

# Chief Executive's Review

*In late 2003, HKEx embarked on a Three-year Strategic Plan to pursue its mission to provide a world-class marketplace for Hong Kong and Mainland China securities and derivatives products. The three key strategic objectives – Building a Quality Market, Becoming a Mainland Partner and Consolidation have remained the key focuses of HKEx ever since.*

## HKEx — THE THREE-PRONGED STRATEGY



### HKEx's Vision

*A world-class marketplace for Hong Kong and Mainland China securities and derivative products*

### Building a Quality Market

*Improving and maintaining market quality is the most important prerequisite for HKEx to uphold and reinforce its roles as an international financial centre and a premier capital market for Mainland enterprises.*

#### *Strengthening the regulatory regime*

In line with our continuous efforts to improve the corporate governance standards, amendments to the Listing Rules embracing the CG Code took effect from 1 January 2005. As strengthening the regulatory framework is an ongoing process, HKEx reviews its rules on a regular basis to ensure that they are in line with the best market practices and international standards. While the majority of companies and market participants have fully complied with the rules and regulations, as in all markets, there may still be a small number of companies and market participants that do not abide by the rules. It is HKEx's belief that, for the benefit of the market, non-compliance cases should be dealt with through stricter enforcement. To this end, HKEx supports the Government's and the SFC's proposals for giving statutory backing to the more important Listing Rules requirements.



The Exchange had also reviewed the composition and structure of the Listing Committees, and the relevant rule amendments will come into effect in May 2006. The measures were aimed at increasing the Exchange's transparency in the discharge of its responsibilities for listing regulation and improving the operation of the Listing Committees. Also for the purpose of improving transparency, the Listing Committees published the second annual report since July 2004 to set out the work done during the service term of their members. In addition, starting from this year, a Listing Committee Report is prepared to record the work done during the financial year of HKEx, which is despatched to the Shareholders together with the Annual Report.



Almost six years after the launch of the GEM, HKEx considers that it is now the right time to conduct a comprehensive review of the GEM, and issued in January 2006 a discussion paper to facilitate public discussion for the purpose of enhancing the further development of the GEM.

In respect of the increased interest in our derivative warrants market, HKEx conducted a review of the market and published an article on derivative warrants in October 2005 to invite public comments thereon.

#### *Fostering corporate governance culture*

Good corporate governance in the market translates into better internal control and risk management practices and higher market integrity, resulting in stronger investor confidence. Hence, a well-established compliance culture is equally important to a regulatory regime for maintaining an open, secure, fair, orderly, efficient and transparent marketplace.

As the exchange controller as well as a listed company, HKEx has focused intently upon observing the best corporate governance standards and practices, and setting a good example in leading the Hong Kong market in the area of corporate governance. HKEx strongly believes that the awareness of good corporate governance among issuers could be raised by sharing with them the best practices that we have observed. Over the years, HKEx has received several awards in recognition of our achievements in corporate governance from both local and overseas organisations. In 2005, we were particularly delighted that HKEx has been recognised as a member of the FTSE4Good Index Series, a group of real-time indices designed to reflect the performance of companies in social responsibility aspect, and identified as a corporate governance star in the CG Watch 2005 conducted by the CLSA Asia-Pacific Markets and the Asian Corporate Governance Association. A summary of the public recognitions is set out on page 87 of this Annual Report.

HKEx will continue to strive to engender trust and confidence by pursuing ongoing enhancements to its internal governance and upholding the highest standards of transparency. The Corporate Governance Report on page 72 will provide more details.



### *Meeting customers' demands*

In response to market needs and with the aim of improving market liquidity and efficiency, HKEx reduced the monthly user fees for all AMS/3 trading devices, and completed its review on clearing fees in 2005. In fact, investors and market participants have been enjoying substantial cost savings as a result of a series of fee reductions implemented since 2004. Details of the fee reductions implemented in the past two years and in the coming year can be found on page 51 under the Business Review of this Annual Report.

To add value to our business, HKEx has been reviewing the existing products and services and exploring new ones in collaboration with the market. To name a few, FTSE/Xinhua China 25 Index Futures and Options and three ETFs were newly introduced and six additional classes for stock options and futures were launched during the year. Various measures were taken to give market participants more choices and to ensure sustained long-term growth in the stock options market. In addition, HKEx plans to introduce CBBCs in June/July 2006 subject to the readiness of the market. On information services, HKEx has also introduced new service for redistribution of historical data products and extended special offer of real-time market data for Mainland users.

In the interests of the investing public, HKEx has increased its efforts to promote investor education by offering ongoing training and seminars to our participants and investors to familiarise them with our products and services.

