

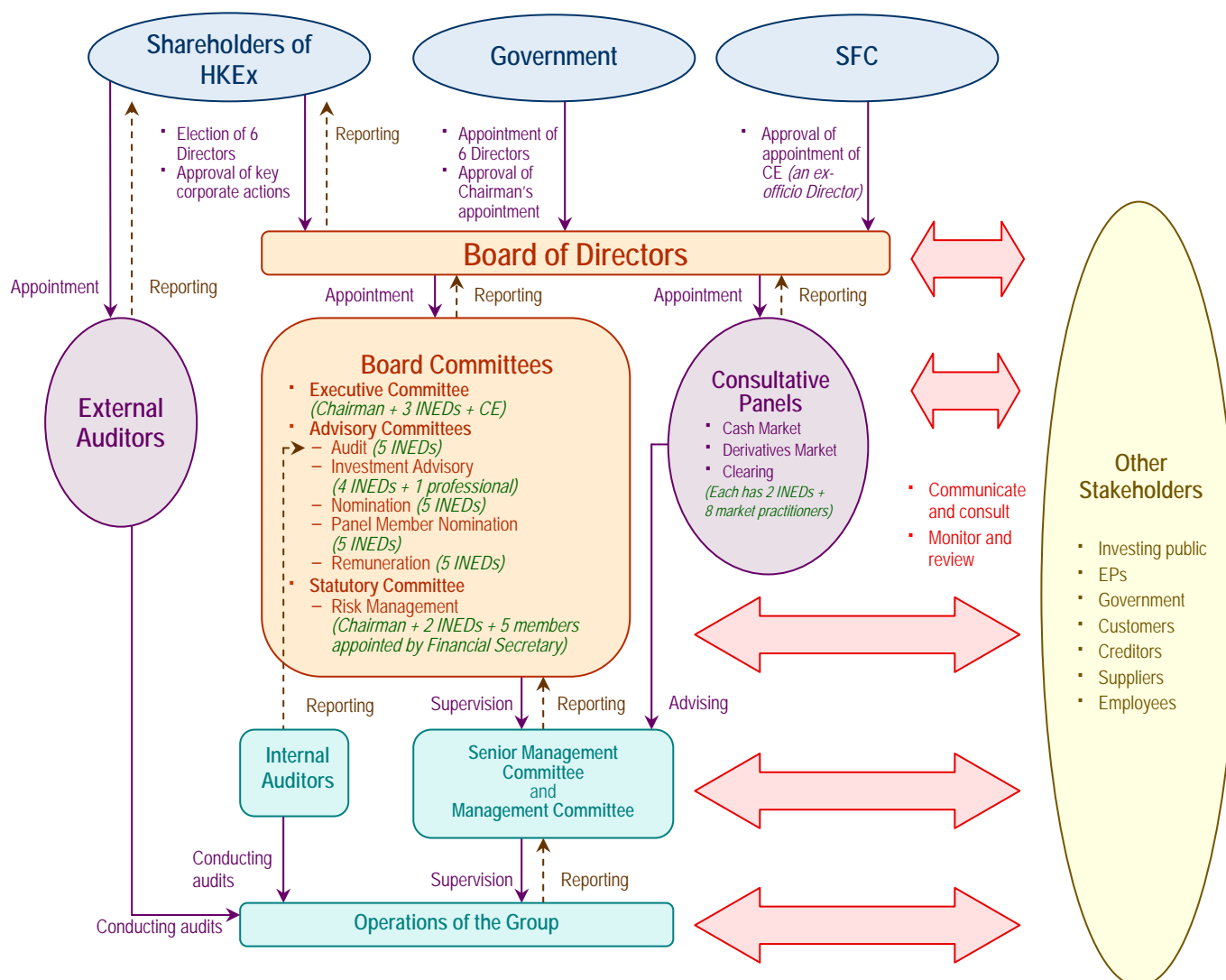
(Financial figures in this report are expressed in Hong Kong Dollar)

**ACCOUNTABILITY, TRANSPARENCY, FAIRNESS and INTEGRITY** are the cornerstones of corporate governance. Good governance practices can help ensure the protection of shareholders' rights, enhance the effectiveness of the board and improve transparency of the company's business and performance. HKE<sub>x</sub> recognises that long-term success and good corporate governance are linked inextricably. At HKE<sub>x</sub>, pursuing the best corporate governance standards has always been a very top priority, not only for its growth, but also for the prosperity of Hong Kong.

HKE<sub>x</sub> has developed a Corporate Governance Section on HKE<sub>x</sub>'s corporate website. Details of our key governance principles, practices and a complete checklist summarising HKE<sub>x</sub>'s achievements in complying with the provisions under the CG Code are available in the Corporate Governance Section on HKE<sub>x</sub>'s corporate website.

## CORPORATE GOVERNANCE STRUCTURE

HKE<sub>x</sub>'s corporate governance structure, as shown below, provides a comprehensive framework to enhance accountability to our Shareholders and other stakeholders, and to ensure that an appropriate management structure is in place. The overall governance structure of HKE<sub>x</sub> is set out below:



Notes: INED(s) represent Independent non-executive Director(s)  
CE represents the Chief Executive of HKE<sub>x</sub>

## **KEY CORPORATE GOVERNANCE PRINCIPLES AND PRACTICES**

### **THE BOARD**

#### **Roles and Responsibilities**

The Board assumes responsibility for leadership and control of HKEx and is collectively responsible for promoting the success of HKEx.

Apart from the usual role as a company director, all Directors are aware of their specific role to act in the interest of the public, having particular regard to the interest of the investing public. They have to ensure that the interest of the public prevails where it conflicts with any other interest of HKEx.

