

Corporate Governance Report

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HKEx is committed to high standards of corporate governance in discharging its obligations to ensure an orderly and fair market, to act in the interests of the public, and to enhance shareholders' value.

In 2001, Standard & Poor's (S&P) was engaged to conduct an evaluation on HKEx's corporate governance. In the evaluation, S&P acknowledged the outstanding performance of HKEx in Financial Transparency and Information Disclosure by assigning it a score of 9.3 out of 10. The other areas: Ownership Structure and Influence, Financial Stakeholders Relations, and Board Structure and Process, were each assigned a score of 8.0 out of 10. The overall corporate governance score was 8.3 (out of a possible maximum score of 10).

Since the evaluation by S&P, HKEx has strengthened its corporate governance by establishing a Remuneration Committee, a Nomination Committee, and improved the disclosure in its public reports to provide more extensive information to shareholders. Despite these further improvements, achievement of a higher score might be constrained by the unique constitution of HKEx, given its public interest role as a recognised exchange controller.

S&P has been retained for conducting a second year review on HKEx's corporate governance in 2002.

The Board

HKEx Board comprises eight Public Interest Directors appointed by the Financial Secretary to represent public and market interests, six Directors elected by shareholders, and the Chief Executive of HKEx who is an *ex officio* Board member. Pursuant to the Exchanges and Clearing Houses (Merger) Ordinance (Merger Ordinance), the number of Public Interest Directors will be reduced to no more than the number of elected Directors immediately following the annual general meeting of HKEx in 2003.

Other than the Chief Executive, the SFC has confirmed that all fourteen members of the Board, including the Chairman, are independent non-Executive Directors.

The Board is scheduled to meet on a monthly basis and additional Board meetings will be held, if and when required. Twelve Board meetings were held in 2001, and the average attendance rate of Board members stood at 85 per cent. About one-third of the members have attended all twelve Board meetings.

The biographies of each Director are set out on page 38. They illustrate the broad experience of the Board members who have provided independent advice on issues of strategy, performances, resources, risk management and standards of conduct which are vital to the success of HKEx. The Chief Executive of HKEx is responsible to the Board for the management of the HKEx's business.

The Board deals with strategic and policy issues and approves corporate plans, budgets, and monitors the performance of the management. The Board has established a solid framework of corporate governance and is supported by six committees, each of which has defined terms of reference covering its authority and duties. The chairman of the respective committees reports regularly to the Board on matters discussed.

In addition to the appointed committees, the Group is also receiving advice from market practitioners and professionals through the formally constituted Cash Market Consultative Panel, Derivatives Market Consultative Panel, and Clearing Consultative Panel and other informal channels.

Audit Committee

The Audit Committee is comprised of five non-Executive Directors, and members are set out on page 7. The Chief Executive, Chief Financial Officer, and other management staff may attend meetings by invitation together with external auditors. The Committee examines any matter relating to accounting principles and practices adopted by the Group, and discusses auditing, internal control issues and financial reporting matters.

The Audit Committee is scheduled to meet at least four times a year to review audit reports, status of the Group's audits, internal controls and the interim and the

final results of the Group prior to recommending them to the Board for approval.

Executive Committee

The Executive Committee is comprised of three non-Executive Directors, the Chief Executive and the Chief Operating Officer of HKEx. Members are set out on page 7. The Executive Committee meets regularly, normally twice a month to serve as an executive arm of the Board, to formulate policies for consideration of the Board and to carry out and implement the policies laid down by the Board.

Investment Advisory Committee

The Investment Advisory Committee is comprised of two non-Executive Directors and three outside professionals. Members are set out on page 7. The Investment Advisory Committee meets regularly, at least four times a year. It provides market expertise and advice to the Board on the investments of the funds of HKEx, including advice on investment policies, asset allocation and selection of fund managers and custodians.

Nomination Committee

The Nomination Committee, established on 13 March 2002 is comprised of three non-Executive Directors. Members are set out on page 7. The Nomination Committee is scheduled to meet before every annual general meeting where election of Directors will be considered by shareholders.

The Nomination Committee formulates the nomination policy, determines the selection criteria of non-Public Interest Directors, makes recommendations to shareholders on new candidates standing for election by shareholders by providing sufficient biographical details to enable shareholders to make an informed decision on the election, and nominate candidates to fill casual vacancies of elected Directors.

Remuneration Committee

The Remuneration Committee, established on 13 March 2002 is comprised of three non-Executive Directors. Members are set out on page 7. The Remuneration Committee is scheduled to meet at least once a year.

The Remuneration Committee formulates for the Board's approval the remuneration and succession policies, and the guidelines for the recruitment and the remuneration of Directors, including the Chief Executive who is an Executive Director. The Remuneration Committee ensures that the remuneration offered is appropriate for the duties and in line with market practice. The Remuneration Committee may engage external professional advisors to assist and/or advise the Committee, if and when necessary.

Risk Management Committee

The Risk Management Committee was established under Section 9 of the Merger Ordinance on 3 March 2000 to formulate

policies on risk management matters relating to the activities of HKEx and the exchanges and clearing houses of which HKEx is the controller. The Risk Management Committee is comprised of the Chairman of HKEx who is also the chairman of the Risk Management Committee, and seven other members of whom five were appointed by the Financial Secretary and two were appointed by HKEx. Members appointed by the Financial Secretary includes two non-Executive Directors who are Public Interest Directors, the Chairman of the Securities and Futures Commission, the Chief Executive of the Hong Kong Monetary Authority and an outside professional. Members of the Risk Management Committee are set out on page 7 of the annual report.

