended 31 December 2004 was \$14,290,000 (2003: \$2,771,000).

## DIRECTORS' SERVICE CONTRACTS

No Director has any existing or proposed service contract with any member of the Group (excluding contracts expiring or determinable by the employer within one year without payment of compensation (other than statutory compensation)). Mr Paul M Y Chow is employed as the Chief Executive of HKEx whose contract is on a four-year term commencing 1 May 2003.

## REMUNERATION AND SHARE OPTIONS GRANTED

### Executive Director

#### Remuneration

The Chief Executive is the only Executive Director of HKEx. His remuneration, and interest in share option granted, are set out below:

Chief Executive	Director's Fee (\$)	Salary (\$)	Others Benefits (\$) (note 1)	Performance Award (\$)	Retirement Benefit Cost (\$) (note 2)	Compensation for Loss of Office (\$)	Total (\$)
Paul M Y Chow	–	7,200,000	74,425	900,000	900,000	–	9,074,425

*Share option expenses are not included in the remuneration disclosed above. Please refer to note 11 to the accounts for details of the allocated amortised share expenses in respect of the share option granted to him under the Post-Listing Scheme.*

#### Share Options

Date of grant	Exercise Price	Number of shares issuable under the options granted				Exercise Period
		As at 1 January 2004	Granted during the year	Subscribed during the year	As at 31 December 2004	
2 May 2003	\$8.28 (note 4)	3,000,000	–	–	3,280,000 (note 4)	2 May 2005 – 1 May 2013

## Non-executive Directors

### Remuneration

The remuneration, comprising Director's fee only, of all Non-executive Directors who served for whole year 2004 is set out below:

Name of Non-executive Director	Director's Fee (\$)
Charles Y K Lee	100,000
Henry H L Fan	100,000
Fong Hup	100,000
Tim Freshwater	100,000
Bill C P Kwok	100,000
Dannis J H Lee	100,000
Vincent K H Lee	100,000
Leong Ka Chai	100,000
Lo Ka Shui	100,000
John E Strickland	100,000
David M Webb	100,000
Oscar S H Wong	100,000
Total	1,200,000

Non-executive Directors are not entitled to participate in the share option schemes of HKEx.

Particulars of the Directors' emoluments disclosed pursuant to Section 161 of the Companies Ordinance and Appendix 16 of the Listing Rules are set out in note 11 to the accounts.

## Senior Management

### Remuneration

The remuneration of the Senior Management, and their interests in share options are set out below:

Name of Employee	Salary (\$)	Others Benefits (\$) <i>(note 1)</i>	Performance Award (\$)	Retirement Benefits Cost (\$) <i>(note 2)</i>	Compensation for Loss of Office (\$)	Total (\$)
Patrick K Conroy	5,460,000	109,857	630,000	682,500	–	6,882,357
Lawrence K M Fok	4,500,000	77,016	520,000	562,500	–	5,659,516
						<i>(note 3)</i>
Gerald D Greiner*	2,185,290	339,333	325,000	273,161	–	3,122,784
Mary M L Kao	3,420,000	58,081	490,000	427,500	–	4,395,581
Karen K Y Lee	2,760,000	34,597	395,000	345,000	–	3,534,597
Stewart S C Shing	3,504,000	56,250	520,000	458,016	–	4,538,266
Richard G Williams	3,504,000	76,054	800,000	431,625	–	4,811,679
Alfred K K Wong*	2,282,500	54,125	380,000	285,312	–	3,001,937

\* Mr Gerald D Greiner joined as the Deputy Chief Operating Officer and the Head of the Exchange Division on 17 May 2004, and Mr Alfred K K Wong became the Head of Information Technology Division and Chief Technology Officer on 26 April 2004.

Share option expenses are not included in the remuneration disclosed above. Please refer to note 12 to the accounts for the aggregate of the allocated amortised share expenses of the top four paid employees in respect of the share options granted to them under the Post-Listing Scheme.

