

# Corporate Governance

(Financial figures are expressed in Hong Kong dollars)



## Corporate Governance Statement

HKEx is the recognised Exchange Controller, and has the duty under the Securities and Futures Ordinance (SFO) to ensure an orderly, informed and fair market or arrangements for the trading, clearing, and settlement of securities or futures contracts on or through the Stock Exchange or the Futures Exchange which are wholly-owned subsidiaries of HKEx (The SFO, effective from 1 April 2003, repealed ten ordinances governing financial products, the securities and futures market, and protection of investors, inter alia the Exchanges and Clearing Houses (Merger) Ordinance which governed the operation of HKEx).

Due to the unique business nature, the political importance of HKEx to Hong Kong as an international finance centre, and being a listed company on the Main Board of the Stock Exchange, the Board is committed to achieving high standards of corporate governance practices. The Board believes that high standards and appropriately rigorous corporate governance practices are essential for HKEx to enhance its accountability and transparency, and achieve a balance of the interests of the public and the interests of its stakeholders, inter alia, shareholders, Exchange Participants, customers, employees, creditors, and the Government.

As the recognised Exchange Controller, HKEx accepts that it has a leadership role in setting and articulating corporate governance standards in Hong Kong. A consultation paper on proposed amendments to the Listing Rules in relation to corporate governance issues was issued in January

2002, and the amendments to the Listing Rules and the draft Code on Corporate Governance Practices were released at the end of January 2004. Although the general level of corporate governance practice in Hong Kong is at the forefront of the global economies, continuous refinement of corporate governance practices is critical to Hong Kong as a key member in the international finance market.

HKEx has fully complied with the Code of Best Practice, as set out in Appendix 14 of the Listing Rules throughout the year of 2003.

## Achievements

HKEx is the first listed company in Hong Kong to have an assessment of its corporate governance standard by an independent third party since 2000. Standard & Poor's (S&P) had, after the third annual evaluation, reaffirmed the same score of 8.3 out of a possible score of 10 to HKEx for 2003, which it had assigned to HKEx in 2001 and 2002. Although S&P's scoring standards have further been tightened in accordance with the evolving standards of corporate governance in international markets, the consistent high score demonstrates HKEx's continued efforts in building upon its already strong corporate governance practices.

In 2003, HKEx was awarded the Diamond Award in the Non-Hang Seng Index Stock Category in the Best Corporate Governance Award organised by the Hong Kong Society of Accountants; ranked the leader in corporate governance of the "Diversified Financials" sector at the Asiamoney Corporate Governance Poll 2003; and

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recommended for an Honourable Mention of the Best Annual Reports Awards organised by The Hong Kong Management Association for the second consecutive year.

### **Conflict Management**

In discharging its obligations as the recognised Exchange Controller, HKEx has to act in the interests of the public, having particular regard to the interests of the investing public, and ensure that where the interests of the public conflict with any other interests, the former shall prevail.

A Memorandum of Understanding (MOU) had thus been entered into between HKEx, the Stock Exchange, and the Securities and Futures Commission (SFC) in regard to the listing of HKEx's shares on the Stock Exchange. A specific chapter, Chapter 38, was added to the Listing Rules for governing HKEx, as a listed company. The MOU provides that the SFC is the regulator of HKEx, and shall take all actions and make all decisions in relation to HKEx as a listed company that would normally be taken by the Stock Exchange in the case of other listed companies, including but not limited to the suspension or removal from, listing on the Stock Exchange, and the application for waivers in complying with the Listing Rules.

In addition, HKEx is required, under the MOU, to use its best endeavours to ensure that whenever a conflict or potential conflict of interest exists, the subject matter would be referred to a Conflict Committee comprising the Chief Executive, the Chief Operating Officer, and the Chief Executive of the Stock Exchange for consideration. If the Conflict Committee determines that

a conflict or potential conflict of interest does or may arise, the case would be referred to the SFC's representatives who would consider if the regulatory function could be discharged without its intervention. Any disagreement between the Conflict Committee and the SFC's representatives will be referred to the SFC for resolution.

As noted by S&P in its annual corporate governance evaluation, there is no evidence, to date, that the results of the Group have been adversely affected through placing the public interests ahead of shareholders' interests where the public interests and the financial interests of shareholders might diverge.

### **Organisational Structure**

HKEx's organisational structure is clearly defined by establishing business units and functional units for which individual unit heads are responsible. Unit heads who in respect of their business / functional unit responsibilities, report either to the Chief Executive or the Chief Operating Officer, and have authority for management of their respective units.