Principal responsibilities of the Board:

- to lay down the Group's objectives, strategies, policies and business plan and to monitor implementation
- to monitor and control the Group's operation and financial performance through the determination of the annual budget in particular the capital expenditure budget
- to set appropriate policies to manage risks in pursuit of the Group's strategic objectives
- to determine the appropriate systems of control, including systems for risk management, financial and operational control as the foundation for ensuring the integrity of the Company's accounting and financial reporting system

The Board has delegated the day-to-day operational responsibilities to the executive management under the instruction/supervision of the Chief Executive and various Board committees.

#### **Board Composition**

The Board structure is governed by Article 90 of the Articles of Association and Section 77 of the SFO. Pursuant to the SFO, the Financial Secretary may appoint any person as a Government Appointed Director but the number of such shall not exceed the number of the Elected Directors, excluding the Chief Executive. As at the date of this report, the Board structure is as follows:



Biographies of the Directors and their respective terms of office will be set out in the Annual Report and are also available on HKEx's corporate website.

All Directors, except the Chief Executive who is an ex-officio member, have a service term of not longer than three years. Such a staggered board mechanism enables the Board to change its membership in an orderly manner over time while maintaining leadership stability and continuity, and allows regular evaluation of the mix of skills and experience of the Board.

## Chairman and Chief Executive

To avoid concentration of power and control, the positions of the Chairman and the Chief Executive are segregated and each plays a distinctive role but complementing each other.

	Chairman	Chief Executive
<b>Responsibilities</b>	<ul style="list-style-type: none"> <li>to provide leadership and ensure effective operation of the Board</li> <li>to ensure that all key and appropriate issues are discussed by the Board in a timely and constructive manner</li> <li>to lead the Board in establishing good corporate governance practices and procedures for the Group</li> </ul>	<ul style="list-style-type: none"> <li>to lead the management in the daily operation of the Group</li> <li>to ensure that the approved strategies are effectively implemented to achieve the Group's strategic objectives</li> <li>to implement the adopted corporate governance practices</li> </ul>
<b>Appointment</b>	<ul style="list-style-type: none"> <li>appointed by the Board</li> <li>the appointment is subject to the approval of the Chief Executive of the Government</li> </ul>	<ul style="list-style-type: none"> <li>selected by the Selection Committee (an ad hoc committee) and approved by the Board</li> <li>the appointment is subject to the approval of the SFC</li> </ul>

## Changes in 2006 and latest development subsequent to the year-end date

### Elected Directors

Dr Christine K W Loh and Mr David M Webb were successfully elected and re-elected respectively by Shareholders at the 2006 AGM for a service term of approximately three years from 26 April 2006 until the conclusion of the annual general meeting to be held in 2009. Mr Dannis J H Lee retired after the conclusion of the 2006 AGM.

### Government Appointed Directors

On 26 April 2006, the Financial Secretary appointed Mr Ronald J Arculli, Mrs Laura M Cha and Mr Moses M C Cheng, to succeed Mr Charles Y K Lee, Mr Tim Freshwater and Dr Lo Ka Shui, who retired after the conclusion of the 2006 AGM, for a service term of approximately two years from 26 April 2006 until the conclusion of the annual general meeting to be held in 2008.

### Chairman

The Board appointed Mr Ronald J Arculli as the Chairman of the Board on 27 April 2006, and the Chief Executive of the Government approved Mr Arculli's appointment on 28 April 2006.

### Chief Executive

The Nomination Committee recommended and the Board resolved on 13 December 2006 to reappoint Mr Paul M Y Chow as the Chief Executive of HKEx for a further two-year term from 1 May 2007 to 30 April 2009 and the SFC approved Mr Chow's re-appointment on 14 December 2006.

### Senior Executive

In September 2006, Mr Patrick K Conroy, Chief Operating Officer, informed the Board of his decision to return to the US and effectively resigned on 9 February 2007. A Selection Committee (an ad hoc committee) comprising six Board members was formed to identify suitable candidates to fill the vacancy. On 14 February 2007, the Board, based on the recommendation of the Selection Committee, approved the appointment of Mr Gerald D Greiner, the former Deputy Chief Operating Officer, as the Chief Operating Officer. The appointment was subsequently approved by the SFC on 16 February 2007.

### Conflict Committee

On 14 February 2007, the Board approved to change the composition of the Conflict Committee, which is responsible for handling conflicts or potential conflicts arising from HKEx's dual roles as the exchange controller and a listed company, to include the Chief

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Executive of HKSCC in addition to the Chief Executive and the Chief Operating Officer of HKE<sub>x</sub>, the chief executive of SEHK and the chief executive of HKFE.

**Independence of Directors**

Pursuant to the Listing Rules, every non-executive Director has confirmed his/her independence with the SFC upon his/her appointment. The Nomination Committee made an annual assessment on the independence of all non-executive Directors and affirmed that each of them satisfied the criteria of independence as set out in the Listing Rules. Each of the Board members has confirmed that they are totally unrelated to each other and with the Senior Management in every aspect including financial, business, or family.

**Nomination of Directors**

The Nomination Committee (comprising five INEDs) is mandated to lead the process of identifying and nominating suitable candidates for the Board's consideration and recommendation to stand for election by Shareholders at the general meeting, or when necessary, nominating candidates to fill the casual vacancies of Directors. The terms of reference of the Nomination Committee are posted on HKE<sub>x</sub>'s corporate website.

In the selection process, the Nomination Committee makes reference to criteria including, inter alia, reputation for integrity, accomplishment and experience in the financial service industry, in particular in the Cash and Derivatives Markets and the clearing business, professional and educational background, and commitment in respect of available time and the relevant area.

Mr John E Strickland and Mr Oscar S H Wong will retire as Directors upon the conclusion of the 2007 AGM. On 8 March 2007, the Nomination Committee nominated and the Board recommended the two retiring Elected Directors to stand for re-election as Directors at the 2007 AGM.

**Appointment and Election / Re-election of Directors**

Other than the rules governing the appointment, re-election and removal of Directors laid down in the Articles of Association, details of the procedures for nominating candidates to stand for election at the 2007 AGM will be set out in the circular to Shareholders to be sent together with the Annual Report.