*Share Options*

Name of Employee	Date of grant	Exercise Price (\$)	Number of shares issuable under the options granted				Exercise Period
			As at 1 January 2004	Granted during the year	Subscribed during the year	As at 31 December 2004	
Patrick K Conroy	18 August 2003	12.49 <i>(note 4)</i>	1,800,000	–	–	1,968,000 <i>(note 4)</i>	18 August 2005 to 17 August 2013
Lawrence K M Fok	20 June 2000	6.88 <i>(note 4)</i>	693,146	–	–	758,000 <i>(note 4)</i>	6 March 2002 to 30 May 2010
	31 March 2004	16.96	–	120,000	–	120,000	31 March 2006 to 30 March 2014
Gerald D Greiner	17 May 2004	15.91	–	200,000	–	200,000	17 May 2006 to 16 May 2014
Mary M L Kao	20 June 2000	6.88 <i>(note 4)</i>	637,248	–	476,000	178,000 <i>(note 4)</i>	6 March 2002 to 30 May 2010
	31 March 2004	16.96	–	120,000	–	120,000	31 March 2006 to 30 March 2014
Karen K Y Lee	20 June 2000	6.88 <i>(note 4)</i>	402,472	–	300,000	114,000 <i>(note 4)</i>	6 March 2002 to 30 May 2010
	31 March 2004	16.96	–	88,000	–	88,000	31 March 2006 to 30 March 2014
Stewart S C Shing	15 January 2004	17.30 <i>(note 4)</i>	–	1,000,000	–	1,094,000 <i>(note 4)</i>	15 January 2006 to 14 January 2014
Richard G Williams	14 August 2003	12.45 <i>(note 4)</i>	1,000,000	–	–	1,094,000 <i>(note 4)</i>	14 August 2005 to 13 August 2013
Alfred K K Wong	20 June 2000	6.88 <i>(note 4)</i>	214,546	–	142,000	80,000 <i>(note 4)</i>	6 March 2002 to 30 May 2010
	31 March 2004	16.96	–	100,000	–	100,000	31 March 2006 to 30 March 2014

*Notes:*

- Other benefits include medical benefits, leave pay, joining payment, insurance premium, and club membership.*
- An employee who retires before normal retirement age is eligible to 18 per cent of the employer's contribution to the provident fund after completion of 2 years of service. The rate of vested benefit increases at an annual increment of 18 per cent thereafter until reaching 100 per cent after completion of 7 years of service.*  
*Mr Richard G Williams is a member of a pension scheme operating in the United Kingdom, and he is exempted under Section 4(3) of the Mandatory Provident Fund Schemes Ordinance from participating in HKE's provident fund scheme. The vesting scale of retirement benefits is not applicable to Mr Williams.*
- In respect of the remuneration of Mr Lawrence K M Fok, the amount reported did not include HKE's payment of \$410,200, being the PRC individual income tax in respect of Mr Fok's appointment as Chief Representative of HKE's Beijing Representative Officer for 2004.*
- The subscription price and the contract size of the unexercised options granted prior to the 2004 AGM have been adjusted in accordance with the resolution passed by Shareholders at the 2004 AGM. Please refer to note 7 under "Outstanding Share Options" below for more information.*

## DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS AND SHORT POSITIONS

### Directors' and Chief Executive's Interests and Short Positions

As at 31 December 2004, the Directors, the Chief Executive, and their respective associates had the following interests in the shares and underlying shares of HKEx, as recorded in the register maintained by HKEx pursuant to Section 352 of the SFO:

Name of Director	Personal Interests	Number of shares / underlying shares held			Total	% of the Issued Share Capital
		Family Interests	Corporate Interests	Other Interests		
Paul M Y Chow	3,280,000 (note 1)	–	–	–	3,280,000	0.31
Dannis J H Lee	–	–	1,610,000 (note 2)	–	1,610,000	0.15
David M Webb	2 (note 3)	2 (note 4)	6 (note 5)	–	10	0.00
John E Strickland	18,000 (note 6)	–	–	–	18,000	0.00

*Notes:*

- This represented the outstanding number of shares issuable under a share option granted pursuant to the Post-Listing Scheme to Mr Paul M Y Chow, a Director and the Chief Executive of HKEx. The said option was granted on 2 May 2003, and is exercisable between 2 May 2005 and 1 May 2013 at an exercise price of \$8.28 per share. The number of shares issuable under the option granted and the exercise price have been adjusted in accordance with the resolution passed by Shareholders at the 2004 AGM. Please refer to note 7 under "Outstanding Share Options" below for more information.*
- 1,610,000 shares were owned by DL Brokerage Limited, a private company beneficially wholly-owned by Mr Dannis J H Lee.*
- The shares held by Mr David M Webb as beneficial owner.*
- The shares were owned by the spouse of Mr David M Webb.*
- The shares were owned by Fundamental Consultants Limited, Member One Limited and Member Two Limited which are under the control of Mr David M Webb.*
- The shares held by Mr John E Strickland as beneficial owner.*