### *Improving the market infrastructure*

A quality market can only be built upon a stable, reliable and efficient market infrastructure. We leverage the competency, teamwork and quality culture of our staff to deliver cost-effective IT solutions to support further growth and development of our markets. In 2005, apart from upgrading the operating systems of the HKATS, DCASS and CCASS/3, a total of about \$25 million was spent on upgrading the capacity of the AMS/3. HKEx's securities market trading and clearing systems are highly recognised in the IT industry. Following the awards received in 2004 for the AMS/3, a Gold Award (top honour) of the Application Category of the 7th IT Excellence Awards was conferred on HKEx in respect of its CCASS/3 by the Hong Kong Computer Society in October 2005.

As part of HKEx's commitment to enhance the market infrastructure and ensure the highest standard of system performance, HKEx, in October 2005, completed the construction and implementation of the SDNet, a new Optical Ethernet network, and successfully migrated its participants' links to the HKATS, DCASS and PRS onto the SDNet, which constituted the first phase of the network consolidation project. The migration of the CCASS/3 and AMS/3

participants' circuits to the SDNet is expected to be completed in mid-2006 and 2007 respectively. This initiative has improved the quality of the market by offering significant technological improvements and greater operational efficiency and cost effectiveness to both HKEx and participants.

Other enhancements to the market infrastructure included improvements in money settlement services and nominee services, harmonisation of the capital requirements of different categories of clearing participants of the three clearing houses, reduction in trading spreads (Phase 1), revamp of HKEx website, improvement of HKEx disaster recovery website and refurbishment of the Trading Hall.

After reviewing the trading and market data for the first six months following Phase 1 spreads reduction, on 15 February 2006 the Board decided to implement the Phase 2 proposal for securities trading between \$0.25 and \$20 in July 2006 subject to the SFC's approval.

### Becoming a Mainland Partner

*HKEx is well-placed to capitalise on the steady economic growth in the Mainland and will continue to offer an effective and prestigious listing venue for potential Mainland enterprises to raise capital and enhance their profile to enable them to further develop their businesses.*

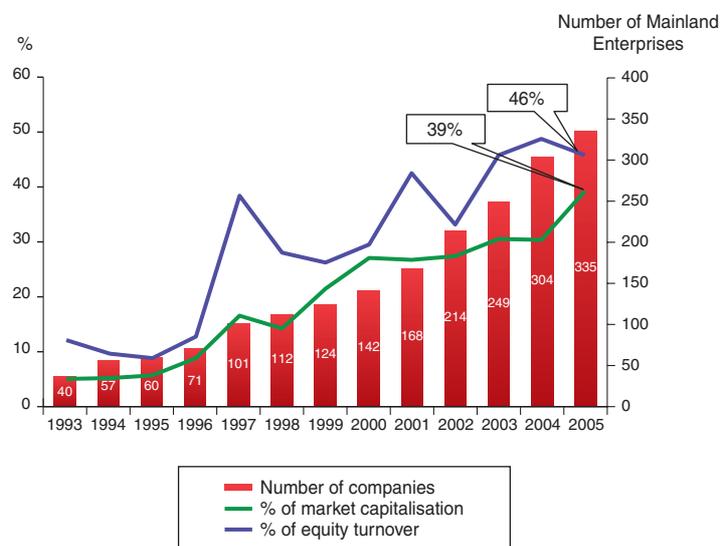
#### *Encouraging listings of Mainland enterprises*

The listing of Mainland enterprises has contributed significantly to the growth of the Hong Kong Cash and Derivatives Markets. In 2005, out of the 10 largest companies by turnover, six of them were Mainland enterprises. At the end of December 2005, the 335 Mainland enterprises accounted for 30 per cent of the total number of 1,135 issuers on the Exchange, 39 per cent of the total year-end market capitalisation of \$8,179.9 billion and 46 per cent of the equity market's total turnover. The trading turnover of H-shares, reached a record high last year, rising to \$953.3 billion, signifies strong investor interest in Mainland enterprises.

#### *Raising the awareness of good corporate governance*

In addition to the access to capital denominated in a freely convertible currency, Mainland enterprises, through becoming listed companies on the Exchange, are subject to market discipline and compliance requirements which help bring their standards of corporate governance, accounting, disclosure and management on a par with international best practices. The vitality of the equity market depends fundamentally on the quality of listed companies. Education programmes are frequently organised, in particular, in the Mainland for newly listed companies and potential issuers so as to properly equip them with better knowledge of the regulatory framework in Hong Kong and to promote the awareness of post-listing compliance.

**Mainland Enterprises Contributed Significantly To The Hong Kong Market**



*Strengthening cooperation with the Mainland regulators*

In the light of the challenges on cross-border enforcement of local rules and regulations on Mainland issuers, HKEx has been co-operating closely with the SFC, the CSRC, the Shanghai Stock Exchange and the Shenzhen Stock Exchange to promote good corporate governance practices to Mainland listed and potential issuers. In the way forward, in addition to the Memorandum of Regulatory Cooperation meeting, more frequent meetings and liaison will be conducted with the Mainland regulators to share experience and information and discuss regulatory issues and market development.