**Board Process and Effectiveness**

The Board meets regularly, and meeting schedules of each year are normally available to all members before start of the year. The attendance record is shown on page 6 of this report. Other than regular Board meetings, non-executive Directors also meet periodically without the management to discuss matters of particular interests.

Directors, who have declared to have conflict of interests or material interests (i.e. an interest of five per cent or more according to the Articles of Association) in the proposed transactions or issues to be discussed, would not be counted in the quorum of meeting and would abstain from voting on the relevant resolution.

Minutes of the Board/committee meetings with sufficient details of matters and concerns discussed are kept in safe custody by the Company Secretary, and are open for inspection by Directors.

In order to have an effective Board, the management provides appropriate and sufficient information to Directors and committee members in a timely manner to keep them apprised of the latest development of the Group and to enable them to have a thorough consideration of all matters to be discussed at the relevant meetings.

A comprehensive Director's Handbook is issued to every Director, which sets out the guidelines on conduct by making reference to the applicable laws and the Listing Rules, and reminds Directors of their responsibilities to make disclosure of their interests, potential conflict of interests and changes in personal particulars to HKE<sub>x</sub> in a timely manner. The Director's Handbook is updated periodically to reflect the relevant changes in the applicable laws and Listing Rules.

The proceedings of the Board are well defined and follow all the recommended best practices of the CG Code.

### **BOARD COMMITTEES**

The Board is supported by six committees and a statutory committee. Each of them is dedicated to a specific key area of the issues of the Group. The terms of reference of each committee covering its duties, powers and functions are available on HKE<sub>x</sub>'s corporate website. The composition of each committee will be set out in the Annual Report.

To discharge their respective functions, the Board and the committees are provided with sufficient resources, including retention of outside advisers, if necessary, to provide advice on any specific matter at the cost of HKE<sub>x</sub>.

Save for the Executive Committee, the Investment Advisory Committee and the Risk Management Committee, all committees comprise solely INEDs. The chairmen of the respective committees report regularly to the Board, and as appropriate, make recommendations on matters discussed.

The Listing Committees of the Stock Exchange operate independently, under no influence from the Board. The regulatory function of the Stock Exchange is assumed by the Listing Division under the direction and supervision of the Listing Committees. A separate Listing Committee Report for 2006 is prepared and will be despatched together with the Annual Report.

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The following table summarises the attendance of individual Director and committee member in 2006.

Meetings attended/held in 2006									
	Board	Executive Committee	Audit Committee	Investment Advisory Committee	Nomination Committee	Panel Member Nomination Committee	Remuneration Committee	Risk Management Committee (statutory)	2006 AGM
<b>Number of meetings held during the year</b>	<b>14</b>	<b>18</b>	<b>5</b>	<b>4</b>	<b>2</b>	<b>1</b>	<b>5</b>	<b>11</b>	<b>1</b>
<b>Independent non-executive Chairman</b>									
Ronald J Arculli <sup>1</sup>	10/10	10/10			1/1			7/7	
Charles Y K Lee <sup>2</sup>	4/4	8/8			1/1			4/4	1/1
<b>INEDs</b>									
Laura M Cha <sup>3,8</sup>	9/10			3/3		1/1			
Moses M C Cheng <sup>3,4</sup>	9/10		3/3				2/4		
Marvin K T Cheung <sup>5</sup>	6/14		3/5				2/5		1/1
Henry H L Fan <sup>6</sup>	13/14		1/2	3/3				10/11	1/1
Fong Hup <sup>4,7,8</sup>	12/14	9/10	5/5		2/2	1/1	4/4	11/11	1/1
Tim Freshwater <sup>2</sup>	2/4			1/1					1/1
Bill C P Kwok <sup>8</sup>	14/14	18/18				1/1		11/11	1/1
Dannis J H Lee <sup>2,4,8</sup>	4/4	8/8				0/0	1/1		1/1
Vincent K H Lee <sup>4,7,8</sup>	13/14	10/10	5/5		2/2	1/1	4/4		1/1
Lo Ka Shui <sup>2,4</sup>	3/4						1/1		1/1
Christine K W Loh <sup>3,4</sup>	9/10						4/4		
John E Strickland	13/14		5/5						1/1
David M Webb	14/14			4/4	2/2				1/1
Oscar S H Wong <sup>8</sup>	12/14			4/4	2/2	1/1			1/1
<b>Executive Director</b>									
Paul M Y Chow (Chief Executive)	14/14	18/18							1/1
<b>Others</b>									
Patrick K Conroy <sup>7</sup> (Chief Operating Officer)		8/8							
<b>Market Professionals</b>									
Chan Ka-lok								11/11	
He Guangbei <sup>9</sup>								10/11	
Keith K K Lui <sup>10</sup>								5/5	
David T K Sun				3/4					
Martin Wheatley <sup>10</sup>								6/6	
Peter T S Wong <sup>9</sup>								0/0	
Eddie W M Yue								11/11	
<b>Average attendance rate</b>	<b>88%</b>	<b>99%</b>	<b>88%</b>	<b>95%</b>	<b>100%</b>	<b>100%</b>	<b>78%</b>	<b>98%</b>	<b>100%</b>