Other than the holdings disclosed above, no interests and short positions were held or deemed or taken to be held under Part XV of the SFO by any Director or the Chief Executive of HKEx or their respective associates in the shares, underlying shares and debentures of HKEx or any of its associated corporations (within the meaning of Part XV of the SFO) which were required to be notified to HKEx and the Stock Exchange pursuant to Part XV of the SFO or pursuant to the Model Code or which are required pursuant to Section 352 of the SFO to be entered in the register referred to therein. Nor any of the Directors and the Chief Executive (including their spouses and children under the age of 18) had, as at 31 December 2004, any interest in, or had been granted any right to subscribe for the securities and options of HKEx and its associated corporations within the meaning of the SFO, or had exercised any such rights.



## SENIOR MANAGEMENT'S INTERESTS AND SHORT POSITIONS

As at 31 December 2004, the Senior Management had the following interests in the shares and underlying shares of HKEx:

Name of Employee	Number of shares held	Number of shares issuable under staff option granted
Patrick K Conroy	–	1,968,000
Lawrence K M Fok	–	878,000
Gerald D Greiner	–	200,000
Mary M L Kao	476,000	298,000
Karen K Y Lee	300,000	202,000
Stewart S C Shing	–	1,094,000
Richard G Williams	–	1,094,000
Alfred K K Wong	110,000	180,000

## OUTSTANDING SHARE OPTIONS

Details of the share options outstanding as at 31 December 2004 and under the Schemes were as follows:

### Pre-Listing Scheme

	Date of grant	Exercise price	Number of shares issuable under the options granted				Exercise period
			As at 1 January 2004	Issued upon subscription during the year	Lapsed during the year	As at 31 December 2004	
Aggregate total for employees (note 1)	20 June 2000	\$6.88 (note 2)	14,171,626	7,640,000 (note 3)	524,829 (note 4)	6,680,000 (note 2)	6 March 2002 – 30 May 2010 (note 5)

### Post-Listing Scheme

Date of grant	Exercise price	Option value as at the date of grant	Number of shares issuable under the options granted				Exercise period
			As at 1 January 2004	Issued upon subscription during the year	Lapsed during the year	As at 31 December 2004	
<i>Options granted prior to year 2004</i>							
<b>Director (note 6)</b>							
2 May 2003	\$8.28 (note 7)	\$8,036,000 (note 8)	3,000,000	–	–	3,280,000 (note 7)	2 May 2005 – 1 May 2013 (note 9(a))
<b>Employees (note 1)</b>							
14 August 2003	\$12.45 (note 7)	\$4,561,980 (note 8)	1,000,000	–	–	1,094,000 (note 7)	14 August 2005 – 13 August 2013 (note 9(b))
18 August 2003	\$12.49 (note 7)	\$8,226,240 (note 8)	1,800,000	–	–	1,968,000 (note 7)	18 August 2005 – 17 August 2013 (note 9(c))
15 January 2004	\$17.30 (note 7)	\$6,564,000 (note 8)	–	–	–	1,094,000 (note 7)	15 January 2006 – 14 January 2014 (note 9(d))
31 March 2004 (note 10)	\$16.96 (note 11)	\$32,250,960 (note 8)	–	–	106,000 (note 4)	5,582,000	31 March 2006 – 30 March 2014 (note 9(e))
17 May 2004 (note 10)	\$15.91 (note 12)	\$1,156,000 (note 8)	–	–	–	200,000	17 May 2006 – 16 May 2014 (note 9(f))

As at 31 December 2004, a total number of shares that may be issued upon exercise of all share options granted and yet to be exercised under the Post-Listing Scheme was 13,218,000 shares.

After the year end of 2004, the Board approved the grant of share options in respect of 5,884,000 shares under the Post-Listing Scheme to certain eligible employees. The said options were granted on 26 January 2005, and are exercisable between 26 January 2007 and 25 January 2015 at an exercise price of \$19.25.

