

# Corporate Governance Report

The Company is committed to remaining an exemplary corporate citizen and maintaining a high level of corporate governance in order to protect the interests of its shareholders.

## Corporate Governance Practices

In November 2004, the HKSE issued its report entitled the “Code on Corporate Governance Practices and Corporate Governance Report”, which subject to a grace period, has taken effect for accounting periods commencing on or after January 1, 2005. The HKSE’s Code on Corporate Governance Practices (the “CG Code”) as set out in Appendix 14 of the Listing Rules, which contains code provisions to which an issuer such as the Company, are expected to comply or advise as to reasons for deviations (the “Code Provisions”) and recommended best practices to which an issuer is encouraged to comply (the “Recommended Practices”). At the meeting of the Board on January 25, 2005, the Board approved the Corporate Governance Policy (the “CG Policy”) with effect from such date. The updated CG Policy, a copy of which can be obtained on the Company’s website at [www.smics.com](http://www.smics.com) under “Corporate Governance”, incorporates all of the Code Provisions of the CG Code and many of the Recommended Practices.

In addition, the Company has adopted or put in place various policies, procedures, and practices in compliance with the provision of the CG Policy. None of the Directors is aware of any information which would reasonably indicate that the Company is not, or was not, during the financial period from January 1, 2006 to December 31, 2006, in compliance with the CG Policy.

## Model Code for Securities Transactions by Directors of Listed Issuers

The Company has adopted an Insider Trading Compliance Program (the “Insider Trading Policy”) which encompasses the requirements of the Model Code as set out in Appendix 10 of the Listing Rules. The Company, having made specific enquiry of all Directors, confirms that all members of the Board have complied with the Insider Trading Policy and the Model Code throughout the year ended December 31, 2006. The senior management as well as all officers, Directors, and employees of the Company and its subsidiaries are also required to comply with the provisions of the Insider Trading Policy.

### **The Board**

The Board has a duty to the Company’s shareholders to direct and oversee the affairs of the Company in order to maximize shareholder value. The Board acting itself and through the various committees of the Board, actively participates in the determination of the overall strategy of the Company, the establishment and monitoring of the achievement, of corporate goals and objectives, the oversight of the Company’s financial performance and the responsibility for preparing the accounts, the establishment of corporate governance practices and policies, and the review of the Company’s system of internal controls. The management of the Company is responsible for the implementation of the overall strategy of the Company and its daily operations and administration. The Board has access to the senior management of the Company to discuss enquiries on management information.

The Board consists of nine Directors as at the date of the annual report. Directors may be elected or re-elected to hold office until the expiration of their respective terms upon a resolution passed at a duly convened shareholders’ meeting by holders of a majority of the Company’s outstanding shares being entitled to vote in person or by proxy at such meeting. The Board is divided into three classes with no more than one class eligible for re-election at any annual general meeting of shareholders.

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Each class of Director will serve terms of three years. The Class I Directors were elected for a term of three years at the 2005 AGM (except Dr. Albert Y. C. Yu who was elected at the 2006 AGM). The Class II Directors were re-elected for a term of three years at the 2006 AGM. The Class III Directors will be re-elected at the AGM for a term of three years.

The following table sets forth the names, classes and categories of the Directors:

| <b>Name of Director</b> | <b>Category of Director</b>                            | <b>Class of Director</b> |
|-------------------------|--|--------------------------|
| Yang Yuan Wang          | Chairman, Independent Non-executive Director           | Class III                |
| Richard Ru Gin Chang    | President, Chief Executive Officer, Executive Director | Class I                  |
| Henry Shaw              | Independent Non-executive Director                     | Class I                  |
| Albert Y. C. Yu         | Independent Non-executive Director                     | Class I                  |
| Ta-Lin Hsu              | Independent Non-executive Director                     | Class II                 |
| Jiang Shang Zhou        | Independent Non-executive Director                     | Class II                 |
| Lip-Bu Tan              | Independent Non-executive Director                     | Class II                 |
| Tsuyoshi Kawanishi      | Non-executive Director                                 | Class III                |
| Fang Yao                | Non-executive Director                                 | Class III                |

Brief biographical details for Board members are set out on pages 35 through 37. During the year ended December 31, 2006, the Board at all times exceeded the minimum requirements of the Listing Rules relating to the appointment of at least three Independent Non-executive Directors on the board, and complied with the requirement that these should include one such director with appropriate professional qualifications or accounting or related financial management expertise.