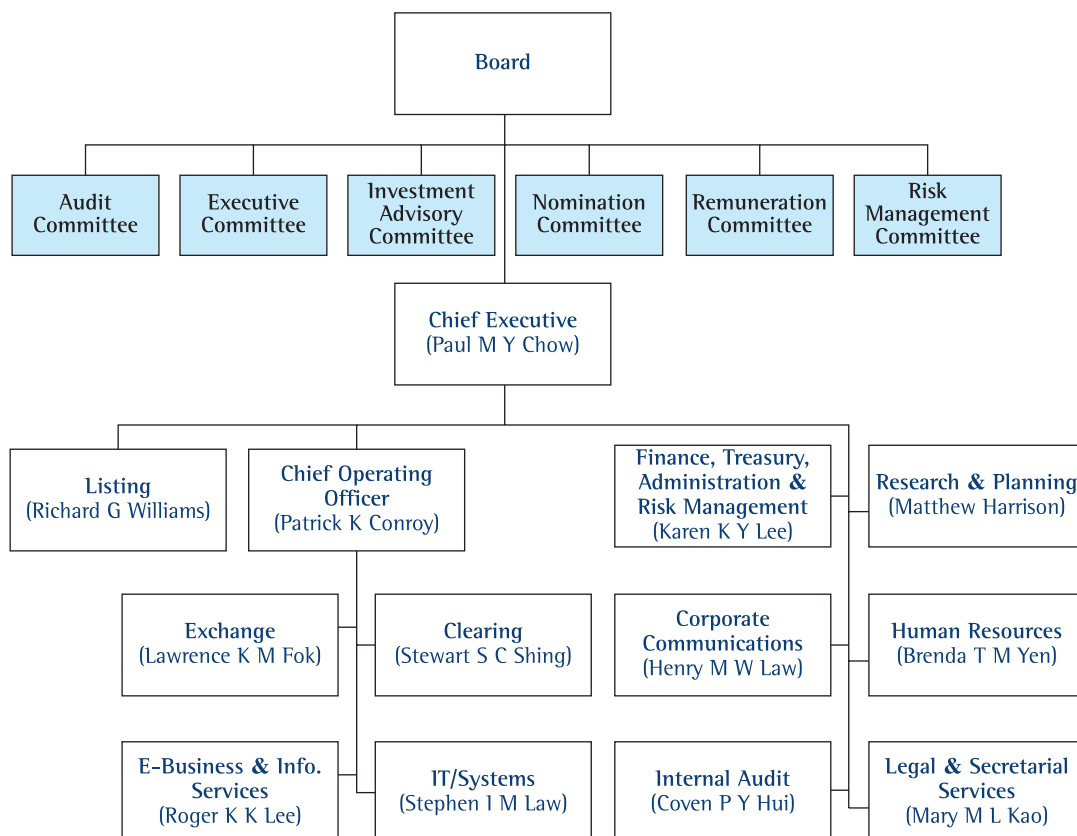
A Management Committee comprising the Chief Executive, the Chief Operating Officer and all unit heads, meets on a monthly basis to review and make recommendations to the Executive Committee and to the Board on strategic plan, annual operating plan, annual budget, enterprise balanced scorecard, significant business proposals, and general management and internal development issues, inter alia, culture change, unit coordination, and staff training.

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The Chief Executive and the Chief Operating Officer are appointed by the Board subject to approval by the SFC. The Board is able to remove the Chief Executive or the Chief Operating Officer, and the SFC may also

remove them on grounds of public interests, the interests of the investing public or the proper regulation of markets in securities and futures contracts after consultation with the Chairman and the Financial Secretary of the HKSAR (Financial Secretary).

The organisational structure as at 31 December 2003 is as follows:



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## The Board

### Composition and appointment

Pursuant to the SFO, the number of Directors to be appointed by the Financial Secretary (Public Interest Directors) immediately after the annual general meeting held in 2003 shall not be more than the number of Directors elected by shareholders (Elected Directors). As at 31 December 2003, the Board comprised twelve Non-executive Directors, plus the Chief Executive who is an *ex-officio* member of the Board. Among the twelve Non-executive Directors, six of them are Public Interest Directors, and the rest are Elected Directors. Given the nature of HKEx's statutory objectives, and the complexity and breadth of the financial markets in which it operates, the wide range of business, financial, fund management, and securities trading experience of the Non-executive Directors provides an appropriate balance of public interests and stakeholders' interests. The list of Directors and their respective biographies are set out on pages 50 to 57 respectively.

### Independence

After the reconstitution of the Board in April 2003, the SFC had re-affirmed that the twelve Non-executive Directors are all independent directors, including Mr Henry H L Fan who was appointed in November 2003 to fill the casual vacancy arisen after the resignation of Dr Liu Jinbao. The Chairman is an independent Non-executive Director, and his appointment was recommended by the Board, and approved by the Chief Executive of the HKSAR. The roles of the Chairman and the Chief Executive are distinct and

separate with a clear division of responsibilities.

### Functions

The Board oversees HKEx's strategic development, and determines the objectives, strategies and policies of the Group. The Board also monitors and controls operating and financial performance and sets appropriate policies to manage risks in pursuit of the Group's strategic objectives. The Board has delegated the implementation of strategies, and day-to-day operation of HKEx to the Chief Executive. The Board has separate and independent access to the senior management for making enquiries on management information.

The Board meets regularly, normally once a month, and additional meetings would be arranged, if and when required. The Company Secretary is responsible for providing detailed papers to be circulated normally four days in advance of Board meetings with the aim of ensuring that Directors are able to make informed decisions on matters put before them. All Directors have access to the Company Secretary who is responsible for ensuring the Board procedures are complied with, and for advising the Board on compliance matters. Orientations are also organised for providing induction to new Directors.

The Board is supported by six committees and three advisory panels, each of them has defined terms of reference covering its duties, powers and functions. The chairmen of the respective committees and panels report regularly to the Board and, as appropriate,

make recommendations on matters discussed. The Board and the committees may retain outside advisors at HKEx's expense, as they deem necessary. Individual Directors may also retain outside advisors, at HKEx's expense, to provide advice on any matter. The list of members of the various committees are set out in the "Corporate Information" section on page 8.

### Guidelines on Conduct

A Director's Handbook has been issued to every Board member setting out the guidelines on conduct, under which, Directors are required, *inter alia*, to declare any conflict of interests they may have and where necessary, to withdraw from any consideration of or abstain from voting on a matter in which they have a material interest. The Board has, at all time fully complied with the statutory and Listing Rules requirements governing disclosure of interests, the dealing in securities, connected transactions, and meeting procedures and practices.