*Notes:*

1. *Employees working under employment contracts that were regarded as "continuous contracts" for the purpose of the Employment Ordinance of Hong Kong.*
2. *At the 2004 AGM, Shareholders approved the adjustments to the subscription price and the contract size of the unexercised options granted under the Pre-Listing Scheme. The subscription price of the shares issuable under the unexercised options granted under the Pre-Listing Scheme was adjusted from \$7.52 per share to \$6.88 per share. The aggregate contract size of the unexercised options granted was adjusted, resulting in the additional grant of 673,203 shares. After taking into account the shares issued and lapsed under the Pre-Listing Scheme during the year ended 31 December 2004, the number of shares issuable as at 31 December 2004 was 6,680,000.*
3. *The weighted average closing price immediately before the dates on which the options were exercised was \$20.06.*
4. *Options lapsed in accordance with the terms of the Pre-Listing / Post-Listing Schemes due to resignation of employees.*
5. *Options granted are exercisable between 6 March 2002 and 30 May 2010, in tranches of 25 per cent each reaching 100 per cent as from 6 March 2005.*
6. *The option was granted to Mr Paul M Y Chow, a Director and the Chief Executive.*
7. *At the 2004 AGM, Shareholders approved the adjustments to the subscription price and the contract size of the unexercised options granted under the Post-Listing Scheme prior to the 2004 AGM. Adjustments made to the four unexercised options granted under the Post-Listing Scheme prior to the 2004 AGM are set out in note 33 to the accounts.*
8. *HKEx had used Binomial Option Pricing Model, the fair value of the options granted as at the date of grant and the revaluation of the adjusted options (as approved by Shareholders at the 2004 AGM) are set out in note 33 to the accounts.*  
*The Binomial Option Pricing Model was developed to estimate the fair value of American style options. It is one of the commonly used models to estimate the fair value of an option which can be exercised before the expiry of the option period. The value of an option varies with different variables of certain subjective assumptions. Any change in variables so adopted may materially affect the estimation of the fair value of an option.*
9. *Options granted are subject to a vesting scale in tranches of 25% each per annum starting from the second anniversary and fully vested in the fifth anniversary of the date of grant, corresponding vesting period are as follows:*

	Date of Grant	Exercise period	Reaching 100% as from
(a)	2 May 2003	2 May 2005 – 1 May 2013	2 May 2008
(b)	14 August 2003	14 August 2005 – 13 August 2013	14 August 2008
(c)	18 August 2003	18 August 2005 – 17 August 2013	18 August 2008
(d)	15 January 2004	15 January 2006 – 14 January 2014	15 January 2009
(e)	31 March 2004	31 March 2006 – 30 March 2014	31 March 2009
(f)	17 May 2004	17 May 2006 – 16 May 2014	17 May 2009

10. *Options granted on or after 31 March 2004 under the Post-Listing Scheme, and are not subject to the adjustments as referred to in note 7.*
11. *The closing price immediately before the date on which the options were granted was \$16.85.*
12. *The closing price immediately before the date on which the options were granted was \$15.55.*

## DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE

No contracts of significance in relation to the Group's business to which HKEx or any of its subsidiaries was a party, and in which a Director of HKEx had a material interest, whether directly or indirectly subsisted at the year-end or at any time during the year.

## CONTINUING CONNECTED TRANSACTIONS

During the year ended 31 December 2004, the Group had the following continuing connected transactions, details of which are set out below:

- (A) For the year ended 31 December 2004, transactions between the following connected persons and HKEx or its subsidiaries arising from or in connection with the use of (i) the facilities provided by HKEx or its subsidiaries for the trading, clearing and/or settlement of securities and futures products and transactions and (ii) all services offered by HKEx or its subsidiaries which are ancillary, incidental or otherwise related to the foregoing:
- (1) Dr Bill C P Kwok, an INED, was interested in the transactions entered into by Wocom Securities Limited and Wocom Limited, which are EPs indirectly-held by a company where Dr Kwok and his close family members in aggregate have an interest over 30 per cent.
  - (2) Mr Dannis J H Lee, an INED, was interested in the transactions entered into by DL Brokerage Limited, an EP which is beneficially wholly owned by Mr Lee.
  - (3) Mr K C Leong, an INED, was interested in the transactions entered into by Roctec Securities Company Limited and Roctec Futures Trading Company Limited, which are EPs where Mr Leong has a 30 per cent interest in each of the companies.

All the above continuing connected transactions were entered into in the ordinary course of business and on normal commercial terms.