At the AGM, Yang Yuan Wang, Tsuyoshi Kawanishi and Fang Yao will retire from office on the date of the AGM pursuant to Article 90 of the Articles. Prof. Wang, Mr. Kawanishi and Mr. Yao will each offer himself for re-election at the AGM. If re-elected, each of Prof. Wang, Mr. Kawanishi and Mr. Yao would hold office until the 2010 AGM.

On an annual basis, each Independent Non-executive Director confirms his independence to the Company, and the Company considers these Directors to be independent as such term is defined in the Listing Rules. There are no relationships among members of the Board, including between the Chairman of the Board and the Chief Executive Officer.

The Board meets in person at least on a quarterly basis and on such other occasions as may be required to discuss and vote upon significant issues affecting the Company. The Board meeting schedule for a year is planned in the preceding year. The Company Secretary assists the Chairman in preparing the agenda for meetings and the Board in complying with relevant rules and regulations. The relevant papers for the Board meetings were dispatched to Board members in accordance with the CG Code. Directors may include matters for discussion in the agenda if the need arises. Upon the conclusion of the Board meeting, minutes are circulated to all Directors for their comment and review prior to their approval of the minutes at the following or subsequent Board meeting. Transactions in which Directors are considered to have a conflict of interest or material interests are not passed by written resolutions and the interested Directors are not counted in the quorum and abstain from voting on the relevant matters.

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All Directors have access to the Company Secretary who is responsible for assisting the Board in complying with applicable procedures regarding compliance matters. Every Board member is entitled to have access to documents provided at the Board meeting or filed into the Company's minute-book. Furthermore, the Board has established the procedures pursuant to which a Director, upon reasonable request, may seek independent professional advice at the Company's expense in order for such Director to exercise such Director's duties. The Company Secretary continuously updates all Directors on the latest development of the Listing Rules and other applicable regulatory requirements to assist the Company's compliance with and maintenance of good corporate governance practices. Each new Director is provided with training with respect to such Director's responsibilities under the Listing Rules and other regulatory requirements and the Company's corporate governance policies and practices.

During the year ended December 31, 2006, the Board held a total of twelve (12) meetings. Details of Directors' attendance at the Board meetings are set forth below:

|                                    | Number of Meetings Attended | Attendance Rate |
|------------------------------------|-----------------------------|-----------------|
| <b>From January to May</b>         |                             |                 |
| Wang Yang Yuan <sup>(1a)</sup>     | 6/6                         | 100%            |
| Richard Ru Gin Chang               | 6/6                         | 100%            |
| Fang Yao <sup>(2a)</sup>           | 5/6                         | 83%             |
| Ta-Lin Hsu <sup>(3a)</sup>         | 6/6                         | 100%            |
| Yen-Pong Jou <sup>(4)</sup>        | 5/6                         | 83%             |
| Tsuyoshi Kawanishi <sup>(5a)</sup> | 6/6                         | 100%            |
| Henry Shaw                         | 6/6                         | 100%            |
| Lip-Bu Tan                         | 6/6                         | 100%            |
| Average Attendance Rate            |                             | 96%             |
| <b>From June to December</b>       |                             |                 |
| Wang Yang Yuan <sup>(1b)</sup>     | 8/8                         | 100%            |
| Richard Ru Gin Chang               | 8/8                         | 100%            |
| Fang Yao <sup>(2b)</sup>           | 8/8                         | 100%            |
| Ta-Lin Hsu <sup>(3b)</sup>         | 8/8                         | 100%            |
| Jiang Shang Zhou <sup>(6)</sup>    | 3/8                         | 38%             |
| Tsuyoshi Kawanishi <sup>(5b)</sup> | 6/8                         | 75%             |
| Henry Shaw                         | 8/8                         | 100%            |
| Lip-Bu Tan <sup>(7)</sup>          | 5/8                         | 63%             |
| Albert Y. C. Yu <sup>(8)</sup>     | 8/8                         | 100%            |
| Average Attendance Rate            |                             | 86%             |

(1a) 2 of these meetings were attended by proxy

(1b) 5 of these meetings were attended by proxy

(2a) 1 of these meetings was attended by proxy

(2b) 1 of these meetings was attended by proxy

(3a) 1 of these meetings was attended by proxy

(3b) 1 of these meetings was attended by proxy

(4) Such meetings were attended by proxy and Mr. Jou retired as Director at the 2006 AGM.