## Notes:

- Mr Ronald J Arculli, being appointed as a Director on 26 April 2006, succeeded Mr Charles Y K Lee as the Chairman of the Board effective 28 April 2006. Mr Arculli also assumed the chairmanship of the Executive Committee and the Risk Management Committee pursuant to the terms of reference of the Executive Committee and Section 65 of the SFO respectively. Mr Arculli was also appointed as the chairman of the Nomination Committee effective 27 April 2006.
- Mr Charles Y K Lee, Mr Tim Freshwater, Mr Dannis J H Lee and Dr Lo Ka Shui retired as Directors and members of the respective committees upon conclusion of the 2006 AGM.
- Mrs Laura M Cha, Mr Moses M C Cheng and Dr Christine K W Loh were appointed as Directors and members of the respective committees on 26 April 2006 and 27 April 2006 respectively.
- Mr Moses M C Cheng, Mr Fong Hup and Mr Vincent K H Lee and Dr Christine K W Loh were appointed as members of the Remuneration Committee effective 27 April 2006. Dr Lo Ka Shui and Mr Dannis J H Lee retired on 26 April 2006.
- Due to personal health conditions, Dr Marvin K T Cheung has taken special leave of absence from Board meetings and relevant committee meetings.
- Mr Henry H L Fan resigned as a member of the Audit Committee and was appointed as the chairman of the Investment Advisory Committee effective 27 April 2006.
- Mr Fong Hup and Mr Vincent K H Lee were appointed as members of the Executive Committee effective 27 April 2006. With the Board's approval of changing the composition of the Executive Committee to comprise solely Directors, Mr Patrick K Conroy, the then Chief Operating Officer, retired as a member of the Executive Committee on the same date.
- On 12 April 2006, the Panel Member Nomination Committee was established with members comprising Mr Fong Hup, Dr Bill C P Kwok, Mr Dannis J H Lee, Mr Vincent K H Lee and Mr Oscar S H Wong. Mrs Laura M Cha was appointed as a member of the Panel Member Nomination Committee to succeed Mr Dannis J H Lee effective 27 April 2006. No meeting of the Panel Member Nomination Committee was held in 2006 before Mr Dannis J H Lee's retirement.
- Mr Peter T S Wong retired as a member of the Risk Management Committee effective 19 January 2006, and was succeeded by Mr He Guangbei effective 20 January 2006. No meeting of the Risk Management Committee was held in 2006 before Mr Wong's retirement.
- Mr Keith K K Lui succeeded Mr Martin Wheatley as a member of the Risk Management Committee effective 28 August 2006.



**CONSULTATIVE PANELS**

There are three Consultative Panels, namely the **Cash Market Consultative Panel**, **Derivatives Market Consultative Panel** and **Clearing Consultative Panel**. The major responsibilities of the Consultative Panels include the provision of 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, Derivatives Market and clearing business respectively. Each Consultative Panel consists of no more than 10 members appointed by the Board, comprising two Directors and no more than eight members selected from representatives of market participants and industry experts in that particular area. The lists of members of the three Consultative Panels are available on HKE<sub>x</sub>'s corporate website.

Each Consultative Panel normally meets once a year with additional meetings if the work of which demands.

**REMUNERATION OF DIRECTORS AND SENIOR MANAGEMENT**

The Remuneration Committee has prepared a report for inclusion in the Annual Report, which summarises its work performed during 2006, and also sets out details of the Group's new remuneration structure and policy, and the remuneration, including the awarded share benefits, of the Directors and the Senior Management for the year ended 31 December 2006, on an individual, named basis.

**ACCOUNTABILITY AND AUDIT****Reporting**

Directors are responsible for overseeing the preparation of the annual accounts which give a true and fair view of the Group's state of affairs, the results and cash flow for the year. In preparing the accounts for the year ended 31 December 2006, the Directors:

- adopted all HKFRSs which are in conformity to the International Financial Reporting Standards in all material respects;
- selected suitable accounting policies and applied them consistently; and
- made judgements and estimates that are prudent and reasonable, and ensured that the accounts were prepared on the going concern basis.

HKE<sub>x</sub> recognises that high quality corporate reporting is important in reinforcing the trustworthy relationship with the Company's stakeholders, and aims at presenting a balanced, clear and comprehensible assessment of the Company's performance, position and prospects in all corporate communications. The annual, interim, and quarterly results of HKE<sub>x</sub> are published in a timely manner within the limits of three months, two months and 45 days respectively after the end of the relevant periods.

**Internal Control**

The Board acknowledges its responsibility to ensure that a sound and effective internal control system, which serves as an integral part of HKE<sub>x</sub>'s management system, is maintained. The Board is responsible for approving and reviewing internal control policy, while the responsibility of day-to-day management of operational risks and implementation of

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mitigation measures lies with the management. An internal control system is designed to provide reasonable, but not absolute, assurance that material misstatement or loss can be avoided, and to manage and minimise risks of failure in operational systems. Key control procedures include:

- Establishing a structure with defined authority and proper segregation of duties
- Monitoring the strategic plan and performance
- Designing an effective accounting and information system
- Controlling price-sensitive information
- Ensuring swift actions and timely communication with our stakeholders
- Encouraging internal reporting on serious concern about malpractice
- Conducting internal independent review by Internal Audit Department

HKEx places great value upon creating an environment where employees maintain the highest standard of integrity. To this end, HKEx maintains a whistle-blowing policy to facilitate the raising of concerns by employees about internal malpractice directly to the chairman of the Audit Committee, who will review complaints and decide how the investigation should be conducted. Details of the key control procedures and methodology and process for assessing the internal control system are set out in the Corporate Governance Section on HKEx's corporate website.

**Audit Committee**

A separate report prepared by the Audit Committee which summarised its works performed during 2006 will be set out in the Annual Report.

**External Auditors**

The Board acknowledges that independence of the external auditors is essential to the provision of an objective opinion on the truth and fairness of the financial statements. The Audit Committee is mandated to ensure continuing objectivity and independence of the external auditors.