### Retirement

None of the Public Interest Directors and the Chief Executive shall whilst holding office as such be subject to retirement by rotation or be taken into account in determining the number of Directors to retire at each annual general meeting after the annual general meeting in 2003. At every annual general meeting subsequent to that in 2003, one-third of the Directors subject to retirement by rotation or, if their number is not three or a multiple of three, then the number nearest to but not exceeding one-third shall retire and are eligible for re-election. The Directors to retire by rotation shall be those who have been longest in office since their last

appointment or re-appointment or those who were appointed by the Board during the year to fill casual vacancy. However, as between persons who became or were last re-appointed on the same day, those to retire shall be determined by drawing of lots (unless they otherwise agree among themselves).

Mr John E Strickland, a Director appointed by the Board to fill a casual vacancy after the 2003 annual general meeting shall retire at the conclusion of the 2004 annual general meeting to be held in March 2004, and Mr Oscar S H Wong, one of the five Elected Directors subject to retirement by rotation shall also retire at the conclusion of the 2004 annual general meeting, as determined by the draw of lots. Both Mr John E Strickland and Mr Oscar S H Wong are eligible for re-appointment.

### Remuneration and Indemnification

Shareholders had, at the annual general meeting held on 15 April 2003, approved the Remuneration Committee's recommendation of remunerating Non-executive Directors. The approved remuneration of \$100,000 serves as a recognition of the time and effort contributed by Non-executive Directors to HKEx, and is payable in proportional to the period of service during the period from the conclusion of the 2003 general meeting to the conclusion of the next annual general meeting. The remuneration of the Chief Executive is approved by the Non-executive, independent Directors of the Board. The remuneration, excluding share option benefit, of every Director, including the Chief Executive who is an *ex-officio* member for the year ended 31 December 2003 is set out in Note 9 to the accounts.

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Pursuant to Article 155 of the Articles of Association, every Director and every member of a committee appointed by the Board shall be entitled to be indemnified, subject to the provision of the Companies Ordinance, by HKEx against all costs, charges, losses, expenses and liabilities incurred by him in the execution and discharge of his duties or in relation thereto. A Directors' and Officers' Liabilities insurance has been arranged for that purpose.

### Directors' and Chief Executive's Interests and Short Positions

As at 31 December 2003, the Directors, the Chief Executive and their respective associates had the following interests in the shares and underlying shares of HKEx, as recorded in the register maintained by HKEx pursuant to Section 352 of the SFO:

#### (i) Shares

Name of Director	Number of shares held			Total
	Personal Interests	Family Interests	Corporate Interests	
Dannis J H Lee	–	–	1,610,000 (note 1)	1,610,000
David M Webb	2 (note 2)	2 (note 3)	6 (note 4)	10
John E Strickland	18,000 (note 5)	–	–	18,000

#### Notes:

- 1,610,000 shares were owned by DL Brokerage Limited, a private company beneficially wholly owned by Mr Dannis J H Lee, representing approximately 0.15 per cent of the issued share capital of HKEx.
- The shares held by Mr David M Webb as beneficial owner represent approximately 0.00 per cent of the issued share capital of HKEx.
- The shares were owned by the spouse of Mr David M Webb, representing approximately 0.00 per cent of the issued share capital of HKEx.
- The shares were owned by Fundamental Consultants Limited, Member One Limited and Member Two Limited which are under the control of Mr David M Webb, representing approximately 0.00 per cent of the issued share capital of HKEx.
- The shares held by Mr John E Strickland as beneficial owner represent approximately 0.00 per cent of the issued share capital of HKEx.

### (ii) Underlying Shares

As at 31 December 2003, the outstanding number of shares issuable under a share option granted pursuant to the Post-Listing Share Option Scheme to Mr Paul M Y Chow, a Director and the Chief Executive of HKEx, was 3,000,000 (2002: Nil), which represents approximately 0.29 per cent of the issued share capital of HKEx. The said option was granted on 2 May 2003, and is exercisable between 2 May 2005 and 1 May 2013 at an exercise price of \$9.05 per share.

During 2003, Mr K C Kwong exercised his option granted under the Pre-Listing Share Option Scheme in June 2000 (for the subscription of 1,454,126 shares at HK\$7.52 each) to subscribe for 362,000 shares at an exercise price of \$7.52 per share (2002: 362,000 shares were subscribed at HK\$7.52). The share option granted to Mr K C Kwong was cancelled, and the remaining shares issuable under the said option (730,126 shares) were forfeited upon his retirement on 15 April 2003.

Other than the holdings disclosed above, no interests and short positions were held or deemed or taken to be held under Part XV of the SFO by any Director or Chief Executive of HKEx or their respective associates in the shares, underlying shares and debentures of HKEx or any of its associated corporations (within the meaning of Part XV of the SFO) which were required to be notified to HKEx and the Stock Exchange pursuant to Part XV of the SFO

or pursuant to the Model Code for Securities Transactions by Directors of Listed Companies or which are required pursuant to Section 352 of the SFO to be entered in the register referred to therein. Nor any of the Directors and the Chief Executive (including their spouses and children under the age of 18) had, as at 31 December 2003, any interest in, or had been granted any right to subscribe for the securities and options of HKEx and its associated corporations within the meaning of the SFO, or had exercised any such rights.

### Directors' Interests in Contracts of Significance

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.