(5a) 4 of these meetings were attended by proxy

(5b) 2 of these meetings were attended by proxy

- (6) 2 of these meetings were attended by proxy. Mr. Jiang was elected as Director at the 2006 AGM.
- (7) 1 of these meetings was attended by proxy
- (8) 2 of these meetings were attended by proxy. Dr. Yu was elected as Director at the 2006 AGM.

### **Procedure regarding the Appointment of Directors**

The standard procedures regarding the appointment of Directors, which was adopted by the Board on September 22, 2005, sets forth the process by which individuals are appointed as members of the Board. Under the policy, the Board will consider, among other factors, (i) the skills, qualifications and experience of the nominee, including other directorships held in listed public companies in the last three years and other major appointments; (ii) the nominee's shareholdings in the Company; (iii) the independence of the nominee under United States and/or Hong Kong listing rules; and (iv) the impact with respect to the Company's status as a "foreign private issuer" under the United States securities laws. The Board will then decide whether to appoint such nominee to fill a casual vacancy on the Board or to add the nominee to the existing Directors and to appoint such nominee into one of the three classes of directors as stipulated in the Articles of Association.

## **Board Committees**

The Board has established the following principal committees to assist it in exercising its obligations. These committees consist of only Independent Non-executive Directors who have been invited to serve as members. The committees are governed by their respective charters setting out clear terms of reference.

### **Compensation Committee**

As of December 31, 2006, the members of the Company's compensation committee (the "Compensation Committee") were Ta-Lin Hsu (chairman of Compensation Committee), Tsuyoshi Kawanishi and Lip-Bu Tan. None of these members of the Compensation Committee has been an executive officer or employee of the Company or any of its subsidiaries. See "Connected Transactions" for a description of transactions between the Company and the members of the Compensation Committee.

The responsibilities of the Compensation Committee include, among other things:

- approving and overseeing the total compensation package for the Company's executive officers and any other officer, evaluating the performance of and determining and approving the compensation to be paid to the Company's Chief Executive Officer and reviewing the results of the Chief Executive Officer's evaluation of the performance of the Company's other executive officers;
- reviewing and making recommendations to the Board with respect to Director compensation, including equity-based compensation;
- administering and periodically reviewing and making recommendations to the Board regarding the long-term incentive compensation or equity plans made available to the Directors, employees and consultants;
- reviewing and making recommendations to the Board regarding executive compensation philosophy, strategy and principles and reviewing new and existing employment, consulting, retirement and severance agreements proposed for the Company's executive officers; and

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- ensuring appropriate oversight of the Company's human resources policies and reviewing strategies established to fulfill the Company's ethical, legal and human resources responsibilities.

In 2006, the Compensation Committee reviewed and approved the total compensation package for Richard Ru Gin Chang, who is the President and Chief Executive Officer of the Company and an Executive Director, as well as that of the other members of the management team of the Company. Based on the Compensation Committee's review of the Company's corporate goals for 2006 and comparable total compensation packages for presidents and chief executive officers of other publicly-listed companies in the same or a similar industry, the Compensation Committee awarded Richard Ru Gin Chang an emolument of US\$348,968. In 2005, the Compensation Committee granted Dr. Chang fifteen million (15,000,000) options to purchase ordinary shares under the 2004 Stock Option Plan and awarded him two million (2,000,000) RSUs under the 2004 Equity Incentive Plan. As of December 31, 2006, none of such options have been exercised and 50% of such RSUs have vested.

On September 29, 2006, the Board granted to each Director an option to purchase 500,000 ordinary shares at a price per ordinary share of US\$0.132. These options will be vested as to 50% on May 30, 2007 and as to 50% on May 30, 2008, and both options will expire on the earlier of September 29, 2016 or 120 days after termination of the director's service to the Board. Mr. Fang Yao and Mr. Jiang Shang Zhou have declined such option.

On September 29, 2006, the Board granted to Dr. Albert Y. C. Yu 500,000 Restricted Share Units. Shares under the Restricted Share Units are to be automatically vested as to 50% per year starting from May 30, 2007.