Following the succession of Mr Peter Wong as the Chairman of Hong Kong Interbank Clearing Limited, Dr Liu Jinbao retired from, and Mr Peter Wong was appointed by the Financial Secretary to, the Risk Management Committee on 20 January 2002.

Attendance Record

The following is a record of the meetings held by the Board and various committees and panels in 2001 and the average attendance of the meetings:

	Number of meetings held in 2001	Average attendance of members
Board	12	85%
Audit Committee	4	75%
Executive Committee	22	90%
Investment Advisory Committee	4	85%
Risk Management Committee	10	91%

	Number of meetings held in 2001	Average attendance of members
Cash Market		
Consultative Panel	6	65%
Derivatives Market		
Consultative Panel	4	82%
Clearing Consultative Panel	3	80%

Group Internal Audit

HKEx has a Group Internal Audit Functional Unit (GIA) which reviews both manual and computerised systems and procedures in all major financial and operational activities on a continuing basis and the frequency of the reviews is determined by an internal audit programme which has been approved by the Audit Committee. The Head of GIA is directly responsible to the Chairman of the Board and submits regular reports to the Audit Committee.

Shareholders' Relation

The Board recognises its accountability to shareholders for the performance and activities of the Group and attaches considerable importance to the effectiveness of its communication with shareholders. To this end, an Investor Relations Corner has been specially set up as part of the HKEx website <www.hkex.com.hk> to provide information to shareholders about the Group. This is in addition to other corporate communication with shareholders, such as circulars, notices, announcements, annual reports and interim reports which can also be found in the HKEx website.

The annual and interim reports contain a full financial review and an operational review. In accordance with Listing Rule requirements, shareholders may elect to receive the full annual report or a summary financial report.

The Annual General Meeting (AGM) is the principal forum for direct dialogue with shareholders at which shareholders are invited to ask questions on the company's operations or financial information.

At the AGM, shareholders can vote on each proposed resolution by a show of hands (unless otherwise required by the Listing Rules). All issues to be considered by shareholders will be proposed at the general meeting as separate resolutions. There are provisions in the articles of association where the chairman of the meeting; or at

least three members present in person or by proxy having the right to vote on the resolution; or a member or members present in person or by proxy representing in aggregate not less than one-tenth of the total voting rights of all members; or a member or members present in person or by proxy holding shares conferring the right to attend and vote at the meeting on which an aggregate sum has been paid up to or equal to not less than one-tenth of the total sum paid up on all the shares conferring that right, may demand poll voting. Independent scrutineers are appointed to count the number of votes cast at a general meeting whether on a show of hands or on a poll.

Corporate Communications Policy

HKEx has maintained regular communications with the media. HKEx news releases, announcements and publications are circulated to all major news media simultaneously and fairly, and are made available on the HKEx website for free and open access by the public. News conferences and briefings are organised from time to time to explain HKEx's latest business initiatives and market development plans.

There are also occasional meetings with investment analysts and potential investors, but matters discussed are confined to topics of non-price sensitive nature and clarification of the technical details of public announcements or publications.

Regulation

HKEx is a recognised exchange controller under the Merger Ordinance. SEHK has the exclusive right under the Stock Exchanges Unification Ordinance to operate and maintain a stock market in Hong Kong and HKFE is licensed under the Commodities Trading Ordinance to establish and operate a commodity exchange.

HKSCC, SEOCH and HKCC are the recognised clearing houses for the purposes of the Securities and Futures (Clearing Houses) Ordinance.

A Memorandum of Understanding had been executed between HKEx, SEHK and the SFC whereby the SFC takes up all actions and makes all decisions in relation to HKEx that would normally be taken by SEHK in respect of other listed issuers. The SFC is responsible for supervising and monitoring the activities of HKEx, the exchanges and clearing houses as well as administering and enforcing the relevant Ordinances. The SFC has established a framework for exercising its power as set out in Chapter 38 of the Listing Rules that includes the procedures to deal with any conflicts of interest or potential conflicts of interest.

HKEx and the SFC had also entered into another Memorandum of Understanding that covers matters relating to SFC oversight and supervision of Exchange Participants, and market surveillance.

The management, under the direction and supervision of the Board, has ensured strict compliance and adherence with the statutes and regulations relevant to the Group and each of its subsidiary companies during the year.

Guidelines on Conduct

HKEx and its major subsidiaries are designated public bodies listed in the Schedules of the Prevention of Bribery Ordinance. All employees of HKEx, including Directors and committee members, are considered public servants for the purposes of that Ordinance. Guidelines on Conduct for the persons concerned have been worked out in consultation with the Independent Commission Against Corruption and promulgated by the Board.

HKEx has issued a Directors' Handbook to each Director and a Human Resources Manual to its employees that include the Guidelines on Conduct as well as a code on dealing in securities and derivatives. The provisions of the latter code closely resemble the Model Code for Securities Transactions as contained in Appendix 10 of the Listing Rules but carry more stringent internal reporting requirements.

Compliance with the Code of Best Practice of the Listing Rules

HKEx has complied fully with Appendix 14 of the Listing Rules during the year.

By order of the Board

Joseph Mau

Company Secretary

13 March 2002