

Directors' Report

The Directors submit their report together with the audited financial statements for the year ended 31 December 2005.

PRINCIPAL ACTIVITIES

HKEx is the recognised exchange controller under the SFO. It owns and operates the only stock exchange and futures exchange in Hong Kong and their related clearing houses, namely HKSCC, SEOCH and HKCC.

The Stock Exchange and the Futures Exchange are recognised exchange companies under the SFO to operate and maintain a stock market and futures market in Hong Kong respectively. HKSCC, SEOCH and HKCC are the recognised clearing houses for the purposes of the SFO.

The Group's revenue is derived solely from business activities in Hong Kong. An analysis of the Group's income and contribution to operating profit for the year ended 31 December 2005 is set out in note 4 to the consolidated accounts.

RESULTS AND APPROPRIATIONS

The results of the Group for the year ended 31 December 2005 are set out in the consolidated profit and loss account on page 113.

An interim dividend of \$0.49 per share, amounting to a total of about \$521 million, was paid to Shareholders on 15 September 2005.

The Directors recommend the payment of a final dividend of \$0.64 (2004: \$0.47) per share to Shareholders whose names appear on the register of members on 26 April 2006, which together with the interim dividend payment amounts to a total of about \$1,201 million (2004: \$953 million), and the retention of the remaining profit for the year.

RESERVES

The distributable reserves of HKEx as at 31 December 2005, calculated under Section 79B of the Companies Ordinance, amounted to \$3,235 million (2004: \$3,221 million).

Movements in reserves of the Group and HKEx during the year are set out in notes 31 to 35 and 37 to the consolidated accounts.

GROUP FINANCIAL SUMMARY

A summary of the results and the assets and liabilities of the Group for the past six financial years is set out on page 70.

FIXED ASSETS

Movements in fixed assets of the Group and HKEx during the year are set out in note 17 to the consolidated accounts.

SHARE CAPITAL

Details of the movements in the share capital during the year are set out in note 30 to the consolidated accounts.

DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

Share Option Schemes

HKEx operates two share option schemes, the Pre-Listing Scheme and the 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. However, the Board decided that, after adoption of the Employees' Share Award Scheme as mentioned hereunder, no further options will be granted under the Post-Listing Scheme.

Employees' Share Award Scheme

HKEx adopted an Employees' Share Award Scheme ("Award Scheme") on 14 September 2005, under which the Board or the trustee of the scheme shall select the employees (including without limitation any Executive Directors) of the Group for participation in the scheme, and determine the number of shares of HKEx to be awarded.

Details of the schemes, the options granted and shares awarded thereunder are set out in the "Remuneration Committee Report" on page 94.

Apart from the schemes, at no time during 2005 was HKEx or any of its subsidiaries a party to any arrangements to enable the Directors of HKEx to acquire benefits by means of acquisition of shares in, or debenture of, HKEx or any body corporate.

SUBSIDIARIES

Particulars of HKEx's subsidiaries as at 31 December 2005 are set out in note 29 to the consolidated accounts.

DIRECTORS

The list of Directors of HKEx during the year and up to the date of this Annual Report is set out on page 20.

As at 31 December 2005, the Board consisted of 13 Directors. Six of them are Government Appointed Directors, namely, Mr Charles Y K Lee, Dr Marvin K T Cheung, Mr Henry H L Fan, Mr Fong Hup, Mr Tim Freshwater and Dr Lo Ka Shui, who were appointed by the Financial Secretary pursuant to Section 77 of the SFO. Six of them are Elected Directors, namely, Dr Bill C P Kwok, Mr Dannis J H Lee, Mr Vincent K H Lee, Mr John E Strickland, Mr David M Webb and Mr Oscar S H Wong, who were elected by Shareholders at annual general meetings. The Chief Executive of HKEx is an *ex-officio* member of the Board.

According to Articles 90(1), 90(1A) and 90(3) of the Articles of Association of HKEx, any Elected Director and any Government Appointed Director shall be elected or appointed for a term of not more than approximately three years expiring at the conclusion of the annual general meeting of HKEx held in the third year following the year of his appointment. On expiration of his term, he shall retire but be eligible for re-appointment pursuant to Article 93(5). Two of the Elected Directors, Messrs Dannis J H Lee and David M Webb, whose terms of office will expire at the conclusion of the 2006 AGM, shall retire but both of them are eligible for re-appointment. Shareholders are invited to elect up to two Elected Directors at the 2006 AGM to fill the vacancies available due to retirement of the two said Directors. Details of the proposed candidates standing for election are set out in the circular to the Shareholders sent together with this Annual Report.