On November 10, 2004, the Board granted to each independent Non-executive Director and Non-executive Director, an option to purchase 500,000 ordinary shares at a price per ordinary share of US\$0.22. These options were fully vested on March 19, 2005 and will expire on November 9, 2009. As of December 31, 2006, these options have not been exercised. Lai Xing Cai (who resigned as a Non-executive Director on February 6, 2006) has declined such option. The option granted to Mr. Yen-Pong Jou (who retired as an Independent Non-executive Director at the annual general meeting held on May 30, 2006) lapsed and cancelled on September 27, 2006.

In addition to reviewing the remuneration of the Non-executive Directors and the members of the Company's management, the Compensation Committee reviewed:

- (i) the remuneration policy for employees for the fiscal year 2006;
- (ii) the profit-sharing and bonus policies;
- (iii) the long term compensation strategy, including a review of the issuance of the shares under the Option Plans;
- (iv) the accounting treatment and financial implications of the employees' share options under U.S. GAAP; and

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(v) the attrition rate.

The Compensation Committee reports its work, findings and recommendations to the Board during each quarterly Board meeting.

The Compensation Committee meets in person at least on a quarterly basis and on such other occasions as may be required to discuss and vote upon significant issues affecting the compensation policy of the Company. The meeting schedule for a year is planned in the preceding year. The Company Secretary assists the chairman of the Compensation Committee in preparing the agenda for meetings and assists the Compensation Committee in complying with the relevant rules and regulations. The relevant papers for the Compensation Committee meeting were dispatched to Compensation Committee members in accordance with the CG Code. Members of the Compensation Committee may include matters for discussion in the agenda if the need arises. Upon the conclusion of the Compensation Committee meeting, minutes are circulated to the members of the Compensation Committee for their comment and review prior to their approval of the minutes at the following or a subsequent Compensation Committee meeting.

During the year ended December 31, 2006, the Compensation Committee held a total of five (5) meetings. Details of Directors' attendance at the Compensation Committee are set forth below:

|                         | Number of Meetings Attended | Attendance Rate |
|-------------------------|-----------------------------|-----------------|
| Ta-Lin Hsu              | 5/5                         | 100%            |
| Tsuyoshi Kawanishi      | 4/5                         | 80%             |
| Lip-Bu Tan              | 5/5                         | 100%            |
| Average Attendance Rate |                             | 93%             |

### Audit Committee

As of December 31, 2006, the members of the Audit Committee were Henry Shaw (co-chairman of Audit Committee), Lip-Bu Tan (co-chairman of Audit Committee) and Yang Yuan Wang. None of these members of the Audit Committee has been an executive officer or employee of the Company or any of its subsidiaries. See "Connected Transactions" for a description of transactions between the Company and the members of the Audit Committee. In addition to acting as Audit Committee member of the Company, Mr. Lip-Bu Tan, one of the members of the Audit Committee, currently also serves on the audit committee of three other publicly traded companies, namely SINA Corporation, Flextronics International Ltd. and Integrated Silicon Solution, Inc. In general and in accordance with section 303A.07(a) of the Listed Company Manual of the New York Stock Exchange, the Board considered and determined that such simultaneous service would not impair the ability of Mr. Tan to effectively serve on the Company's Audit Committee.

The responsibilities of the Audit Committee include, among other things:

- making recommendations to the Board concerning the appointment, reappointment, retention, evaluation, oversight and termination of compensating and overseeing the work of the Company's independent auditor, including reviewing the experience, qualifications and performance of the senior members of the independent auditor team and pre-approving all non-audit services to be provided by the Company's independent auditor;