### Connected Transactions

During the year ended 31 December 2003, the Group had the following connected transactions, details of which are set out below -

- (A) For the year ended 31 December 2003, transactions between the following connected persons and HKEx or its subsidiaries arising from or in connection with the use of (i) the facilities provided by HKEx or its subsidiaries for the trading, clearing and/or settlement of securities and futures products and transactions and

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(ii) all services offered by HKEx or its subsidiaries which are ancillary, incidental or otherwise related to the foregoing:

- (1) Mr Paul C H Fan, a former Director of HKEx, was interested in the transactions entered into by Compu-Chart Investment Adviser Limited and Paul Fan Securities Limited, Exchange Participants in which Mr Fan has a 99.99 per cent interest.
- (2) Mr Dannis J H Lee, a Director of HKEx, was interested in the transactions entered into by DL Brokerage Limited, an Exchange Participant which is beneficially wholly owned by Mr Lee.
- (3) Mr K C Leong, a Director of HKEx, was interested in the transactions entered into by Roctec Securities Company Limited and Roctec Futures Trading Company Limited, Exchange Participants in which Mr Leong has a 30 per cent interest in each of the companies.
- (4) Mr Yue Wai Keung, a former Director of HKEx, was interested in the transactions entered into by Luen Fat Securities Company Limited, an Exchange Participant in which Mr Yue has a 47.66 per cent interest.

All the above connected transactions were entered into in the ordinary course of business and on normal commercial terms.

(B) For the year ended 31 December 2003, transactions between the following connected persons and HKEx or its subsidiaries arising from or in connection with HKSCC's arrangement on behalf of a Clearing Participant of a Buy-in Transaction:

- (1) Mr Dannis J H Lee, a Director of HKEx, was interested in the Buy-in Transactions entered into by DL Brokerage Limited beneficially wholly owned by Mr Lee. For the year ended 31 December 2003, the total consideration of such transactions, which were transacted on normal commercial terms was \$1,250,838.80.
- (2) Mr Paul C H Fan, a former Director of HKEx, was interested in the Buy-in Transactions entered into by Paul Fan Securities Limited in which Mr Fan has a 99.99 per cent interest. For the year ended 31 December 2003, the total consideration of such transactions, which were transacted on normal commercial terms was \$20,901,129.58.



(3) Mr Yue Wai Keung, a former Director of HKEx, was interested in the Buy-in Transactions entered into by Luen Fat Securities Company Limited in which Mr Yue has a 47.66 per cent interest. For the year ended 31 December 2003, the total consideration of such transactions, which were transacted on normal commercial terms was \$2,602,328.75.

Two independent Non-executive Directors who have not entered into any connected transactions with the Group have reviewed and confirmed that the connected transactions, as set out above had been entered into by the Group in accordance with the waiver conditions granted by the SFC that:

- (a) the connected transactions disclosed above were in the ordinary and usual course of business of the relevant Group company and conducted on an arm's length basis;
- (b) in respect of transactions other than Buy-in Transactions, they were in accordance with the rules and regulations of the relevant Group company governing such transactions and where the rules and regulations do not govern those transactions in full, in accordance with the standard terms and conditions of the relevant Group company relating to such transactions;

- (c) in respect of transactions which are Buy-in Transactions, they were in accordance with the standard terms and conditions of HKSCC applicable generally to all Buy-in Brokers in such transactions for and on behalf of HKSCC and at the standard commission rate payable by HKSCC in respect of all such Buy-in Transactions; and
- (d) the connected transactions were in the opinion of the Directors fair and reasonable so far as the shareholders of HKEx are concerned.

The external auditors of HKEx have also confirmed that:

- (a) the connected transactions disclosed above had received approval from the Directors; and
- (b) the connected transactions were in accordance with the relevant rules and regulations of the relevant Group company governing fees for the applicable facilities, services or goods provided by, or to, the Group and where the rules and regulations do not govern the transaction in full, are in accordance with the standard terms and conditions of the relevant Group company relating to the applicable facilities, services or goods provided by, or to, the Group.

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### Attendance

Attendance at Board meetings during 2003 is set out below:

Board member	Attendance at meetings	
Charles Y K Lee (Chairman)	15/15	
John C C Chan	6/6	Retired on 15 April 2003
Paul M Y Chow	8/8	Appointed on 1 May 2003
Henry H L Fan	1/1	Appointed on 15 November 2003
Paul C H Fan	6/6	Retired on 15 April 2003
Fong Hup	9/9	Appointed on 16 April 2003
Tim Freshwater	14/15	
Bill C P Kwok	15/15	
K C Kwong	5/6	Retired on 15 April 2003
Dannis J H Lee	15/15	
Vincent K H Lee	15/15	
Leong Ka Chai	14/15	
Liu Jinbao	3/8	Resigned on 28 May 2003
Lo Ka Shui	15/15	
John G C Seto	5/6	Retired on 15 April 2003
John E Strickland	13/14	Retired on 15 April 2003 and re-appointed on 16 April 2003
Rodney G Ward	5/6	Retired on 15 April 2003
David M Webb	9/9	Elected on 15 April 2003
Oscar S H Wong	9/9	Elected on 15 April 2003
Yue Wai Keung	5/6	Retired on 15 April 2003

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15 meetings were held in 2003, and the average attendance rate at Board meetings is 94 per cent.

### Committees and Panels

**Executive Committee** consists of three Non-executive Directors appointed by the Board, the Chief Executive and the Chief Operating Officer. It meets regularly, normally twice a month, and serves as an executive arm of the Board in the formulation of policies for consideration of the Board, and in

carrying out and implementing the policies laid down by the Board. The Executive Committee is delegated with the authority from the Board to administer, enforce, interpret and supervise compliance with those parts of the Rules, Regulations and Operational Procedures of its subsidiaries, other than the Listing Rules, and conduct regular reviews of the same, recommend, and advise on appropriate amendments which do not involve policy matters for the approval by the boards of the respective subsidiaries, and as appropriate by the SFC.