- (B) For the year ended 31 December 2004, transactions between the following connected persons and HKEx or its subsidiaries arising from or in connection with the listing of securities on the Stock Exchange and all services offered by the Group which are ancillary, incidental or otherwise related to the foregoing:
- (1) Dr Bill C P Kwok, an INED, was interested in the transactions entered into by Wing On Company International Limited, a listed company on the Stock Exchange in which Dr Kwok and his close family members in aggregate have an interest over 30 per cent.

- (2) Dr Lo Ka Shui, an INED was interested in the transactions entered into by Great Eagle Holdings Limited (“Great Eagle”), a listed company on the Stock Exchange by virtue of it being an associate of Dr Lo, the deputy chairman and managing director, and substantial shareholder of Great Eagle.

All the above transactions were entered into in the ordinary course of business and on normal commercial terms.

- (C) For the year ended 31 December 2004, transactions between the following connected persons and HKEx or its subsidiaries arising from or in connection with HKSCC’s arrangement on behalf of Clearing Participants of Buy-in Transactions:

- (1) Dr Bill C P Kwok, an INED, was interested in the Buy-in Transactions entered into by Wocom Securities Limited, an indirect subsidiary of a company where Dr Kwok and his close family members in aggregate have an interest over 30 per cent. For the year ended 31 December 2004, the total consideration of such transactions, which were transacted on normal commercial terms was \$4,165,630.

- (2) Mr Dannis J H Lee, an INED, was interested in the Buy-in Transactions entered into by DL Brokerage Limited beneficially wholly owned by Mr Lee. For the year ended 31 December 2004, the total consideration of such transactions, which were transacted on normal commercial terms was \$4,583,183.

- (3) Mr K C Leong, an INED, was interested in the Buy-in Transactions entered into by Roctec Securities Company Limited in which Mr Leong has a 30 per cent interests. For the year ended 31 December 2004, the total consideration of such transactions, which were transacted on normal commercial terms was \$4,488,099.

- (D) On 5 February 2003, HKFE as the tenant entered into a tenancy agreement with Shine Hill Development Limited (“Shine Hill”) as the landlord in respect of the tenancy (“Tenancy”) of premises of Suites 501-3 and Storeroom on 5th Floor and Suites 1101 & 1109-11 on 11th Floor, ICBC Tower, Citibank Plaza, 3 Garden Road, Central, Hong Kong (“Premises”) for a period of two years commencing 1 January 2003. The lettable area of the Premises is approximately 10,348 square feet. Shine Hill is a subsidiary of Great Eagle and is a connected person of HKEx by virtue of it being an associate of Dr Lo Ka Shui, an INED. The Tenancy constituted a continuing connected transaction of HKEx under the Listing Rules. A waiver had been granted by the SFC to HKEx in respect of the Tenancy from strict compliance with Rule 14A.47(2) of the Listing Rules. For the year ended 31 December 2004, the total rent, management charges and operating charges paid in respect of the Tenancy was \$4,697,542. The Tenancy expired on 31 December 2004.

As there were practical needs for HKFE to retain its existing offices at the Premises, prior to its expiry, HKFE engaged Chesterton Petty Limited, professional property consultants, to negotiate the lease renewal with Shine Hill. The negotiation of the terms of the new tenancy was conducted on an arm's length basis and the rental of the Premises was determined by reference to the open market rent of properties of comparable size and location. The Tenancy was subsequently renewed for a further term of 2 years commencing 1 January 2005 at a monthly rental of \$310,440, exclusive of management charges, rates and operating expenses. The new tenancy constituted a continuing connected transaction of HKEx ("New Tenancy"), and details of the transaction were announced on 14 December 2004.

Two INEDs who have not entered into any connected transactions with the Group, have reviewed and confirmed that the continuing connected transactions, as set out above had been entered into by the Group in accordance with the waiver conditions granted by the SFC and the requirements of the Listing Rules that:

- (a) the continuing connected transactions disclosed above were entered in the ordinary and usual course of business of the relevant Group company and conducted on an arm's length basis;
- (b) in respect of transactions other than Buy-in Transactions and the lease of Premises, they were in accordance with the rules and regulations of the relevant Group company governing such transactions and where the rules and regulations do not govern those transactions in full, in accordance with the standard terms and conditions of the relevant Group company relating to such transactions;
- (c) in respect of transactions which are Buy-in Transactions, they were in accordance with the standard terms and conditions of HKSCC applicable generally to all Buy-in Brokers in such transactions for and on behalf of HKSCC and at the standard commission rate payable by HKSCC in respect of all such Buy-in Transactions;
- (d) in respect of the Tenancy and the New Tenancy, they were entered into in the ordinary and usual course of business of HKFE, and terms as contained therein, were on normal commercial terms; and
- (e) the continuing connected transactions were in the opinion of the Directors fair and reasonable so far as the Shareholders are concerned.