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- approving the remuneration and terms of engagement of the Company's independent auditor;
- reviewing reports from the Company's independent auditor regarding its internal quality-control procedures and any material issues raised in the most recent review or investigation of such procedures and regarding all relationships between the Company and the independent auditor;
- pre-approving the hiring of any employee or former employee of the Company's independent auditor who was a member of the audit team during the preceding two years;
- reviewing the Company's annual and interim financial statements, earnings releases, critical accounting policies and practices used to prepare financial statements, alternative treatments of financial information, the effectiveness of the Company's disclosure controls and procedures and important trends and developments in financial reporting practices and requirements;
- reviewing the planning and staffing of internal audits, the organization, responsibilities, plans, results, budget and staffing of the Company's Internal Audit Department (as defined and discussed below) and the quality and effectiveness of the Company's internal controls;
- reviewing the Company's risk assessment and management policies;
- reviewing any legal matters that may have a material impact and the adequacy and effectiveness of the Company's legal and regulatory compliance procedures;
- establishing procedures for the treatment of complaints received by the Company regarding accounting, internal accounting controls, auditing matters, potential violations of law and questionable accounting or auditing matters; and
- obtaining and reviewing reports from management, the Company's internal auditor and the Company's independent auditor regarding compliance with applicable legal and regulatory requirements.

During 2006, the Audit Committee reviewed:

- the financial reports for the year ended December 31, 2005 and the six month period ended June 30, 2006;
- the quarterly earnings releases and any updates thereto;
- the report and management letter submitted by the Company's outside auditors summarizing the findings of and recommendations from their audit of the Company's financial reports;
- the Company's budget for 2006;
- the findings and recommendations of the Company's outside consultants regarding the Company's compliance with the requirements of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act");

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- the effectiveness of the Company's internal control structure in operations, financial reporting integrity and compliance with applicable laws and regulations in collaboration with the Internal Audit Department;
- the findings of the Company's Risk Management Committee (as defined and discussed below) which assesses risks relating to the Company and the compliance office, which ensures compliance with the CG Code and Insider Trading Policy;
- the audit fees and other non-audit fees such as fees relating to transfer pricing, Sarbanes-Oxley compliance testing, for the Company's outside auditors; and
- the Company's outside auditors' engagement letters.

The Audit Committee reports its work, findings and recommendations to the Board during each quarterly Board meeting.

The Audit Committee meets in person at least on a quarterly basis and on such other occasions as may be required to discuss and vote upon significant issues affecting the audit policy of the Company. The meeting schedule for a year is planned in the preceding year. The Company Secretary assists the co-chairmen of the Audit Committee in preparing the agenda for meetings and assists the Compensation Committee in complying with the relevant rules and regulations. The relevant papers for the Audit Committee meetings were dispatched to the Audit Committee in accordance with the CG Code. Members of the Audit Committee may include matters for discussion in the agenda if the need arises. Upon the conclusion of the Audit Committee meeting, minutes are circulated to the members of the Audit Committee for their comment and review prior to their approval of the minutes at the following or a subsequent Audit Committee meeting.

During the year ended December 31, 2006, the Audit Committee held a total of eight (8) meetings. Details of Directors' attendance at the Audit Committee are set forth below:

|                               | <b>Number of Meetings Attended</b> | <b>Attendance Rate</b> |
|-------------------------------|------------------------------------|------------------------|
| Henry Shaw                    | 8/8                                | 100%                   |
| Lip-Bu Tan <sup>(1)</sup>     | 8/8                                | 100%                   |
| Yang Yuan Wang <sup>(2)</sup> | 8/8                                | 100%                   |
| Average Attendance Rate       |                                    | 100%                   |

<sup>(1)</sup> 1 of these meetings was attended by proxy

<sup>(2)</sup> 4 of these meetings were attended by proxy

At each quarterly Audit Committee meeting, the Audit Committee reviews with the Acting Chief Financial Officer and the Company's outside auditors, the financial statements for the financial period and the financial and accounting principles, policies and controls of the Company and its subsidiaries. In particular, the Committee discusses (i) the changes in accounting policies and practices, if any; (ii) the going concern assumptions, (iii) compliance with accounting standards and applicable rules and other legal requirements in relation to financial reporting and (iv) the internal controls of the Company relating to financial reporting. Upon the recommendation of the Audit Committee, the Board will approve the financial statements.