### Attendance

Attendance at the Executive Committee meetings during 2003 is set out below:

Committee member	Attendance at meetings	
Charles Y K Lee (Chairman)	20/20	
Patrick K Conroy	7/7	Appointed on 18 August 2003
Paul M Y Chow	13/13	Appointed on 1 May 2003
Frederick J Grede	7/10	Resigned on 13 June 2003
K C Kwong	6/6	Retired on 15 April 2003
Dannis J H Lee	14/14	Appointed on 16 April 2003
Leong Ka Chai	18/20	
John G C Seto	5/6	Retired on 15 April 2003

20 meetings were held in 2003, and the average attendance rate at the Executive Committee meetings is 94 per cent.

**Audit Committee**, comprising five Non-executive Directors appointed by the Board, meets at least four times a year. It examines any matter relating to accounting principles and practices adopted by the Group, and discusses auditing, internal control issues,

information systems and financial reporting matters. It also reviews quarterly, interim and the final results of the Group prior to recommending them to the Board for approval, and recommends the application of accounting policies and changes to financial reporting requirements. Senior representatives of the external auditors, the Chief Executive and senior executives are invited to attend the meetings. The Audit

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Committee reviews the appointment of HKEx's external auditors on an annual basis including a review of the audit fees. The Audit Committee also, as a good corporate governance practice, sets restrictions on the employment of HKEx's external auditors for non-audit related activities.

During the year, the fees paid to HKEx's external auditors for non-audit related activities amounted to \$1,372,950 comprising taxation services fees of \$673,750, executive secondment to the Listing Unit of \$600,000, and other miscellaneous item of \$99,200.

### Attendance

Attendance at the Audit Committee meetings during 2003 is set out below -

Committee member	Attendance at meetings	
John E Strickland (Chairman)	6/6	
Paul C H Fan	2/2	Retired on 15 April 2003
Henry H L Fan	0/0	Appointed on 10 December 2003
Fong Hup	4/4	Appointed on 16 April 2003
Tim Freshwater	2/2	Term expired on 15 April 2003
Leong Ka Chai	2/2	Term expired on 15 April 2003
Liu Jinbao	1/1	Appointed on 16 April 2003, and resigned on 28 May 2003
Vincent K H Lee	3/4	Appointed on 16 April 2003
David M Webb	3/4	Appointed on 16 April 2003
Yue Wai Keung	1/2	Retired on 15 April 2003

6 meetings were held in 2003, and the average attendance rate of the Audit Committee meetings is 89 per cent.

**Investment Advisory Committee** consists of three Non-executive Directors and one market professional appointed by the Board.

It meets at least four times a year, and provides market expertise and advice to the Board on the investments of HKEx, including advice on investment policies, asset allocation, and selection of fund managers and custodians.

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### Attendance

Attendance at the Investment Advisory Committee meetings during 2003 is set out below:

Committee member	Attendance at meetings	
Tim Freshwater (Chairman)	4/4	
Peter Clarke	1/1	Resigned on 23 May 2003
John G C Seto	1/1	Retired on 15 April 2003
David Sun	3/4	
Patrick Sun	1/1	Resigned on 16 April 2003
David M Webb	3/3	Appointed on 16 April 2003
Oscar S H Wong	2/3	Appointed on 16 April 2003

4 meetings were held in 2003, and the average attendance rate of the Investment Advisory Committee meetings is 88 per cent.

Nomination Committee, comprising three Non-executive Directors appointed by the Board, meets at least once a year, and is responsible for the formulation of the nomination policy, determination of the

selection criteria for the nomination of candidates to stand for election by shareholders as Directors, make recommendations to shareholders on candidates standing for election, provide sufficient biographical details of candidates to enable shareholders to make an informed decision on the election, and where necessary, nominate candidates to fill casual vacancies of Elected Directors.

### Attendance

Attendance at the Nomination Committee meeting during 2003 is set out below:

Committee member	Attendance at meetings	
Charles Y K Lee (Chairman)	1/1	
Paul C H Fan	1/1	Retired on 15 April 2003
Lo Ka Shui	1/1	
Oscar S H Wong	0/0	Appointed on 16 April 2003

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1 meeting was held in 2003, and the average attendance rate of the Nomination Committee meetings is 100 per cent.

**Remuneration Committee** consists of three Non-executive Directors appointed by the Board. It meets at least once a year, and

formulates 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.

### Attendance

Attendance at the Remuneration Committee meetings during 2003 is set out below:

Committee member	Attendance at meetings	
Lo Ka Shui (Chairman)	2/2	Appointed on 16 April 2003
John C C Chan	0/0	Retired on 15 April 2003
Dannis J H Lee	1/2	
Vincent K H Lee	2/2	Appointed on 16 April 2003
Rodney G Ward	0/0	Retired on 15 April 2003

2 meetings were held in 2003, and the average attendance rate of the Remuneration Committee meetings is 83 per cent.

**Risk Management Committee** is chaired by the Chairman of the Board, and consists of seven other members of whom five were appointed by the Financial Secretary and two were appointed by the Board. The Risk Management Committee was established under Section 65 of the SFO to review and formulate policies on risk management matters relating to the activities of HKEx and the exchanges and clearing houses of which HKEx is the controller, and submit such policies to HKEx for its consideration. The Risk Management Committee is aimed

at identifying, measuring, managing and control risks including legal risks, credit risks, market risks, concentration risks, operational risks, environmental risks, behavioral risks, and systemic risks that may have an impact on the securities and derivatives markets in Hong Kong.

Market-wide rehearsals are conducted periodically in conjunction with a number of Government bureaux, regulatory bodies, inter alia, the SFC, Hong Kong Monetary Authority, and Financial Services and Treasury Bureau as part of ongoing efforts to ensure an efficient response to emergency market events, and effective communications among the parties concerned.

