

# GROUP RISK COMMITTEE REPORT



*We placed our emphasis on improving the design and effectiveness of the Group's risk management process*

As Chairman of the Group Risk Committee (GRC), which is a sub-committee of the Group Management Board, my objective is for the GRC to enhance our focus on existing and potential risks. GRC also acts as a coordinator to ensure each operation addresses the risks we have identified, and track progress of risk treatment plans and activities and report on examinations of specified risks as required.

**Chairman:** Mr Matthew J. Lawson (Chief Financial Officer)

**Members:** Group General Manager, Audit & Risk Management  
Selected members of senior management  
Group General Manager, Operations

The GRC holds four regular meetings every year to evaluate the Group's risks. We assess the top risks and risk treatments for our operation or major projects, as well as monitor the actions required for critical and major incidents, with examination of specific risks as required. Heads of relevant departments are invited to give in-depth presentations on selected risks. The GRC is also responsible for reviewing and approving the Group Risk Management Report for submission to the Audit Committee and the Board. The Group Risk Management Report is a semi-annual reporting tool which consolidates the risk registers of each operations and the risks faced by the Group as a whole, in order to provide the Board and the Audit Committee with an overview of the Group's major business risks and how management has sought to monitor and mitigate them.

## Key Areas of Focus

We placed our emphasis on improving the design and effectiveness of the Group's risk management process. The review began with an assessment of the Group's existing risk management structure against internationally accepted criteria. Improvement opportunities were identified and the key focus areas for 2016 are set out on the next page.

## 5 Step Risk Management Methodology

We streamlined our Group's risk management methodology. The new methodology introduced a new step for assessing both external and internal context to ensure the risk assessment process and internal controls remained current and are adapted and modified as business conditions and the organisation changes.



### Risk Assessment

The Group's risk assessment which includes a likelihood and impact matrix for assessing risk was broadened to align with the Group's strategies. Financial criteria using EBITDA objectives was added and non-financial criteria, such as brand and reputation were added. The overall risk rating was extended to identify those risks where prompt executive management and/or Audit Committee attention would be required.

### Group Risk Register

During the year we trimmed and enhanced the format and structure of the Group Risk Register. The new register now shows a description of the risk event, whether the risk had a short or long-term impact, an assessment of the effectiveness of the risk treatment, options to accept or treat the risk, details of further risk treatment and mitigation plans, the control executive and the control owner. Plans for risk treatment and mitigation are further summarised and monitored at business unit and functional level.

Using its respective risk register, each operation reports its risks and controls on a half-yearly basis to the GRC for further discussion and consideration. Critical or major risks are escalated immediately via the Incidents Self-Reporting process or directly to senior management, as appropriate.

### Risk Transfer and Insurance

This year, the Group also took its risk transfer approach a step further by conducting a series of risk and insurance workshops with key insurers, advisors and our insurance broker to assess the adequacy of our insurance policies using a number of downside scenarios across risk classes including cybersecurity, terrorism, property damage, business interruption and general liability.

### Risk Workshops

The Audit & Risk Management team held face-to-face workshops to train the operations on the new risk management methodology throughout 2016. Around 200 senior executives across the Group engaged in these workshops where hypothetical and relevant real risk events were used to facilitate discussion, risk identification, analysis and evaluation.

## Principal Risks

The Board supported by the Audit Committee and the GRC has assessed the principal risks facing the Group, taking into account those that would impact its strategies, future performance and long-term objectives.

Our principal risks are compiled through prioritisation of risks from a total Group perspective taking into account each of the business unit's detailed risk registers. This process includes an ongoing review by the Group Management Board of the most significant risks facing the Group, and the identification and evaluation of potential new risks.

### Understanding why and how our principal risks change

The ongoing review of the most significant risks faced by the Group focuses on how changes may arise and how our controls need to be adapted in response to changing business conditions and organisational changes.