The external auditors of HKEx have also confirmed that:

- (a) the continuing connected transactions disclosed above had been approved the Directors;

- (b) the continuing connected transactions, other than the Tenancy and the New Tenancy, were in accordance with the relevant rules and regulations of the relevant Group company governing fees for the applicable facilities, services or goods provided by, or to, the Group and where the rules and regulations do not govern the transaction in full, are in accordance with the standard terms and conditions of the relevant Group company relating to the applicable facilities, services or goods provided by, or to, the Group; and
- (c) the Tenancy had been entered into in accordance with the relevant agreement governing the transaction, and the annual consideration had not exceeded the cap as provided to the SFC under the relevant waiver application.

Save for the above, HKEx was notified by Mr Vincent K H Lee that subsequent to the year-end, Tung Tai Securities Company Limited (“TTS”) and Tung Tai Futures Limited (“TTF”) became his associates by virtue of the Listing Rules following the change in control of TTS and TTF. TTS and TTF, being EPs and Clearing Participants, enter into in their ordinary course of business, transactions with HKEx or its subsidiaries arising from or in connection with (i) the use of facilities or services offered by HKEx or its subsidiaries, or (ii) Buy-in Transactions, which constitute continuing connected transactions of HKEx, but, pursuant to the waiver granted by the SFC, only subject to reporting and annual review requirements.

## RELATED PARTY TRANSACTIONS

The Group also entered into certain transactions with parties regarded as “related parties” under the applicable accounting principles. Details of these transactions are set out in note 44 to the accounts.



## CORPORATE AND SOCIAL RESPONSIBILITY

As a publicly-listed company, HKEx has increased responsibilities to safeguard the interests of its stakeholders, particularly Shareholders, employees, and customers, wider obligations to support the community, and greater commitment to preserving the environment. During 2004, HKEx made positive progress towards achieving its objectives in this regard.

### OUR SHAREHOLDERS: THE BEST POSSIBLE CHOICE

Other than striving for an increase in Shareholder value, HKEx also provides clear and transparent corporate information to Shareholders. A true and fair report on its financial position and operating performance is presented to Shareholders in the quarterly, interim, and annual reports which are posted on HKEx's corporate website. In addition, other corporate communications to Shareholders, such as circulars, notices, and the newsletter – *Exchange*, are available on HKEx's corporate website along with the Memorandum & Articles of Association, information on HKEx's corporate governance practices, the poll voting results, minutes of annual general meetings and updates on the Group's affairs. The objective is to communicate with Shareholders in an open, honest, and prompt manner.

Other initiatives to promote good investor relations have included the creation of the Investor Relations Corner on the HKEx website and the establishment of the Investor Services Department in May 2004 to focus on managing investor relations. We recognise the importance of continuous improvement in promoting transparency and fostering good relationships with investors. Comments and suggestions are welcome and can be addressed to the Investor Services Department or the Company Secretary.

### OUR EMPLOYEES: AN EMPLOYER OF CHOICE

In 2004, HKEx underwent organisational restructuring and cost rationalisation. The staff team as at the end of 2004 comprised 791 employees, including 16 temporary staff (2003: 803 employees, including 38 temporary staff). During the year, 82 employees left the Group, resulting in a turnover rate of 10.9 per cent (2003: 39 employees left and the turnover rate was 5 per cent). Employees' rewards such as bonus and share options are linked to individual performance.

We recognise that our competitiveness is dependent on employing the best people and providing them with appropriate training. To achieve this, it is the policy of the Group to create a working and learning environment which cares about the welfare and rights of employees, provides equal opportunity, and develops the skills and knowledge of employees.

#### Welfare and Rights of Employees

HKEx is committed to achieving a high standard of occupational safety and health through assigning responsible persons to attend risk assessment training, identifying any actual and potential hazards and risks to each individual, monitoring and reviewing the safety management system, performing regular audits on safety and health performance, and maintaining a complete set of emergency procedures. Training courses, such as the Certificate of Competence in Manual Handling and First Aid, have been organised from time to time to equip employees with the knowledge and skills to perform their duties in a safe manner. The Occupational Safety and Health Policy is included in the Human Resources Manual, which has been issued to employees and posted on the HKEx website.