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

The biographical details of Directors and Senior Management are set out on page 22.

DIRECTORS' INTERESTS IN CONTRACTS

Details of the connected transactions and related party transactions are set out on page 89 in the "Corporate Governance Report" and note 43 to the consolidated accounts respectively.

Save for the above, 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.

CORPORATE GOVERNANCE

HKEx is committed to building and maintaining high standards of corporate governance. HKEx applied the principles and complied with all requirements set out in the CG Code contained in Appendix 14 of the Main Board Listing Rules.

Further information on the HKEx's corporate governance practices is set out in the following reports:

- (a) "Corporate Governance Report" – it sets out details on how HKEx applied and complied with the corporate governance principles, including practices as set out in the CG Code and provides information regarding interests of the Directors and the Senior Management in shares of HKEx and contracts with the Group.
- (b) "Audit Committee Report" – it gives a summary of work performed by the Audit Committee during 2005.
- (c) "Remuneration Committee Report" – it gives a summary of work performed by the Remuneration Committee during 2005 and an overview of the remuneration policy of HKEx and remuneration information, including the options and share awards granted, of the Directors and the Senior Management.
- (d) "Corporate and Social Responsibility Report" – it explains how HKEx strives to achieve the well being of its stakeholders and to be a socially responsible corporate citizen.

DIRECTORS' EMOLUMENTS

Details of the remuneration of the Directors for year 2005 are set out in the "Remuneration Committee Report" on page 94. Particulars of the Directors' emoluments disclosed pursuant to Section 161 of the Companies Ordinance and Appendix 16 of the Main Board Listing Rules are set out in note 13 to the consolidated accounts.

DISCLOSABLE INTERESTS AND SHORT POSITIONS OF SHAREHOLDERS UNDER THE SFO

As at 31 December 2005, the Directors are not aware of any party who was directly or indirectly interested in five per cent or more of the issued share capital of HKEx, as recorded in the register required to be kept by HKEx under Section 336 of the SFO.

MINORITY CONTROLLER

Under Section 61 of the SFO, no person shall be or become a Minority Controller, i.e. a person who either alone or with any associated person or persons, is entitled to exercise, or control the exercise of five per cent or more of the voting power at any general meeting of the recognised exchange controller, except with the approval in writing of the SFC after consultation with the Financial Secretary.

The SFC has so far granted approval to five entities to be Minority Controllers of HKEx, on the basis that the shares are held by them in custody for their clients.

As at 31 December 2005, the Minority Controllers were in aggregate holding 64.5 per cent of the issued share capital of HKEx (31 December 2004: 62.2 per cent).

PUBLIC FLOAT

As at the date of this report, the Directors acknowledge that 100 per cent of the issued capital of HKEx are held by the public.

MAJOR CUSTOMERS AND SUPPLIERS

Contracts with the HKEx's five largest suppliers combined by value which are not of a capital nature, contributed to less than 30 per cent in value of supplies purchased during the year ended 31 December 2005. HKEx's five largest customers combined by value contributed to less than 30 per cent in value of the income during the year ended 31 December 2005.

PURCHASE, SALE OR REDEMPTION OF HKEx's LISTED SECURITIES

During the year ended 31 December 2005, HKEx had not redeemed, and neither HKEx nor any of its subsidiaries had purchased or sold, any of HKEx's listed securities.

Following the adoption of the Award Scheme on 14 September 2005 ("Adoption Date"), the Board awarded 960,000 shares, representing 0.09 per cent of the issued share capital as at the Adoption Date, to 139 eligible employees during the year. The purchase of the awarded shares from the market was completed on 4 January 2006 by the trustee of the Award Scheme and the total payout, including the related expenses, amounted to \$30,098,839.62. Details of the Award Scheme are set out in the "Remuneration Committee Report" on page 101.

PROVIDENT FUND SCHEMES

Particulars of provident fund schemes of the Group are set out in note 9 to the consolidated accounts.

AUDITORS

The accounts for the year ended 31 December 2005 have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment at the 2006 AGM.

On behalf of the Board of Directors

LEE Yeh Kwong, Charles

Chairman

Hong Kong, 8 March 2006