In order to maintain their independence, the engagement of external auditors to perform non-audit services is prohibited except for limited tax-related services or specific approved items. The fees paid to HKEx's external auditors for audit and non-audit services for the year ended 31 December 2006 (and the comparative figure for the year ended 31 December 2005) are as follows:

	<b>2006</b>	<b>2005</b>
	<b>\$</b>	<b>\$</b>
Audit fee	<b>2,323,600</b>	2,000,025
Fees for non-audit services:		
– Taxation services fees	<b>442,002</b>	1,190,193 *
– Executive secondment to the Listing Division	-	300,000
– Training	<b>7,200</b>	1,950

\* restated figure

Following the adoption of the five-year rotation policy of the engagement partner of its external auditors, the first rotation took effect from the audit for 2005. Moreover, it is the Group's policy of not hiring employees of external auditors who are or have been involved in the Group's audit so as to ensure no impairment of the auditors' judgement or independence in respect of an audit. The Group strictly complied with the policy in 2006.



## **RELATIONSHIP WITH SHAREHOLDERS AND STAKEHOLDERS**

As a core principle of corporate governance, HKEx treats Shareholders in a fair and non-preferential manner. Shareholders have the right to participate in and vote at general meetings. Since 2003, it has been a practice of HKEx to conduct poll voting at general meetings so that each share is entitled to one vote. Separate resolutions are proposed for each substantial issue, including election of individual Directors. More information about Shareholder's rights is set out in the Corporate Governance Section on HKEx's corporate website.

To enhance Shareholders' and other stakeholders' understanding of HKEx's business and latest business initiatives, HKEx also makes use of various communication channels, including the publication of quarterly reports, interim reports and annual reports, provision of a website with comprehensive information and service about HKEx, publication of the "Exchange" newsletter on a quarterly basis to provide updates on HKEx's latest developments, and collection of market comments through consultation in respect of any proposed changes.

The Board endeavours to maintain an on-going dialogue with Shareholders. The annual general meeting provides a useful forum to exchange views with the Board. All members of the Board presented at the 2006 AGM and the matters resolved are summarised below.

### **Matters resolved at the 2006 AGM**

- Approval of the audited accounts for the year ended 31 December 2005
- Approval of a final dividend of \$0.64 per share for the year ended 31 December 2005
- Mr David M Webb and Dr Christine K W Loh were re-elected and elected respectively as Directors from five candidates nominated by either the Board or Shareholders
- Re-appointment of PricewaterhouseCoopers as the external auditors of HKEx
- Grant of a general mandate to Directors to repurchase shares in HKEx not exceeding 10 per cent of the total issued share capital
- Approval of a remuneration of \$240,000 per annum to each of the non-executive Directors.

The poll results were published in newspapers and on HKEx's corporate website.

The Financial Calendar with important dates in 2006 will be set out in the Annual Report.

A Corporate Social Responsibility Report summarising our approach and work done during 2006 will be set out in the Annual Report.

HKEx's effort on building and maintaining close relationship with its stakeholders was publicly recognised that in January 2007, HKEx received an honourable mention at the IR Magazine Hong Kong Awards 2006 based on the Investor Perception Study (Asia 2006/2007) conducted for the purpose of identifying the leading companies in the field of investor relations.

## **CONFLICT MANAGEMENT**

A number of measures have been undertaken to remove or reduce any potential conflict between HKEx's roles as the exchange controller and a listed commercial entity, including, inter alia, the entering into a Memorandum of Understanding with the SFC, the addition of a new chapter, Chapter 38, to the Main Board Listing Rules, and the establishment of a Conflict Committee. More information about conflict management is set out in the Corporate Governance Section on HKEx's corporate website.

## MAJOR INITIATIVES IMPLEMENTED IN 2006 IN RESPECT OF HKEX'S DUAL RESPONSIBILITIES

<b>PUBLIC RESPONSIBILITY</b> (as the front-line regulator of listed companies)	<b>CORPORATE RESPONSIBILITY</b> (as a listed company)
<p><b>Raising corporate governance profile of Hong Kong</b></p> <p>Initiatives (<i>references in the Annual Report</i>)</p> <ul style="list-style-type: none"> <li>▪ <b>Improving issuer information dissemination regime</b> by launching the “no-paid ad” project with the aim of centralising the dissemination of listed issuers’ corporate information via the HKEx website (<i>Business Review</i>)</li> <li>▪ <b>Improving listing decision-making</b> by introducing a new listing decision-making structure through a change in the composition of the Listing Nominating Committee and an expansion of the membership of the Listing Committees (<i>Business Review</i>)</li> <li>▪ <b>Raising the overall standards of sponsors and compliance advisers</b> by amending the Listing Rules to coincide with the SFC’s revised licensing and monitoring regimes for sponsors and compliance advisers (<i>Business Review</i>)</li> <li>▪ <b>Fostering corporate governance culture</b> by organising regular corporate governance trainings, seminars and programmes in Hong Kong and the Mainland (<i>Business Review</i>)</li> <li>▪ <b>Facilitating communication with various stakeholders</b> by introducing various improvement measures including, introduction of a new web-based Derivative Warrant Resource Centre, provision of an online monthly market highlights and statistics and the simplified Chinese versions of the Listing Rules on the HKEx website, etc (<i>Business Review and Corporate Social Responsibility Report</i>)</li> <li>▪ <b>Further development of GEM</b> by initiating an overall review of GEM (<i>Business Review</i>)</li> <li>▪ <b>Enhancing investor protection</b> by introducing new features to Stock Segregated Account and Investor Participant Account with electronic access and alert service of account movement (<i>Business Review</i>)</li> <li>▪ <b>Enhancing quality of financial reporting</b> by providing operational and funding support to the establishment of the Financial Reporting Council (<i>Corporate Social Responsibility Report</i>)</li> </ul>	<p><b>Adopting the best corporate governance practices</b></p> <p>Initiatives (<i>references in the Annual Report</i>)</p> <ul style="list-style-type: none"> <li>▪ <b>Improving transparency of the Company and communication with our stakeholders</b> by launching a new “Corporate Governance Section” on HKEx’s corporate website to provide more detailed and the latest information about the corporate governance framework and practices of the Company (<i>Corporate Social Responsibility Report</i>)</li> <li>▪ <b>Ensuring swift actions and timely communication with our stakeholders</b> by refining the Escalation and Incident Reporting Policy (<i>Corporate Social Responsibility Report</i>)</li> <li>▪ <b>Facilitating the Group’s strategic objectives</b> by engaging an independent global consulting company to conduct a thorough review on the remuneration structure with the objective of introducing refinements to the remuneration policy and structure (<i>Remuneration Committee Report</i>)</li> <li>▪ <b>Improving the mechanism for identifying and selecting nominees for the three Consultative Panels</b> by establishing the Panel Member Nomination Committee (<i>Corporate Social Responsibility Report</i>)</li> </ul>