In addition, HKEx offers all employees a comprehensive range of benefits, such as the provident fund, medical and dental insurance, life and personal accident insurance, employee compensation, and business travel insurance.

It is important that HKEx's objectives and vision are clearly articulated and completely understood and accepted by the employees. HKEx therefore continues to encourage communication among all levels of the organisation in an effort to foster staff commitment to the Group. The Chief Executive regularly delivers and explains key Group policies and developments to executives at the Monthly Executive Forum and the Quarterly Presentation. Presentations from the Forums and Briefings are posted on HKEx's Intranet for the staff's reference.

Employees are invited to participate in various task groups and committees to enhance the communication and teamwork at all levels and among different Divisions/Departments. For example, in 2004, a Career Development & Training Committee comprising employees of different Divisions/Departments and different grades was formed to review and advise the Chief Executive and the Division/Department Heads on the career development and training policies of the Group. The Provident Fund Committee, comprised of staff representatives, was set up in 2004 to gauge the views of employees on the operation of HKEx's provident fund.

The Staff Social Club has continued to convey the views of employees in respect of social welfare to the senior management and organise a wide range of activities to help increase employees' sense of belonging. The activities have included the annual dinner party, visits and outings, classes on topics such as cooking and skin care, and health talks. HKEx is delighted that, as a result of the strong teamwork of employees, it won the championship in both the Soccer Public Organisations Challenge League and the Supervisory Cup Basketball Competition in 2004.

HKEx promotes fairness, integrity, respect, and teamwork, which are keys to the success of the Group. To assess employee satisfaction and to understand what employees think of their work and the organisation, staff were invited to participate in the second employee opinion survey, which was conducted in the third quarter 2004. The survey attracted an encouraging response rate of about 80 per cent and very comprehensive feedback. The results were analysed thoroughly, and appropriate actions are being taken to further improve the working conditions and enhance the performance culture of HKEx to ensure that it continues to be an employer of choice.

### **Equal Opportunity and Code of Ethics for Employees**

HKEx adopts the Code of Practice on Equal Opportunities recommended by the Equal Opportunities Commission in Hong Kong. It is the Group's policy to eliminate discrimination, harassment, and vilification in employment, to promote equal employment opportunities, and to adopt good management practices. An Equal Opportunity Policy, which includes procedures for handling grievances, is set out in the Human Resources Manual. All employee complaints and grievances, alerts of wrongdoings, and recommendations on improvements will be channelled to the Chief Executive who will make a decision to resolve the matter. In cases involving complaints against the Chief Executive, or appeals against the Chief Executive's decisions, employees can contact the Chairman directly.

As a designated public body listed in the Schedules of the Prevention of Bribery Ordinance and the frontline regulator of companies listed in Hong Kong, HKEx's employees are public servants and therefore subject to the said Ordinance. Employees also are required to comply with the Code of Conduct set out in the Human Resources Manual, which governs mainly securities dealings, soliciting and accepting advantages, loans to and from business associates, conflict of interest, and confidentiality. To ensure full understanding of the requirements, briefings on integrity and corruption prevention are periodically arranged jointly with the Independent Commission Against Corruption for employees.

### Skills and Knowledge of Employees

It is HKEx's responsibility to provide appropriate training to help staff identify and meet development needs. Apart from providing education sponsorship, different kinds of training programmes are prepared for employees to keep them up to date on the market trends and to maintain and enhance their technical and professional knowledge. These programmes include in-house training on communication skills, customer service, business etiquette, accounting standards, project management, and Putonghua, as well as external training. In 2004, HKEx sponsored 225 courses and organised 42 in-house programmes for the employees. Professional staff members are fully reimbursed for professional development courses organised by recognised programme providers.

Promotion is merit-based. The promotion policy has been set out clearly in the Human Resources Manual. Moreover, a systematic performance development process is in place to help employees meet their performance objectives and to align each individual's objectives with HKEx's objectives. In 2004, the performance appraisal process was refined to make it more user-friendly and focused more on the area of training and development.

It is HKEx's objective to encourage and foster a learning culture within the Group. A learning culture combined with the career development and strategic deployment opportunities HKEx offers staff at all levels will help ensure smooth succession when positions must be filled and the continued effective performance of the organisation.