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### Attendance

Attendance at the Risk Management Committee meetings during 2003 is set out below:

Committee member	Attendance at meetings	
Charles Y K Lee (Chairman)	5/5	
John C C Chan (note)	1/1	Term expired on 6 March 2003
Henry H L Fan	0/0	Appointed on 10 December 2003
Mark Dickens (note)	4/4	Appointed on 6 March 2003
Bill C P Kwok	5/5	
Lam Kin (note)	5/5	
James H Lau (note)	4/4	Appointed on 6 March 2003
Leong Ka Chai (note)	4/4	Appointed on 6 March 2003
Liu Jinbao	1/1	Appointed on 16 April 2003, and resigned on 28 May 2003
Andrew T L Sheng (note)	1/1	Term expired on 6 March 2003
John E Strickland	1/1	Term expired on 6 March 2003
Peter T S Wong (note)	5/5	
Joseph C K Yam (note)	1/1	Term expired on 6 March 2003

Note: Appointed by the Financial Secretary under S65 of the SFO.

5 meetings were held in 2003, and the average attendance rate of the Risk Management Committee meetings is 100 per cent.

Cash Market Consultative Panel, Clearing Consultative Panel and Derivatives Market Consultative Panel provide market expertise and advice to the Board on international trends, the needs of intermediaries, issuers, investors and other market participants, technological challenges and new product opportunities relating to the Cash market, Clearing business and Derivatives market

respectively. They act as the sounding boards for policy recommendations, strategic initiatives, and major investments in relation to the three markets. Each panel is consisted of two Non-executive Directors and eight members who are respective market participants or industry experts. Executives are invited to attend the panel meetings. Average attendance rate of the Cash Market Consultative Panel, the Clearing Consultation Panel and the Derivatives Market Consultation Panel meetings is 68 per cent, 86 per cent and 85 per cent respectively.

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## Internal Control

The Board has the ultimate responsibility for the Group's internal control system and, through the Audit Committee, has reviewed the effectiveness of the system. The internal control system, which includes a defined management structure with specified limits of authority, is designed to help the achievement of business objectives, safeguard assets against unauthorised use or disposition, ensure the maintenance of proper accounting records for the provision of reliable financial information for internal use or for publication, and ensure compliance with relevant legislation and regulations. The system is designed to provide reasonable, but not absolute, assurance against material misstatement or loss and to manage rather than eliminate risks of failure in operational systems and achievement of the Group's objectives.

The Group Internal Audit Unit conducts periodic independent reviews of the internal control systems, and on-going projects, and performs information technology related audits and evaluations. The reviews include financial, operational, compliance, and risk management aspects. Findings and recommendations are reported to the Audit Committee. Unit heads would be notified of the deficiencies noted, and the Group Internal Audit Unit would be responsible to oversee the rectification process.

The Group Internal Audit Unit provides objective assurance to the Board that a sound internal control system is maintained and operated by the management in compliance

with agreed processes and standards. The Group Internal Auditor reports directly to the Audit Committee, and is authorised to communicate directly with the Chairman of the Board and other Board members. The frequency of reviews is scheduled according to an internal audit programme approved by the Audit Committee.

The key procedures that the Board established to provide effective internal controls are as follows:

A distinct organisational structure exists with defined lines of authority and control responsibilities. Units head are involved in preparing the strategic plan which laid down the corporate strategies to be pursued in the next five years for achieving the annual operating plan, the annual operational and financial targets. Both the strategic plan and the annual operating plan laid down the foundation for the preparation of the annual budget by which resources are allocated in accordance with identified and prioritised business opportunities. The enterprise balanced scorecard serves to measure performance against targeted results. Other than the strategic plan which was approved by the Board for a five-year period but subject to annual review, the annual operating plan, the annual budget, and the enterprise balanced scorecard are approved by the Board on an annual basis.

A comprehensive management accounting system is in place providing financial and operational performance measure indicators to the management. Variances against



budgets are analysed, and explained, and appropriate actions are taken, if necessary, to rectify deficiencies noted.

The Board has achieved a significant reduction in capital expenditure and rationalisation of human resources during 2003. A major initiative to control and reduce further expenditure is on-going.

### Shareholders

Under the SFO, no person shall be or become a Minority Controller of HKEx, i.e. a person who either alone or with any associates, is entitled to exercise, or control the exercise of 5 per cent or more of the voting power at any general meeting of HKEx, except with the approval in writing of the SFC after consultation with the Financial Secretary.

Details of Minority Controllers as at 31 December 2003, and analysis of the shareholders' structure are set out on pages 59 and 11 respectively.

HKEx conducts regular dialogue with institutional investors. The Board is committed to providing clear and updated performance information of the Group to all shareholders, as soon as it is available, through the publication of quarterly, interim, and annual reports, which are also made accessible on HKEx's website. In addition to sending circulars, notices, financial reports

to shareholders, a range of other information and services for shareholders is provided on the Investor Relations Corner of the HKEx's website < [www.hkex.com.hk](http://www.hkex.com.hk) > for the purpose of keeping direct communication with shareholders and investors. In addition, the quarterly publication of the magazine "Exchange" serves to provide shareholders and the public with up-to-date information on HKEx's policies, products, and services.

The annual general meeting not only deals with the formal business of HKEx but also acts as a forum for direct dialogue with shareholders at which shareholders may ask questions on HKEx's operations or related financial information. The Chairman had demanded poll voting on all proposed resolutions at the annual general meeting in 2003. Poll voting results were announced at the conclusion of the 2003 annual general meeting, and were also made available on HKEx's website so as to provide shareholders with information regarding the level of support and opposition to each resolution. For the sake of good corporate governance practice, the Chairman intends to demand poll voting at future general meetings for all resolutions set out in the relevant notice of meeting so as to allow shareholders to have one vote for every share held. Minutes of annual general meetings have also been posted on HKEx's website for access by shareholders and other interested parties.