## COMPLIANCE WITH THE CG CODE

The Articles of Association were amended in 2005 to specify that all Directors (Government Appointed Directors and Elected Directors), other than the Chief Executive who is an ex-officio Director and whose term of service on the Board is subject to the term of his employment contract with HKEx, are appointed for a term of not more than three years, but shall be eligible for re-appointment upon retirement.

As governed by Section 77 of the SFO, the Government Appointed Directors are not subject to election or re-election by Shareholders. As governed by the Articles of Association, the Chief Executive in his capacity as a Director is not subject to election or re-election by Shareholders. Saved as disclosed in this paragraph, HKEx fully complied with all the provisions set out in the CG Code contained in Appendix 14 to the Main Board Listing Rules, and where appropriate, adopted the recommended best practices throughout the review period.

## CORPORATE GOVERNANCE SCORES AND RATINGS

HKEx has been rated highly or granted awards in recognition of its achievement in corporate governance from a number of local and overseas professional institutions. The governance ratings and awards granted in 2006 to HKEx are as follows:

Organisation	Rating / Awards / Comments
<b>GovernanceMetrics International Inc</b>	<b>Corporate Governance Rating</b> as of December 2006 - Global rating - 7.5 (2005: 6.5); Home market rating: 10.0 (2005: 9.5) out of the full score of 10.0
<b>FTSE4Good Policy Committee</b>	<b>FTSE4Good Index Series</b> HKEx continued to be a constituent of the FTSE4Good Global Index
<b>Hong Kong Institute of Certified Public Accountants</b>	<b>2006 Best Corporate Governance Disclosure Awards</b> (Nov 2006) <i>Non-Hang Seng Index Category</i> 2005 Annual Report - Platinum Award
<b>The Hong Kong Management Association</b>	<b>2006 HKMA Best Annual Reports Awards</b> (Nov 2006) <i>General Category</i> 2005 Annual Report - Gold Award; Citation for Achievement in Corporate Governance Disclosure - Winner
<b>Hong Kong Institute of Directors and City University of Hong Kong</b>	<b>Survey on Corporate Governance of Hong Kong Listed Companies</b> (Nov 2006) Among top 10 locally listed companies with best corporate governance practices

## INTERESTS OF DIRECTORS AND SENIOR MANAGEMENT

### Directors' and Chief Executive's Interests in the Shares and Underlying Shares of HKEx

As at 31 December 2006, the Directors, the Chief Executive of HKEx 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, or as otherwise notified to HKEx and the Stock Exchange pursuant to the Model Code:

Name of Director	Number of shares/underlying shares held				Total	% of the issued share capital
	Personal interests	Family interests	Corporate interests	Other interests		
Paul M Y Chow	3,280,000 (note 1)	—	—	—	3,280,000	0.31
Vincent K H Lee	—	—	1,927,500 (note 2)	—	1,927,500	0.18
John E Strickland	18,000 (note 3)	—	—	—	18,000	0.00
David M Webb	2 (note 4)	2 (note 5)	6 (note 6)	—	10	0.00
Notes:						
1. Mr Chow, who is also the Chief Executive of HKEx, has beneficial interests in 820,000 shares, and 2,460,000 underlying shares in respect of the share option granted to him pursuant to the Post-Listing Scheme on 2 May 2003. The said option is exercisable between 2 May 2005 and 1 May 2013 at an exercise price of \$8.28 per share. The number of shares issuable under the option granted and the exercise price had been adjusted in accordance with the resolution passed by Shareholders at the annual general meeting held in 2004.						
2. Mr Lee has interest in 1,927,500 underlying shares through listed equity derivatives (physically settled options) held by Pacific Trust Company Limited, in which Mr Lee holds 33.33 per cent beneficial interests.						
3. The shares were held by Mr Strickland as beneficial owner.						
4. The shares were held by Mr Webb as beneficial owner.						
5. The shares were owned by the spouse of Mr Webb.						
6. The shares were owned by Fundamental Consultants Limited, Member One Limited and Member Two Limited which are under the control of Mr Webb.						

Save for those disclosed above, none of the Director or the Chief Executive of HKEx or their respective associates had any interest and short position in the shares, underlying shares and debentures of HKEx or any of its associated corporations (within the meaning of Part XV of the SFO) as recorded in the register required to be kept pursuant to Section 352 of the SFO or as otherwise notified to HKEx and the Stock Exchange pursuant to the Model Code.

Save for the disclosed, none of the Directors or the Chief Executive of HKE<sub>x</sub> (including their spouses and children under the age of 18) had, during the year ended 31 December 2006, any interest in, or been granted any right to subscribe for the securities of HKE<sub>x</sub> and its associated corporations within the meaning of the SFO, or had exercised any such rights.

All Directors are obliged to observe the requirements stipulated in the Model Code as set out in Appendix 10 to the Main Board Listing Rules. Each of the Directors confirmed, following specific enquiry by HKE<sub>x</sub>, that he/she fully complied with the Model Code throughout 2006.