## OUR CUSTOMERS: THE BEST SERVICE PROVIDER

As an exchange controller and a listed company, EPs, listed issuers, the investing public and all the other market participants and users, including sponsors and intermediaries, are HKEx's customers.

In 2004, the Group further expanded and improved its services. For details, please refer to the Management Discussion and Analysis Section on pages 28 to 62. Moreover, for the benefit of investors, HKEx provides publications on its products and services from time to time. In 2004, the Group published leaflets on equities, trading securities in Hong Kong, the enhanced Investor Account in CCASS, PRiME and the derivatives market, and stock options. It also published booklets on H-shares Index Futures and Options, listing in Hong Kong, and changes to the Listing Rules. To further improve services to participants, a series of enhancements will be launched gradually in 2005.

HKEx treats its customers as valued partners and is always committed to seeking their views on issues which may have implications on the market. Meetings of the various consultative panels are held from time to time to collect views of market participants in respect of proposals related to the markets. In 2004, HKEx issued the Draft Proposed Amendments to the Listing Rules Relating to the Regulation of Sponsors and Independent Financial Advisors, the Exposure of the Draft Code on Corporate Governance Practices and Corporate Governance Report, and the Consultation Paper on the Reduction of Minimum Spreads to invite market input and comments. Appropriate improvement actions have been taken in response to the invaluable comments received.

To better understand the needs and expectations of its customers, HKEx conducted and released the results of its latest Cash Market Transaction Survey, Omnibus Retail Investor Survey, Secondary Market Survey, and Derivatives Market Transaction Survey in 2004. The highly valued feedback was analysed with a view to making improvements to satisfy customers' needs.

## OUR COMMUNITY AND ENVIRONMENT: A SOCIALLY RESPONSIBLE ORGANISATION

As well as being responsible to its customers through its financial service offerings, HKEx believes that it has a responsibility to the wider society in which it operates. This includes supporting employees in their individual and collective efforts to contribute to the community. In 2004, HKEx participated in the Green Day and the Dress Casual Day to raise funds for the Community Chest of Hong Kong, and it held its yearly blood donation activities. In addition, employees responded enthusiastically in December 2004 to the donation campaign to assist the people affected by the earthquake and tsunami in South Asia. Our employees have also enthusiastically supported the activities organised by charitable organisations, such as the Mooncakes Collection Campaign and Chinese New Year's Presents Collection Campaign organised by the St. James Settlement.

HKEx has operated the Stock Code Balloting Scheme with the Community Chest of Hong Kong since 1999. The Scheme raised approximately \$21 million, which accounted for about 13 per cent of the total donations received by the Community Chest for its financial year 2003/2004. HKEx raised a total of about \$28 million from the Scheme in 2004.

In 2004, HKEx sponsored the 2004-2005 China-Hong Kong Investment Simulation Competition jointly organised by Hong Kong and Mainland universities. The participants comprised more than 13,000 students from 133 universities in Hong Kong and various provinces on the Mainland. HKEx allowed the use of HKEx price data by the university students at no charge for the purpose of the competition. The event helped the university students familiarise themselves with the securities markets in Hong Kong and on the Mainland.

To encourage greater public awareness of the importance of corporate governance, HKEx sponsored the Best Annual Reports Awards 2004 organised by the Hong Kong Management Association.

Although HKEx does not operate an environmentally sensitive business, it recognises its duty to minimise its environmental impact. The Group has identified opportunities to reduce and recycle the resources it consumes, and it has adopted key environmental management procedures, including the recycling of paper and IT equipment, and the use of energy-saving office equipment. Moreover, HKEx has continued to review its e-submission system to encourage listed issuers to disseminate information electronically. During 2004, HKEx published 78,030 issuers' disclosures on the HKEx and GEM websites, about an 18 per cent increase over the previous year. There was also increased use of the websites for accessing issuers' information, with page views rising from 68,602,679 in 2003 to 152,244,153 in 2004, a gain of 122 per cent. On Disclosure of Interests as required by the SFO, the total number of disclosure notices published on the HKEx website increased to 31,300 from 27,494 in 2003. About 16 per cent of the notices were filed through the Internet. Page views on Disclosure of Interests information increased by 87 per cent, from 6,103,040 in 2003 to 11,424,354 in 2004.

On behalf of the Board of Directors

**MAU Kam Shing, Joseph**

*Company Secretary*

Hong Kong, 28 February 2005