Since the publication of our 2015 Annual Report, our principal risks have changed as follows:

Increased Risk Profiles	Why?
Decline in retail and commercial letting revenue	Continued decline in spend within the luxury industry in the markets where we operate
Acquisition, investments and developments projects	Increased investment in development projects (e.g. increase of our ownership of the development of The Peninsula London from 50% to 100%)
Foreign exchange and interest rates	Exchange rate volatility negatively impacting the way our performance is reported in our financial report, which are denominated in HK dollars Existing and additional increase in borrowings arising from our development projects which increases our exposure to any material increases in interest rates
Disaster events arising from terrorism	Increased terrorism risk following attacks in key locations such as Istanbul and Paris
Macroeconomic and political	UK's plans to leave the EU and new regulations being introduced as a result New regulations being introduced in the US
Cybersecurity	Number of cybersecurity incidents increased in 2016 around the world
Data privacy	Global trend of crimes involving the stealing of personal data such as credit card data

### The principal risks are:

Principal Risks	Key Controls and Risk Treatment
<p><b>Retail and Commercial Tenants</b></p> <p>Retail and Commercial letting may become difficult due to factors such as increased competition, decline in spend within the luxury industry, or shifts of retail preferences leading to decrease in our arcade traffic</p>	<p style="text-align: center;"></p> <ul style="list-style-type: none"> <li>• Improvements in the utilisation of commercial and retail space to allow flexible usage and conversion possibilities to accommodate tenants</li> <li>• Commitment to maintain high quality properties</li> <li>• Marketing and sales initiatives to increase foot traffic</li> <li>• Proactively working with tenants to jointly develop marketing and incentive plans to drive traffic and repeat customers to our retail arcades</li> <li>• Diversification and maintenance of an appropriate tenant mix to enhance retail proposition</li> </ul>
<p><b>Acquisitions, Investments and Developments</b></p> <p>Acquisitions, investments and developments of properties carry inherent risks. These are often pursued in partnership with third parties. Risks relating to capital allocation, capital funding, meeting budgets, incurring debt, missing targets, partnership relationships and competition for resources will need to be managed. Challenges may arise in relation to obtaining planning or other consents and compliance with different jurisdictions' design and construction standards</p>	<p style="text-align: center;"></p> <ul style="list-style-type: none"> <li>• Partnerships with experienced and reputable local partners, and familiarisation with local authorities</li> <li>• Individual and aggregated acquisition/development-related risk levels reviewed by GRC</li> <li>• Robust and auditable risk management process applied to all live acquisitions/developments</li> <li>• Continuous monitoring and review of all aspects of developments, planning, construction progress and reporting of potential project risks</li> <li>• Business "stress testing" under various downside scenarios</li> <li>• Formation of the Project Executive Committee to oversee governance and co-ordination of Group projects to ensure a disciplined and systematic approach to project management</li> </ul>
<p><b>Foreign Exchange and Interest Rate</b></p> <p>Exchange rate fluctuations could result in significant foreign currency losses and affect our capital projects. Significant floating rate liabilities could result in higher cost of financing if current interest rates increase</p>	<p style="text-align: center;"></p> <ul style="list-style-type: none"> <li>• Operations predominantly charging in local currencies and expending in local currency to minimise currency mismatch</li> <li>• The majority of borrowings are typically denominated in the functional currency of the operations to which they relate</li> <li>• Sensitivity analysis performed by Head Office (ad hoc for projects, and yearly for the Group's financial reporting)</li> <li>• Monitoring of interest rate risk by Head Office</li> </ul>