## Auditors' Remuneration

The following table sets forth the aggregate audit fees, Sarbanes-Oxley compliance testing fee, audit-related fees, tax fees and all other fees we paid or incurred for audit services, audit-related services, tax services and other services rendered by our principal accountants during the fiscal year ended December 31, 2006.

|                    | <b>2006</b>        |
|--------------------|--------------------|
| Audit Fees         | \$1,460,000        |
| Audit-Related Fees | –                  |
| Tax Fees           | \$33,789           |
| All Other Fees     | \$85,597           |
| <b>Total</b>       | <b>\$1,579,386</b> |

## Internal Controls

In June 2004, the Public Company Accounting Oversight Board, or PCAOB, adopted rules for purposes of implementing Section 404 of the Sarbanes-Oxley Act. Pursuant to the Sarbanes-Oxley Act and the various rules and regulations adopted pursuant thereto or in conjunction therewith, the Company is required to perform, on an annual basis, an evaluation of the Company's internal controls over financial reporting and, beginning in fiscal year 2006, to include management's assessment of the effectiveness of the Company's internal controls over financial reporting in the Company's annual report on Form 20F to be filed with the United States Securities and Exchange Commission. Beginning in fiscal year 2006, the Company's external auditors are required to attest to such assessment.

The Board, through the Audit Committee which receives reports on at least a quarterly basis from the Internal Audit Department, is responsible to ensure that the Company maintains sound and effective internal controls. The Company's system of internal control is designed to ensure the achievement of business objectives in operations, financial reporting integrity and compliance with applicable laws and regulations. The system of internal control is designed to manage, rather than completely eliminate, risks impacting the Company's ability to achieve its business objectives. Accordingly, the system can only provide reasonable but not absolute assurance that the financial statements do not contain a material misstatement or loss.

The Company assists the Board with respect to its duty to identify, evaluate, and manage the significant risks faced by the Company. The Company implements the Board's policies and procedures to mitigate such risks by (i) identifying and assessing the risks the Company faces and (ii) designing, operating and monitoring a system of internal controls to mitigate and control such risks. The Company has established an Internal Audit Department and the Risk Management Committee and other policies and procedures, for such purposes.

### Internal Audit Department

Internal Audit Department works with and supports the Company's management team and the Audit Committee to evaluate and contribute to the improvement of risk management, control, and governance systems. On an annual basis, the Audit Committee will review and approve an annual internal audit plan, which is based on a risk assessment methodology, which assists in determining business risks and establishing appropriate audit frequencies.

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Based on this annual audit plan, the Internal Audit Department will audit the practices, procedures, expenditure and internal controls of the various departments in the Company. The scope of the audit includes:

- reviewing management's control to ensure the reliability and integrity of financial and operating information and the means used to identify, measure, classify, and report such information;
- reviewing the systems established or to be established to ensure compliance with policies, plans, procedures, laws, and regulations that could have a significant impact on operations and reports, and determining whether the Company is in compliance;
- reviewing the means of safeguarding assets and, when appropriate, verifying the existence of assets;
- appraising the economy and efficiency with which resources are employed;
- identifying significant risks to the ability of the Company to meet its business objectives, communicating them to management and ensuring that management has taken appropriate action to guard against those risks; and
- evaluating the effectiveness of controls supporting the operations of the Company and providing recommendations as to how those controls could be improved.

In addition, the Internal Audit Department will audit areas of concern identified by the Risk Management Committee or conduct reviews and investigations on an ad hoc basis. In conducting these audits, the Internal Audit Department has free and full access to all necessary functions, records, properties and personnel.

After completing an audit, the Internal Audit Department furnishes the Company's management team with analysis, appraisals, recommendations, counsel, and information concerning the activities reviewed. Appropriate managers of the Company will be notified of any deficiencies cited by the Internal Audit Department, which will follow up with the implementation of audit recommendations. In addition, the Internal Audit Department will report their findings directly to the Audit Committee on at least a quarterly basis.

The Internal Audit Department has direct access to the Board through the co-chairmen of the Audit Committee. The Internal Audit Department may upon request meet privately with the Audit Committee, without the presence of members of the Company's management or the independent accounting firm. The Internal Audit Department consists of members of the Company's management team.

### **Risk Management Committee**

The Risk Management Committee identifies, analyzes, and assesses enterprise-wide risks, monitors the Company's risk management efforts, and reports on the effectiveness of the Company's enterprise risk management programs. The Risk Management Committee is responsible for developing the Company's risk management strategy; establishing, reviewing, and approving policies and procedures to control risks as well as to prevent fraud; determining risk tolerances for measurement; preparing a risk management implementation plan and assigning responsibilities; and designing and preparing education and awareness programs and its implementation plans. Such risks can include without limitation, legal risks, credit risks, market risks, operational risks, environmental risks, and systemic risks. The Risk Management Committee consists of members of the Company's management team, including three executive officers of the Company.