### Senior Management's Interests and Short Positions

As at 31 December 2006, the Senior Management had the following interests in the shares and underlying shares of HKE<sub>x</sub>:

Name of employee	Number of shares held	Number of shares issuable under share options granted	Number of awarded shares (Note)
Patrick K Conroy	–	1,476,000	–
Gerald D Greiner	10,000	350,000	41,677
Lawrence K M Fok	700,000	278,000	25,253
Mary M L Kao	654,000	220,000	29,461
Henry M W Law	–	180,000	23,507
Stewart S C Shing	–	822,000	–
Archie T C Tsim	–	164,000	33,567
Richard G Williams	–	547,000	–
Alfred K K Wong	190,000	200,000	32,952

*Note: Included further shares acquired through reinvesting dividend received.*

## CONTINUING CONNECTED TRANSACTIONS

During the year ended 31 December 2006, the Group had the following continuing connected transactions, details of which are set out below:

(A) For the year ended 31 December 2006, transactions between the following connected persons and HKE<sub>x</sub> or its subsidiaries arising from or in connection with the use of (i) the facilities provided by HKE<sub>x</sub> or its subsidiaries for the trading, clearing and/or settlement of securities and futures products and transactions; and (ii) all services offered by HKE<sub>x</sub> or its subsidiaries which are ancillary, incidental or otherwise related to the foregoing:

- (1) Mr Ronald J Arculli, the Chairman, was interested in the transactions entered into by Bokhary Securities Limited (“BSL”), an EP and a Clearing Participant, in which his sister has 50 per cent interests.
- (2) Dr Bill C P Kwok, an INED, was interested in the transactions entered into by Wocom Securities Limited (“WSL”) and Wocom Limited, EPs and Clearing Participants, which are associates of Dr Kwok by virtue of the Listing Rules.
- (3) Mr Dannis J H Lee, an ex-INED who retired on 26 April 2006, was interested in the transactions entered into by DL Brokerage Limited (“DL Brokerage”), an EP and a Clearing Participant, which is beneficially wholly-owned by Mr Lee.
- (4) Mr Vincent K H Lee, an INED, was interested in the transactions entered into by Tung Tai Securities Company Limited (“TTS”) and Tung Tai Futures Limited, EPs and Clearing Participants, which are associates of Mr Lee by virtue of the Listing Rules.

- (5) Mr Leong Ka Chai, an ex-INED who retired on 12 April 2005, was interested in the transactions entered into by Roctec Securities Company Limited (“RSCL”) and Roctec Futures Trading Company Limited, EPs and Clearing Participants, which are associates of Mr Leong by virtue of the Listing Rules.

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

- (B) For the year ended 31 December 2006, transactions between the following connected persons and HKE<sub>x</sub> or its subsidiaries arising from or in connection with the listing of securities on the Stock Exchange and all services offered by the Group which are ancillary, incidental or otherwise related to the foregoing:

- (1) Dr Bill C P Kwok, an INED, was interested in the transactions entered into by his associate, Wing On Company International Limited, a listed company on the Stock Exchange.
- (2) Mrs Laura M Cha, an INED, was interested in the transactions entered into by her associate, HKR International Limited, a listed company on the Stock Exchange.
- (3) Dr Lo Ka Shui, an ex-INED who retired on 26 April 2006, was interested in the transactions entered into by his associates Great Eagle Holdings Limited (“Great Eagle”) and Champion Real Estate Investment Trust (“Champion REIT”), the respective shares and units are listed on the Stock Exchange.

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

- (C) For the year ended 31 December 2006, transactions between the following connected persons and HKE<sub>x</sub> or its subsidiaries arising from or in connection with the HKSCC arrangement on behalf of Clearing Participants of Buy-in Transactions:

- (1) Mr Ronald J Arculli, the Chairman, was interested in the Buy-in Transactions entered into by BSL, in which his sister has 50 per cent interests. For the period from 26 April 2006 (the date of appointment of Mr Arculli as a Director) to 31 December 2006, the total consideration of such transactions was \$348,891.46, comprising an aggregate of buy-in cost of \$347,980.76 and related brokerage fee of \$910.70 earned by BSL.
- (2) Dr Bill C P Kwok, an INED, was interested in the Buy-in Transactions entered into by WSL which is an associate of Dr Kwok by virtue of the Listing Rules. For the year ended 31 December 2006, the total consideration of such transactions was \$12,141,900.98, comprising an aggregate of buy-in cost of \$12,126,472.15 and related brokerage fee of \$15,428.83 earned by WSL.
- (3) Mr Dannis J H Lee, an ex-INED who was retired on 26 April 2006, was interested in the Buy-in Transactions entered into by DL Brokerage beneficially wholly-owned by Mr Lee. For the year ended 31 December 2006, the total consideration of such transactions was \$5,313,077.83, comprising an aggregate of buy-in cost of \$5,299,583.00 and related brokerage fee of \$13,494.83 earned by DL Brokerage.
- (4) Mr Vincent K H Lee, an INED, was interested in the Buy-in Transactions entered into by TTS which is an associate of Mr Lee by virtue of the Listing Rules. For the year

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ended 31 December 2006, the total consideration of such transactions was \$8,048,666.42, comprising an aggregate of buy-in cost of \$8,037,871.41 and related brokerage fee of \$10,795.01 earned by TTS.

- (5) Mr Leong Ka Chai, an ex-INED who retired on 12 April 2005, was interested in the Buy-in Transactions entered into by RSCL which is an associate of Mr Leong by virtue of the Listing Rules. For the period from 1 January 2006 to 12 April 2006 (the last date on which he was considered as a connected person under the Listing Rules), the total consideration of such transactions was \$343,564.30, comprising an aggregate of buy-in cost of \$342,632.30 and related brokerage fee of \$932.00 earned by RSCL.