# Corporate Governance

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## Employees' Relationship

### Human Resources Planning

Amidst the challenging business environment in 2003, the human resources strategy continues to focus on having the optimum number of employees with the appropriate skill, expertise, and experience to carry out the various functions with the aim of achieving the corporate objectives. As at 31 December 2003, HKEx had a team of 803 employees including 38 temporary staff (2002: 877 employees including 80 temporary staff). The Board has a primary role in ensuring that adequate thought is given to planning for succession to executive director and senior management positions, whilst every Unit Head is required to conduct a thorough review of the operations, structure, and manpower of respective units and furnish an annual manpower plan to be approved by the Board.

Both internal and external sourcing for appropriate candidates would be pursued. Internal transfer or promotion is encouraged before pursuing external recruitment, as it gives employees opportunities to widen their exposures and enables HKEx to deploy employees to areas where they can best contribute to.

### Training

Training and development programmes are in place for staff members, which include staff exchange programmes set up with other exchanges, in-house programmes, offering of sponsorship to employees to attend external programmes for pursuing academic and professional qualifications. During 2003, 49 in-house training courses and seminars

had been arranged for the staff covering topics such as customer service, products, information technology, and market development.

HKEx is a recognised institution for providing continuous professional training (CPT). Training sessions are organised for staff of HKEx to update their knowledge and skills while meeting their CPT requirements.

### Communication

HKEx believes that effective communication is crucial to foster staff commitment to the Group. Starting from May 2003, the Chief Executive delivers and explains key policies and development of the Group to executives at Monthly Executive Forum, and the Group's quarterly performance to all staff at grade 7 and above at the CEO Quarterly Presentation, where staff are free to raise any questions relating to the Group's activities.

### Employee Benefits

HKEx sponsors two staff provident fund schemes which are registered under the Occupational Retirement Schemes Ordinance (ORSO) and have obtained Mandatory Provident Fund (MPF) exemption for all full-time permanent employees. With effect from 1 January 2004, investment choices are built into the schemes, and employees may make up to four investment switches per annum.

In addition, HKEx has participated in a master trust MPF scheme to provide retirement benefits for all temporary employees or those full-time employees who elect not to join the ORSO schemes.

Other benefits include medical insurance, dental insurance, life and personal accident insurance, employees' compensation insurance, and business travel insurance.

### **Performance Development Process (PDP)**

PDP is a systematic approach to maximizing both individual and organisational performance. Performance is defined as a combination of Results (achievement of objectives) and Behaviours (competency development). HKEx uses a "cascading objectives" system which links individual objectives to Unit's objectives, and ultimately to HKEx's strategic objectives. Balanced scorecard is used to specify and measure objectives aiming at having a balanced view of performance.

HKEx's competency model is directly linked to the Group's core values and vision/mission. By linking individual competencies to HKEx core values, employees are focused on the right behaviours which are important for the success of the organisation, and enhanced contribution to the Group.

Individual's performance is evaluated annually through an individual assessment interview between employees and their appraiser. Pre-established performance expectations, and objectives provide a foundation for evaluating performance and determining rewards to employees.

The Group's remuneration policy is subject to review by the Remuneration Committee on an annual basis. The policy is aimed at providing fair and equitable remuneration to employees in relation to responsibility and performance in order to attract, motivate and retain a high-calibre team.

### **Guidelines on dealings**

As the controller of the front-line regulators of the securities and futures markets, HKEx has laid down a code of conduct for securities and derivatives transactions of employees. Employees are required to file declarations with the Head of Human Resources Unit through the employee's Unit Head, the Chief Executive or the Chairman, as the case may be on their investment in securities and derivatives upon joining the Group. Before entering into any securities or derivatives transactions, employees shall seek prior written approval from their respective Unit Head or the Chief Executive, as the case may be. The Chief Executive and his related person who wish to buy or sell securities and derivatives shall obtain the prior written approval of the Chairman. Details of the code of conduct for securities and derivatives transactions are set out in the Human Resources Manual issued to every employee of the Group.

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 in relation to soliciting and accepting advantages have been worked out in consultation with the Independent Commission Against Corruption, and set out in the Human Resources Manual.

## Corporate Governance

### Top Five Paid Employees

The top five paid employees, and the Chief Executive who is an *ex-officio* member of the Board for the year ended 31 December 2003 are:

Chief Executive	Salary HK\$	Performance bonus HK\$	Compensation for loss of office HK\$	Others benefits HK\$ (note 1)	Employer's contribution to provident fund HK\$ (note 2)	Total HK\$
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Paul M Y Chow	4,800,000	200,000	–	43,823	600,000	5,643,823
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Name of Employee	Salary HK\$	Performance bonus HK\$	Compensation for loss of office HK\$	Others benefits HK\$ (note 1)	Employer's contribution to provident fund HK\$ (note 2)	Total HK\$
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Frederick J Grede (note 3)	3,675,000	–	1,575,000	298,954	367,500	5,916,454
Lawrence K M Fok	4,791,690	150,000	–	78,110	598,961	5,618,761
Mary M L Kao	3,420,000	142,500	–	57,004	399,000	4,018,504
Karen K Y Lee	3,300,000	68,750	–	35,849	412,500	3,817,099
Walter A Reisch (note 4)	2,333,360	–	875,010	38,250	291,670	3,538,290

Notes:

- Other benefits include leave pay, relocation and passages allowance, insurance premium, and club membership.
- The employee who retires before normal retirement age is eligible to 18 per cent of the employer's contribution to the provident fund after completion of 2 years of service. The rate of vested benefit increases at an annual increment of 18 per cent thereafter reaching 100 per cent after completion of 7 years of service.
- Mr Frederick J Grede resigned on 13 June 2003.
- Mr Walter A Reisch resigned on 8 August 2003.