The Risk Management Committee reports to the Chief Executive Officer periodically, and to the Audit Committee on a quarterly basis. If requested, the chair of the Risk Management Committee will report to the Board on major issues of the enterprise risk management programs.

The Board, through the Audit Committee, has reviewed the effectiveness of the Company's system of internal control and believes that the system of internal controls in place at December 31, 2006 and at the date of this annual report, is effective and adequate.

### **Disclosure Committee**

The Disclosure Committee oversees all information disseminated by the Company, including regulatory filings and submissions made pursuant to the Exchange Act or the Listing Rules, being properly recorded, processed, summarized, and reported to the management of the Company to allow timely decisions regarding the required disclosure. Accordingly, the Disclosure Committee has established a disclosure policy and procedure, which establishes the procedures for the handling and disseminating of price-sensitive information.

With respect to the Company's periodic filings pursuant to the Exchange Act or the Listing Rules, the Disclosure Committee identifies and communicates the extent and nature of all disclosures to be made in such filings, reviews the filings, with a particular focus on "Management's Discussion and Analysis of Financial Conditions and Results of Operations"; reviews and discusses with the Chief Financial Officer whether the Company's filings provide a fair representation of the Company's financial condition, results of operation, and cash flows, assesses the materiality of specific events and developments to the Company; and reviews financial reporting issues that are significant to the Company and other material reporting matters.

The Disclosure Committee consists of members of the Company's management team, including two executive officers of the Company.

### **Compliance Office**

The Compliance Office monitors the Company's compliance under applicable corporate governance laws and regulations. In particular, the Compliance Office monitors and implements the Company's anti-fraud policy and investigates any reported cases of breach; and monitors the Company's compliance with the Code of Business Conduct and Ethics (as described and defined below) and the Insider Trading Policy. The anti-fraud policy sets forth the Company's policy regarding the prevention, detection and management of fraud and fair dealing in matters pertaining to fraud. The Company has established an email address for the Compliance Officers and the Audit Committee, dedicated to respond to any allegations of fraud and breaches of the Code of Business Conduct and Ethics or the Insider Trading Policy of the Company. The Code of Business Conduct and Ethics provides employees with guidelines pertaining to proper behavior in the workplace and appropriate representation of the Company when outside the workplace. The Insider Trading Policy sets forth the policy and procedures governing the dealing in the Company's securities by employees, including the Chief Executive Officer and members of the Company's management, and members of the Board (and their associates).

On at least a quarterly basis, the Compliance Office will report to the Audit Committee regarding any breaches of any of these policies.

The Compliance Office consists of members of the Company's management team, including an executive officer of the Company

### **Shareholder Rights**

The Company's shareholders may put forth proposals at an annual general meeting of the Company's shareholders by written notice of those proposals being submitted by shareholders, addressed to the Company Secretary at the principal executive offices of the Company. In order for a shareholder to put a proposal before the Company's shareholders, such shareholder must (a) be a member of record on both the date of giving of the notice by such shareholder and the record date for the determination of members entitled to vote at such meeting and (b) comply with the notice requirements, in each case, as specified in the Articles. The notice requirements include requirements regarding the timing of delivery of the notice as well as the contents of such notice. The detailed procedures for the notice requirements vary depending on whether the proposal constitutes an ordinary resolution or a special resolution or whether the proposal relates to a nomination for election of a Director. The procedures for shareholders to put forward proposals at an annual general meeting are available upon request of the Company Secretary.

Enquiries may be submitted to the Board by contacting either the Company Secretary at the principal executive offices of the Company or directly by questions at an annual general meeting or an extraordinary general meeting. Questions on the procedures for putting forward proposals at an annual general meeting may also be put to the Company Secretary by the same means.

