

RISK COMMITTEE REPORT

Risk Statement

Effective risk management is important to HKEX Group's achievement of its strategic goals. HKEX Group manages risk across multiple risk domains, including but not limited to financial, business and strategic, operational (including IT and cyber security) and legal and regulatory risks. Business operations are managed in line with Risk Appetite tolerances set by HKEX Board.

We seek to ensure we achieve our strategic goal of being the global exchange and clearing provider of choice, for investors and participants, seeking exposure in the Hong Kong, Mainland China and international markets. This includes to maintain stakeholder trust and support the integrity of the financial system. We recognise the role of HKEX Group as a market infrastructure operator and manager of systemic risk, and that our long-term sustainability is dependent on pursuing our strategic goals while simultaneously managing our risks, having sufficient capital and liquidity, ensuring continuity of operations, and protecting our reputation.

We aim to maintain sufficient capital and liquidity to meet our regulatory obligations, which require us to maintain financial resources to cover our potential losses and liquidity needs in a range of stress scenarios taking into account extreme but plausible market conditions. As a business, we also aim to maintain sufficient capital over and above that required to meet our regulatory obligations in order to fund our strategic development objectives while ensuring the appropriate balance between risk and shareholder returns. We apply risk management measures to strategic initiatives that are designed to limit our exposure to potential losses to the Group. We also seek to maintain liquid financial resources to meet unforeseen cash outflows. The Group strives to maintain stakeholder trust by avoiding business practices that could lead to reputational damage or harm to the Group. The Group, therefore, seeks to operate within all relevant rules and regulations and to avoid disruptions to our business operations affecting our stakeholders.

The Risk Committee

The Risk Committee is delegated by the Board to oversee the Group's overall Risk Management Framework and to advise the Board on the Group's risk-related matters. The Committee is also responsible for endorsing the Group's risk policies for Board approval and assessing the effectiveness of the Group's risk management and internal control systems. The Committee's terms of reference are available on the HKEX Group website [ORG](#). The Committee comprises five INEDs whose names and biographies are set out in the Board and Committees section of this Annual Report. The Committee held four quarterly meetings in 2016. Members' attendance records are disclosed in the Corporate Governance Report contained in this Annual Report.

Summary of Work in 2016/2017

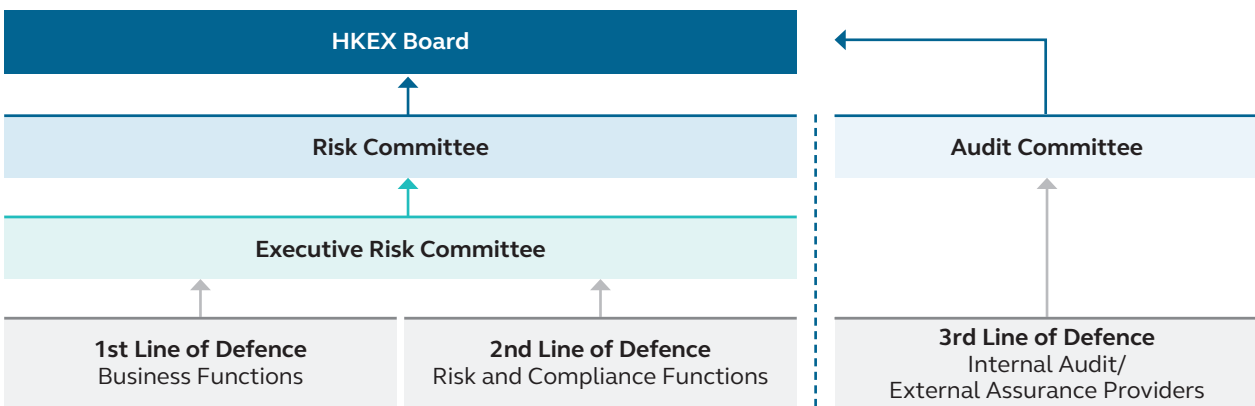
During the period, the Risk Committee oversaw key risk management activities including:

- Improvements to the Group Risk Management Policy and Group Enterprise Risk Management function;
- Implementation of Group Risk Appetite statements and risk reporting metrics;
- Implementation of a Group wide centralised risk reporting tool;
- Received quarterly Group risk reporting on liquidity, capital adequacy and solvency levels of the Group's clearing houses and the results of the Group's Enterprise Risk Management process;
- Enhancements to cash collateral and portfolio margining practices;
- Enhancements to the risk governance model including consolidation of HKEX Group Risk Management fora into a single Executive Risk Committee; and
- Endorsed management confirmation on the effectiveness of the Group's risk management and internal control systems.

Operating an appropriate and effective risk management and internal control system is essential to achieving HKEX Group strategic objectives and maintaining service delivery targets. The Risk Committee is responsible for overseeing the Group’s risk management approach, policy and framework. HKEX Group operates a consistent methodology using the Group Risk Management Framework for the identification, assessment, reporting and management of risks. Risk identification and management is the responsibility of HKEX Group Management. HKEX Group operates a “Three Lines of Defence” risk governance model to effectively identify and manage risk.