## Corporate Governance

As a result of the new executive appointments during the second half of 2003, and on the assumption of full-year service of existing staff, the remuneration of the Chief Executive and the top five paid employees in 2004 would be as follows:

Chief Executive	Salary HK\$	Other benefits HK\$ (note 1)	Employer's contribution to provident fund HK\$ (note 2)	Total HK\$
Paul M Y Chow	7,200,000	85,379	900,000	8,185,379

Name of Employee	Salary HK\$	Other benefits HK\$ (note 1)	Employer's contribution to provident fund HK\$ (note 2)	Total HK\$
Patrick K Conroy (note 3)	5,460,000	109,857	682,500	6,252,357
Lawrence K M Fok	4,500,000	78,318	562,500	5,140,818
Richard G Williams (note 4)	3,504,000	74,524	438,000	4,016,524
Stewart S C Shing (note 5)	3,504,000	57,788	438,000	3,999,788
Mary M L Kao	3,420,000	58,081	427,500	3,905,581

Notes:

1. Other benefits include leave pay, insurance premium, and club membership.
2. The employee who retires before normal retirement age is eligible to 18 per cent of the employer's contribution to the provident fund after completion of 2 years of service. The rate of vested benefit increases at an annual increment of 18 per cent thereafter reaching 100 per cent after completion of 7 years of service.
3. Mr Patrick K Conroy joined as the Chief Operating Officer on 18 August 2003.
4. Mr Richard G Williams was appointed the Head of Listing on 23 June 2003. Mr Williams is a member of a pension scheme operating in United Kingdom, and he is exempted under Section 4(3) of the Mandatory Provident Fund Schemes Ordinance from participating in HKEx's provident fund scheme. The vesting scale of retirement benefits is not applicable to Mr Williams.
5. Mr Stewart S C Shing joined as the Chief Executive of HKSCC and the Head of the Clearing Business Unit on 15 December 2003.

## Corporate Governance

### Pre-Listing and Post-Listing Share Option Schemes

Shareholders had, on 31 May 2000, approved two share option schemes, the Pre-Listing Share Option Scheme which governs the grant of share option to eligible employees, including Executive Directors, before 27 June 2000, the date of first listing of HKEx shares,

and the Post-Listing Share Option Scheme which governs the grant of share option after 27 June 2000. Terms and conditions of the Post-Listing Share Option Scheme were amended by shareholders on 17 April 2002 in compliance with changes to the Listing Rules. The key terms of the two schemes can be found on pages 45 to 49.

During 2003, changes to the share options granted to the top five paid employees are as follows:

Name of Employee	Date of grant	Exercise Price HK\$	No. of shares issuable under the option granted	No. of shares subscribed during 2003	No. of shares forfeited during 2003	Exercise Period
Frederick J Grede	20 June 2000	7.52	1,211,079	302,000	607,079 (note)	–
Lawrence K M Fok	20 June 2000	7.52	693,146	–	–	6 March 2002 to 30 May 2010
Mary M L Kao	20 June 2000	7.52	637,248	–	–	6 March 2002 to 30 May 2010
Karen K Y Lee	20 June 2000	7.52	402,472	–	–	6 March 2002 to 30 May 2010
Walter A Reisch	–	–	–	–	–	–

Note: Mr Frederick J Grede exercised his option also in March 2002 to subscribe for 302,000 shares.

A share option was granted to Mr Patrick K Conroy on 18 August 2003 for the subscription of 1,800,000 shares with an exercise price at \$13.65 per share. Exercise period is from 18 August 2005 to 17 August 2013.

A share option was granted to Mr Richard G Williams on 14 August 2003 for the subscription of 1,000,000 shares with an exercise price at \$13.60 per share. Exercise period is from 14 August 2005 to 13 August 2013.

A share option was granted to Mr Stewart S C Shing on 14 January 2004 for the subscription of 1,000,000 shares with an exercise price at \$18.90 per share. Exercise period is from 15 January 2006 to 14 January 2014.

### Social Responsibilities

#### Environment

HKEx is committed to conduct its business in a manner which fosters the sustainable use of natural resources, and minimises any adverse impact on the environment. In addition to pursuing environmental protection measures internally, HKEx has encouraged listed companies to send or make available corporate communications to holders of securities and to the Stock Exchange by electronic means. HKEx has also published press releases and all notices filed with the Stock Exchange on the HKEx's website.

#### Education and training

HKEx is one of the five supporting organisations for a Professional Diploma in Corporate Governance & Directorship programme that began in early June until the end of August 2003. HKEx and the SFC had sponsored a continuing professional development forum for directors of listed companies organised by the Hong Kong Institute of Directors and the Hong Kong Securities Institute. The forum is designed to help directors of listed companies maintain their standards in a changing business environment.

Other than providing training sessions to internal staff, HKEx, as a recognised institution for providing CPT, also organises CPT sessions to help industry participants enhance their professional expertise. 21 investors seminars were organised in 2003.

#### Donations

HKEx supports various charitable institutions in Hong Kong through donations and sponsorship. In 2003, HKEx raised \$13.1 million for the Community Chest through balloting of special stock codes for new listed companies on both the Main Board and the GEM.

### Changes to the Memorandum and Articles of Association

HKEx had, with the approval of shareholders at the 2003 annual general meeting, and the subsequent approval of the SFC, amended the Memorandum and Articles of Association to cope with changes brought by the SFO which was effective from 1 April 2003. The revised Memorandum and Articles of Association can be found on HKEx's website.

By Order of the Board

Joseph Mau

Company Secretary

26 February 2004