**Consolidation**

*HKEx will be able to offer greater value to its stakeholders by effectively implementing its policies and developments and improving its operations as a streamlined, dedicated and efficient business entity.*

In the past two years, HKEx has focused on prudent cost controls, a streamlined project portfolio, corporate reorganisation, staff development and training, integration of business operations and policies, and strengthening of risk management. All these have contributed positively to the remarkable performance of HKEx in 2005.

**HKEx posted the best results since listing in 2000**

- Income increased by 13 per cent to \$2,694 million (2004: \$2,394 million)
- Reduction in the IT and computer maintenance expenses of 9 per cent
- Net profit increased by 27 per cent to \$1,340 million (2004: \$1,057 million)

As part of the succession plan, the corporate structure was revised in August 2005 to provide senior executives with the opportunities to further enrich their exposures and management experience. The Cash Clearing Systems Development and Support Department and the Derivatives Clearing Systems Development and Support Department have been consolidated into the Clearing Systems Development and Support Department and the Investor Services has been transferred to the Corporate Communications Department, resulting in a more efficient organisation structure.

To implement the initiatives to develop a comprehensive electronic listing management system and the establishment of a China Affairs Team, the Listing Division was also reorganised in February 2006.

HKEx's objective is to establish a robust corporate culture in order to deliver an enhanced performance in the long term and to help deliver HKEx's wider strategic aims. To this end, we will continue to emphasise our corporate goal that life-long learning is important to all staff and provide academic sponsorship and job-related trainings to employees at all levels. Driven by the need to better serve our customers, HKEx will also focus on improving its customer services by understanding better and responding faster to their needs. In addition, HKEx will strengthen the capability of its management by providing a more effective MIS, reviewing the remuneration structure and policies, and implementing the succession plan. Promotion of corporate citizenship is another goal. Since 2000, over \$130 million had been donated to the Hong Kong Community Chest via the Stock Code Balloting for Charity Scheme. HKEx will continue to actively participate in various community and charitable activities. The Corporate and Social Responsibility Report on page 103 will give further information about HKEx's commitments towards the community.

## 2006 MAJOR INITIATIVES

Consolidation of operations through mainly the organisational restructuring, cost rationalisation, and prioritisation of projects in 2004 and 2005 has underpinned our strength and helped better allocate our available resources to meet future challenges in completing the Three-year Strategic Plan. The executives are now working on the next three-year plan for the period 2007 – 2009. In 2006, we have a wide range of initiatives on our agenda, some are new and others are ongoing. The Key Achievements and Priorities on page 55 provides a summary of HKEx's achievements in 2005 and the key initiatives planned for 2006.

## APPRECIATION

The overview of the work by various divisions and departments in the past year is given in more detail under the Business Review of this Annual Report. I wish to thank everyone within HKEx for their valuable contributions to a remarkable 2005, which would not have been made possible without their hard work and dedication. I am also deeply grateful for the unswerving confidence of our loyal Shareholders and the notable support of our business partners and customers. I would also like to take this opportunity to thank my fellow Board members for their support, guidance and advice throughout the year.

While we can all be proud of the progress achieved to date, I and on behalf of all the Board members and employees of HKEx, want to express our sincere gratitude to our Chairman, Mr Charles Lee, who will be retiring at the conclusion of the 2006 AGM. The Chairman's commitment and tireless efforts over the past six years have been instrumental in steering HKEx to develop into an internationally respected exchange for liquidity, opportunity, accessibility and reliability. HKEx has now become one of the most successful international publicly-owned exchange operators.

The Chairman has also played a pivotal role in reinforcing Hong Kong's position as the pre-eminent international financial centre over the past two decades. Of his many contributions, the introduction of the listing of H-shares in Hong Kong in 1993 paved the way for the listing of Mainland enterprises in Hong Kong, which has created tremendous business opportunities for the Cash and Derivatives Markets. Under his steadfast leadership, the successful demutualisation of the exchanges and clearing houses and listing of HKEx in 2000 opened a new chapter for the history of the Hong Kong financial industry. His noteworthy achievements underpin the high respect and great support accorded to him in the global financial arena.

It has been a distinct honour and privilege to have had the opportunity to work with the Chairman. I would like to record my personal thanks and sincere appreciation to him for his invaluable advice and continuous encouragement extended to me in fulfilling the duties of the Chief Executive of HKEx in the past three years. I look forward to receiving his continued support for the further growth of HKEx.

**Chow Man Yiu, Paul**

*Director and Chief Executive*

Hong Kong, 8 March 2006