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

**(D) Lease of premises between a connected person and HKFE**

On 16 February 2005, HKFE as the tenant entered the tenancy (“Tenancy”) with Shine Hill Development Limited (“Shine Hill”), the landlord, in respect of the premises of Suites 501-3 and storeroom on 5th Floor and Suites 1101 & 1109-11 on 11th Floor, ICBC Tower, 3 Garden Road, Central, Hong Kong (“Premises”) for a term of two years commencing 1 January 2005 at a monthly rental of \$310,440, exclusive of management charges, rates and operating expenses. Shine Hill is owned and controlled by Champion REIT in which Great Eagle owns 49.2 per cent interests. Prior to 24 May 2006 (public listing of Champion REIT following the spin-off exercise of Great Eagle), Shine Hill was a subsidiary of Great Eagle. Dr Lo Ka Shui (“Dr Lo”), an ex-INED who retired on 26 April 2006, is a controlling shareholder of Great Eagle. The Tenancy constituted a continuing connected transaction of HKEx, and details of which were announced on 14 December 2004. For the year ended 31 December 2006, the total rent, management charges and operating expenses paid in respect of the Tenancy was \$5,101,013.68.

As part of the reorganisation under the spin-off of Champion REIT by Great Eagle, Shine Hill entered into a sale and purchase agreement dated 26 April 2006 with CP (SH) Limited (“CP(SH)”) pursuant to which Shine Hill agreed to sell and CP(SH) agreed to purchase, among others, ICBC Tower, 3 Garden Road, Central, Hong Kong and CP(SH) has the right to enter into further tenancies and licences in respect of the building.

As the Tenancy came to expire on 31 December 2006, HKFE entered into an agreement with CP(SH) on 13 December 2006 to renew the Tenancy (“New Tenancy”) for a further two-year term commencing 1 January 2007 at a monthly rental of HK\$745,056, exclusive of management charges, rates and operating expenses. Both CP(SH) and Shine Hill are owned and controlled by Champion REIT in which Great Eagle owns 49.2 per cent interests, they are connected persons of HKEx by virtue of them being associates of Dr Lo and accordingly, the New Tenancy constituted a continuing connected transaction of HKEx under the Listing Rules. Details of the New Tenancy were announced on 13 December 2006.

The Premises have been occupied and used by HKFE as offices since 1992. There are practical needs for HKFE to retain its existing offices in ICBC Tower as the primary data centre of HKFE and the office accommodating its system support team.

In respect of the above continuing connected transactions, two INEDs who had not entered into any connected transactions with the Group, reviewed the transactions and confirmed that the continuing connected transactions entered into by the Group were in compliance with the

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conditions of the waiver granted by the SFC and/or with the requirements of the Listing Rules in such a way that:

- (a) the continuing connected transactions disclosed above were entered into in the ordinary and usual course of business of the Group and conducted on an arm's length basis on normal commercial terms or on terms no more favourable than terms available to independent third parties;
- (b) in respect of transactions other than Buy-in Transactions, the Tenancy and the New Tenancy, 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 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 acting for and on behalf of HKSCC and at the agreed commission rate payable by HKSCC in respect of all such Buy-in Transactions; and
- (d) in respect of the Tenancy and the New Tenancy, they were entered into in accordance with the terms as contained therein, and were on normal commercial terms.

Based on the opinion of the two INEDs, the Board considered and decided that the continuing connected transactions were fair and reasonable and in the interests of Shareholders as a whole.

The external auditors of HKEx also confirmed that:

- (a) the continuing connected transactions disclosed above had been approved by the Board;
- (b) the continuing connected transactions, other than the Tenancy and the New Tenancy, were in accordance with the 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 transactions in full, were 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; and
- (c) the Tenancy had been entered into in accordance with the relevant agreement governing the transaction, and the annual rental had not exceeded the cap disclosed in the announcement of HKEx made on 14 December 2004.

**RELATED PARTY TRANSACTION**

The Group also entered into certain transactions with parties regarded as "related parties" under the applicable accounting standards. Details of these transactions are set out in note 45 to the consolidated accounts.

On behalf of the Board  
**Mau Kam Shing, Joseph**  
*Company Secretary*

Hong Kong, 8 March 2007



**GLOSSARY**

2006 AGM	Annual general meeting held on 26 April 2006
2007 AGM	Annual general meeting to be held on 26 April 2007
Articles of Association	Articles of Association of HKE <sub>x</sub>
Board	Board of HKE <sub>x</sub>
CG Code	Code on Corporate Governance Practices as set out in the Listing Rules
Director(s)	Director(s) of HKE <sub>x</sub>
Elected Director(s)	Director(s) elected by the Shareholders at general meetings
EP(s)	Exchange Participant(s)
Financial Secretary	Financial Secretary of Hong Kong
GEM	The Growth Enterprise Market
GEM Listing Rules	Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited
Government	The Government of the Hong Kong Special Administrative Region of People's Republic of China
Government Appointed Director(s)	Director(s) appointed by the Financial Secretary of Hong Kong pursuant to section 77 of the SFO
Group	HKE <sub>x</sub> and its subsidiaries
HKE <sub>x</sub> or the Company	Hong Kong Exchanges and Clearing Limited
HKFRS(s)	Hong Kong Financial Reporting Standards(s)
HKFE or the Futures Exchange	Hong Kong Futures Exchange Limited
HKSCC	Hong Kong Securities Clearing Company Limited
INED(s)	Independent Non-executive Director(s) of HKE <sub>x</sub>
Listing Committees	Listing Committee and the GEM Listing Committee
Listing Rules	Main Board Listing Rules and GEM Listing Rules
Main Board Listing Rules	Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited
Model Code	Model Code for Securities Transactions by Directors of Listed Issuers
Post-Listing Scheme	Post-Listing Share Option Scheme approved by Shareholders on 31 May 2000 which was subsequently amended by Shareholders on 17 April 2002
SEHK or the Stock Exchange or the Exchange	The Stock Exchange of Hong Kong Limited
Senior Management	Senior executives of HKE <sub>x</sub> as referred to in the section "Senior Management" as set out in the Annual Report
SFC	Securities and Futures Commission
SFO	Securities and Futures Ordinance
Shareholders	Shareholders of HKE <sub>x</sub>