

Directors' Report

The Directors submit their report together with the audited financial statements for the year ended 31 December 2006.

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 2006 is set out in note 4 to the consolidated accounts.

RESULTS AND APPROPRIATIONS

The results of the Group for the year ended 31 December 2006 are set out in the consolidated profit and loss account on page 125.

An interim dividend of \$0.94 (2005: \$0.49) per share, amounting to a total of about \$1,001 million (2005: \$521 million), including dividend of about \$912,000 for shares held on trust under the Share Award Scheme (2005: \$Nil), was paid to Shareholders on 19 September 2006.

The Directors recommend the payment of a final dividend of \$1.19 (2005: \$0.64) per share to Shareholders whose names appear on the Register of Members on 26 April 2007, which together with the interim dividend payment amounts to a total of about \$2,269 million (including dividend of about \$2,409,000 for shares held upon trust under the Share Award Scheme) (2005: \$1,202 million, including dividend of about \$614,000 for shares held on trust under the Share Award Scheme), and the retention of the remaining profit for the year.

RESERVES

The distributable reserves of HKEx as at 31 December 2006, calculated under Section 79B of the Companies Ordinance, amounted to \$3,375 million (2005: \$3,235 million).

Movements in reserves of the Group and HKEx during the year are set out in notes 33 to 37 and 39 to the consolidated accounts.

DONATIONS

Charitable and other donations made by the Group during the year amounted to \$111,600.

GROUP FINANCIAL SUMMARY

A summary of the results and the assets and liabilities of the Group for the past seven financial years is set out on page 82.

FIXED ASSETS

Movements in fixed assets of the Group and HKEx during the year are set out in note 18 to the consolidated accounts.

SHARE CAPITAL

Details of the movements in the share capital during the year are set out in note 32 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 26.

As at 31 December 2006, the Board consisted of 13 Directors. Six of them are Government Appointed Directors, namely, Mr Ronald J Arculli, Mrs Laura M Cha, Mr Moses M C Cheng, Dr Marvin K T Cheung, Mr Henry H L Fan and Mr Fong Hup, 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 Vincent K H Lee, Dr Christine K W Loh, 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, 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 John E Strickland and Oscar S H Wong, whose terms of office will expire at the conclusion of the 2007 AGM, shall retire but both of them are eligible for re-appointment. Shareholders are invited to elect up to two Elected Directors at the 2007 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 in the Board of Directors and Senior Management section of this Annual Report.

DIRECTORS' INTERESTS IN CONTRACTS

Details of the connected transactions and related party transactions are set out on page 96 in the Corporate Governance Report and note 45 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.

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 subject to the terms and conditions stipulated in the two schemes. 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 Board also decided that, after adoption of the Share Award Scheme as mentioned hereunder, no further options will be granted under the Post-Listing Scheme.

Share Award Scheme

HKEx adopted the Share Award Scheme on 14 September 2005, under which the Board or the trustee of the scheme shall select the employees (including any executive director) of the Group for participation in the scheme, and determine the number of shares of HKEx to be awarded. Effective 16 August 2006, the rules of the Share Award Scheme have been amended, such that the Board shall determine the lump sum for acquiring the awarded shares instead of approving a fixed number of awarded shares.

Details of the schemes, the options granted and shares awarded thereunder are set out in the Remuneration Committee Report of the Annual Report.

Apart from the Share Option Schemes and the Share Award Scheme, at no time during 2006 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 2006 are set out in note 31 to the consolidated accounts.

CORPORATE GOVERNANCE

HKEx is committed to building and maintaining high standards of corporate governance. Further information on the HKEx's corporate governance practices is set out in the following reports:

- (a) **Corporate Governance Report** – it sets out details of 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 2006.

- (c) **Remuneration Committee Report** – it gives a summary of work performed by the Remuneration Committee during 2006 and an overview of the remuneration policy of HKEx and the emoluments, including the options and share awards granted, of the Directors and the Senior Management.
- (d) **Corporate Social Responsibility Report** – it explains how HKEx has achieved the well being of its stakeholders and has behaved as a socially responsible corporate citizen.

DIRECTORS' EMOLUMENTS

Details of the Directors' emoluments for year 2006 are set out in the Remuneration Committee Report on page 104, and particulars as required to be 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.

DISCLOSEABLE INTERESTS AND SHORT POSITIONS OF SHAREHOLDERS UNDER THE SFO

As at 31 December 2006, the following corporation had interests in five per cent or more of the issued share capital of HKEx as recorded in the register required to be kept under Section 336 of the SFO. Details of the interests in the shares or underlying shares of HKEx as notified to HKEx are set out below.

Long positions in the shares of HKEx

Name	Capacity	Number of shares held	Total	% of the issued share capital
JPMorgan Chase & Co	Beneficial owner	6,713,586	65,106,894 ^(note)	6.11
	Investment manager	12,744,310		
	Custodian corporation/ approved lending agent	45,648,998		

Note:

JPMorgan Chase & Co's interests included an aggregate interests of 1,155,650 underlying shares through its holding of certain listed physically settled equity derivatives (25,150 underlying shares) and unlisted physically settled equity derivatives (1,130,500 underlying shares). It also included 45,648,998 shares in the lending pool.

Apart from the aforesaid, the Directors are not aware of any other 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, ie 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.

According to the CCASS Participants Shareholding Report of HKEx as at 31 December 2006, the Minority Controllers were in aggregate holding 63.8 per cent of the issued share capital of HKEx (31 December 2005: 64.5 per cent).

PUBLIC FLOAT

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

An analysis of shareholding by type including a summary of the Shareholders with the top ten holdings, and the public float capitalisation of HKEx as at 31 December 2006 are set out on pages 210 and 214 respectively of this Annual Report.

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 2006. 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 2006.

PURCHASE, SALE OR REDEMPTION OF HKEx's LISTED SECURITIES

During the year ended 31 December 2006, HKEx had not redeemed, and neither had HKEx nor any of its subsidiaries purchased or sold, any of HKEx's listed securities, except that the trustee of the Share Award Scheme had, pursuant to the terms of the rules and trust deed of the Share Award Scheme, purchased from the market a total of 274,500 shares being the awarded shares (2,000 of which related to the shares awarded in 2005 and the remaining balance was acquired with the sum approved by the Board on 13 December 2006) and a further 25,500 shares with the dividend income received during the year in respect of the shares held under the trust. The total amount paid to acquire these 300,000 shares during the year was about \$21,269,000.

Details of the Share Award Scheme are set out in the Remuneration Committee Report on page 109 of this Annual Report.

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 2006 have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment at the 2007 AGM.

On behalf of the Board of Directors

Ronald Joseph ARCULLI

Chairman

Hong Kong, 8 March 2007