## Shareholder Communications and Investor Relations

The Company and the Board recognizes the importance of maintaining open and frequent communications with its shareholders. At the 2006 AGM, the President of the Company, as well as the Company's outside auditors, were present to answer questions from the shareholders. Together with this annual report, an annual general meeting circular is distributed to all shareholders within the prescribed time period required by the Listing Rules, notifying the shareholders about the AGM. The circular and the accompanying materials set forth the procedures for demanding and conducting a poll, including applicable notice requirements, and other relevant information relating to the proposed resolutions. Separate resolutions are proposed at these annual general meetings on each substantially separate issue, including the election of individual Directors. The Chairman reveals how many proxies for and against have been filed in respect to each resolution. The results of the poll are published in newspapers with circulation in Hong Kong and on the web sites of the Company and HKSE.

On the first business day after the 2006 AGM, which was held on May 30, 2006 at the Company's headquarters in Shanghai, China, the results of the poll were published in two newspapers with circulation in Hong Kong and on the web sites of the Company and HKSE. During the 2006 AGM, the Company's shareholders:

- received and considered the audited financial statements and the reports of the Directors and Auditors of the Company for the year ended December 31, 2005;
- elected Albert Y. C. Yu as Class I Director to hold office until 2008 AGM and authorized the Board to fix his remuneration;
- re-elected Ta-Lin Hsu and Lip-Bu Tan as Class II Directors and elected Jiang Shang Zhou as Class II Director for terms of three years and authorised the Board to fix their remuneration;
- re-elected Fang Yao as Class III Director to hold office until 2007 AGM and authorised the Board to fix his remuneration;
- re-elected Deloitte Tohmatsu as Auditors of the Company and authorised the Audit Committee to fix their remuneration;
- approved the general mandate to Directors to allot, issue, grant, distribute, and otherwise deal with additional shares in the Company not exceeding 20% of the issued share capital of the Company as of the date of the 2006 AGM;
- approved the general mandate to Directors to repurchase shares in the Company not exceeding 10% of the issued share capital of the Company as of the date of the 2006 AGM;
- approved amendments to the 2004 Stock Option Plan;
- approved amendments to the 2004 EIP;

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- approved amendments to the 2004 ESPP; and
- approved a standard form of stock option plan for subsidiaries of the Company.

A key element of effective communication with shareholders and investors is the timely dissemination of information relating to the Company. In addition to announcing annual and interim reports, the Company announces its quarterly financial results approximately one month after the end of each quarter. In connection with such announcement, the Company holds conference calls which are open and available to the Company's shareholders. During these conference calls, the President and Chief Executive Officer and the Acting Chief Financial Officer report about the latest developments in the Company and answer questions from participants. The members of the Company's Investor Relations Department and senior members of the Company's management also hold regular meetings with equity research analysts and other institutional shareholders and investors.

In addition to the 2006 AGM and the above referenced conference calls, the Company's shareholders were invited to gatherings in Hong Kong to meet members of the management of the Company.

A table setting forth information regarding the beneficial ownership as of December 31, 2006 of the ordinary shares, of each shareholder who is known by the Company to beneficially own more than 5% of the Company's outstanding shares, is contained on page 51.

The market capitalization of the Company as of December 31, 2006 was HK\$18,617,084,027.6 (issued share capital of 18,432,756,463 ordinary shares at the closing market price of HK\$1.01 per ordinary share). The public float as of such date was approximately 84.59%.

The AGM is scheduled to be held at the Company's headquarters at 18 Zhangjiang Road, PuDong New Area, Shanghai, China 201203 on May 23, 2007 at 3:00 p.m. All shareholders are invited to attend.

### Code of Business Conduct and Ethics

The Board has adopted a code of business conduct and ethics (the "Code of Conduct") which provides guidance about doing business with integrity and professionalism. The Code of Conduct addresses issues including among others, fraud, conflicts of interest, corporate opportunities, protection of intellectual property, transactions in the Company's securities, use of the Company's assets, and relationships with customers and third parties. Any violation of the Code of Conduct is reported to the Compliance Office, which will subsequently report such violation to the Audit Committee.

### US Corporate Governance Practices

Companies listed on the New York Stock Exchange must comply with certain corporate governance standards under Section 303A of the New York Stock Exchange Listed Company Manual. However, foreign private issuers such as the Company are permitted to follow home country practices in lieu of the provisions of Section 303A, except that such companies are required to comply with the rules relating to the audit committee. Please refer to the following website at <http://www.smics.com/website/enVersion/IR/corporateGovernance.htm> for a summary of the significant differences between the Company's corporate governance practices and those required of U.S. companies under New York Stock Exchange listing standards.