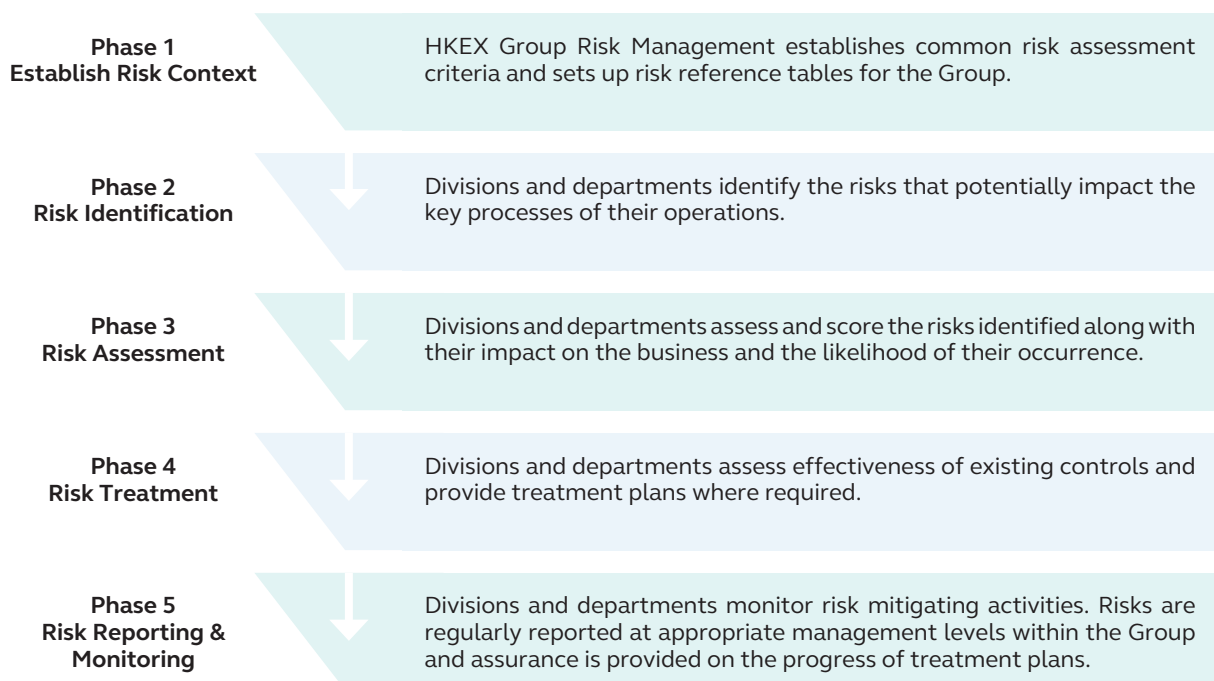
Risk Governance

The Group’s risk governance structure is based on a “Three Lines of Defence” model, with oversight and directions from the Board, Risk Committee, and Group Management through the Executive Risk Committee.



Group Risk Management

The Group Risk Management Framework, approved by the Risk Committee, mandates a consistent and effective approach applied across the Group to manage the risks associated with its business and operations. The framework is based on the International Standard ISO (International Organisation for Standardisation) 31000:2009 Risk Management – Principles and Guidelines. The following diagram illustrates the key processes adopted under the Group Risk Management Framework.



Principal Risks

The Group faces a number of principal risks and uncertainties that if not properly managed could create an exposure for the Group. Thorough risk assessment and mitigation help ensure these risks are well managed and governed effectively. The Group focuses on addressing the following principal risks.

Principal Risks	Description	Key Mitigations
Business and Strategic Risk	The risk of material adverse changes to the Group's business performance, development prospects and/or ability to deliver its strategy, caused by changes in the business, economic, competitive, regulatory or political environment in which the Group operates.	<ul style="list-style-type: none"> Proactive monitoring of global exchange industry trends, competitors and innovations; Proactive monitoring of and preparation for global and local changes in regulations affecting the Group; and Responsive project controls to allow strategic flexibility and dedicated strategy resources.
Credit Risk	The risk that a counterparty will not settle an obligation in full value, either when due or at any time thereafter.	<ul style="list-style-type: none"> Default management and recovery procedures in place; Established credit risk management function; Stress tested collateral and margin deposits; and Clearing market risk managed through collateral management and margin practices.
Market Risk	The risk resulting from adverse movements in market rates or prices such as foreign exchange rates, interest rates or equity prices impacting the Group's investment portfolio (Investment Market Risk).	<ul style="list-style-type: none"> Investment capital at risk limited by investment policies, restrictions and guidelines; and Exposure to foreign exchange risk through subsidiaries limited due to HKD/USD peg
Liquidity Risk	The risk of being unable to settle obligations as they fall due whether relating to HKEX's cash flow requirements and/or regulatory requirements for clearing coverage confidence levels under extreme but plausible market conditions.	<ul style="list-style-type: none"> Investment policy, restrictions and guidelines in place covering Corporate Funds, Margin Funds and Clearing House Funds; and Clearing liquidity risk management requirements met through established stress testing practices.
Operational Risk	The risk of material adverse changes to the Group's business due to inadequate or failed internal processes, IT systems or external events.	<ul style="list-style-type: none"> Environment, Social and Governance programmes; Low latency, highly resilient IT service design; Defence-in-depth cyber security controls; Comprehensive cyber testing programme; and Service delivery controls covering people, process and technology.
Legal and Compliance Risk	The risk of loss resulting from breach of or non-compliance with applicable laws, regulations or contractual obligations.	<ul style="list-style-type: none"> Internal and where appropriate external legal advice sought and compliance reviews conducted on business activities and new initiatives; Legal review of contracts; and Compliance review monitoring program.
Listing Risk	The risk of reputational damage resulting from a failure on the part of SEHK to comply fully with its statutory obligations or the provisions of, or obligations under, the January 2003 MOU.	<ul style="list-style-type: none"> Existing checks and balances under three-tiered regulatory structure (including the Listing Committee); Listing Division Market Contingency Plan to deal with potential business disruption events; Monitoring of unusual movements in price or trading volume of issuers' listed securities; and Physical segregation from other parts of HKEX under Chinese Wall to avoid leakage of inside information.

CHOW Chung Kong

Chairman of the Risk Committee

Hong Kong, 16 February 2017