Principal Risks	Key Controls and Risk Treatment
<b>Disaster Events</b>	
<p>A major disaster event, such as a “force majeure” event, natural catastrophe, extreme weather due to climate change impact, terrorist activity, war or contagious diseases could impact on our assets, business levels, level of travel activity, and therefore our ability to conduct business, and reduce earnings</p>	<ul style="list-style-type: none"> <li>• Ongoing risk surveys by external risk engineering consultant on selected properties focusing on insurable risks</li> <li>• Alignment of corporate security practices to international standards for security risk management</li> <li>• Ongoing group-wide security threat awareness training sessions, bespoke to our hotels and the locations in which we operate</li> <li>• Increased capital investment across the Group to upgrade all physical security systems to enhance our global crisis management capabilities</li> <li>• A comprehensive and effective travel risk management programme for all employees travelling and working abroad</li> <li>• Strengthening our network with security stakeholders to enhance our global intelligence monitoring</li> </ul>
<b>Macroeconomic and Political</b>	
<p>Changing macroeconomic conditions could impact our business. Political instability and uncertainties, including actions or interventions impacting hospitality and travel related activities, could impact travel patterns and guest spend</p>	<ul style="list-style-type: none"> <li>• Continuous monitoring of the macroeconomic, political and regulatory landscape in all our key markets to anticipate issues for possible adjustment of any business activities promptly</li> <li>• Maintain comfortable level of gearing</li> <li>• Close monitoring of operating costs and savings measures when required</li> </ul>
<b>Cybersecurity</b>	
<p>Frequency of cyber and ransomware attacks increased in 2016. The threat of an attack is high</p>	<ul style="list-style-type: none"> <li>• Ongoing group-wide security training and enforcement of IT compliance checklists</li> <li>• Mandate ongoing internal and external vulnerability assessments</li> <li>• Continue enhancing the security measures and data protections</li> <li>• Formation of Technology Steering Committee to oversee the strategic direction of the Group’s technology development</li> </ul>
<b>Data Privacy</b>	
<p>Given our wide guest base and global operations, we are regulated by privacy laws and regulations of many jurisdictions. Compliance could increase our operating costs and impact our direct marketing abilities. Breaches could result in fines and may adversely affect our brand and business</p>	<ul style="list-style-type: none"> <li>• Updated Data Privacy Manual and e-commerce policy for sending direct marketing material</li> <li>• Implementation of group-wide Data Privacy Manual and training (classroom and online formats)</li> <li>• Compliance assessments by Data Privacy teams across operations</li> <li>• Providing channels for reporting and dealing with data breaches</li> </ul>
<b>Business Portfolio/Concentration</b>	
<p>A significant portion of our Group revenues is derived from our operations in Hong Kong. Unfavourable events in the city could disrupt our overall business, lower our revenues, and impact the valuation of our assets</p>	<ul style="list-style-type: none"> <li>• Focus on increasing overseas earnings contribution, by entering new markets and increasing revenues and profits from markets outside of Hong Kong</li> <li>• Ongoing focus to strengthen our brand values to existing customers and, within the fast-changing business environment of Hong Kong, make prompt adjustment to our business strategies when necessary</li> <li>• Continue to support the overall tourism direction of Hong Kong and work on authentic offerings to maintain the city’s global position as one of the most attractive global tourism destinations</li> <li>• Maintain comfortable level of gearing</li> </ul>

Principal Risks	Key Controls and Risk Treatment
<b>Brand and Reputation</b>	↔
Significant adverse publicity in traditional or social media could result in a loss of confidence in our brand, a decline in guest, tenant and/or customer base and our ability to recruit and retain good people	<ul style="list-style-type: none"> <li>• Clear guidelines on incident communication and crisis management process by Crisis Management team</li> <li>• Implementation of group-wide social media usage guidelines</li> <li>• Our Code of Conduct and behavioural standards regulate staff conduct</li> </ul>
<b>Competition</b>	↔
Increased competition, cyclical over-supply of luxury hotels in some markets could also harm our business	<ul style="list-style-type: none"> <li>• Continuously monitor and analyse competitive and market information in order to anticipate unfavourable changes</li> <li>• Brand and communication initiatives to drive revenue growth and strengthen our brand's market position</li> <li>• Reinvestments into our properties to ensure competitiveness</li> <li>• Continue to focus on strengthening our people development platforms, in order to retain the best talent in the Company and within the industry as a whole</li> <li>• Maintain comfortable level of gearing</li> </ul>



Risk level increased



Risk level remains broadly the same

## Emerging Risks

The Group has not identified any emerging risks during 2016.

## Major Initiatives for 2017

In 2017, the GRC's main focus will continue to be on i) enhancement of internal controls to manage the strategic risks of the Group; ii) the roll-out of the 5-step risk management methodology to other areas of the Group such as the functional divisions and iii) a focus on communication, awareness and ownership of risks and controls across the Group.

On behalf of the Group Risk Committee

Matthew Lawson

*Chairman of the Group Risk Committee*

20 March 2017