

**KWONG Ki Chi**  
GBS



**Director, Chief Executive**  
**Hong Kong Exchanges and Clearing Limited**



## REVIEW OF OPERATIONS

(Expressed in Hong Kong dollars)

### Financial Review

Hong Kong emerged from two years of economic recession, and this is reflected in the financial results reported by the Chairman.

At the end of the period under review, the balance of retained earnings was \$2,892 million and the Development Reserve amounted to \$136 million. The Reserve will continue to support infrastructural development and the introduction of new markets, products and services.

### Integration

HKEx became the holding company of the stock and futures exchanges and the associated clearing houses on 6 March. It has established business units in the four functions that drive the growth of HKEx — equity, or cash market products, derivative products, electronic business and information services, and clearing and settlement. During the current year, an information technology (IT) and systems unit will be established to provide better management of the Company's IT needs.

Following the integration, HKEx has established cash market, derivatives market and clearing consultative panels. The panels act as sounding boards for policy formulation, strategic initiatives and major investments in product, trading and clearing development.

The merger integration programme included a detailed analysis of staffing levels and functions in order to avoid duplication following the merger. By the end of June this year, total staff will have reduced from 1,052 at the time of the merger to 860.

### Operational Review

By almost every measure, the year under review was a record one.

### Cash – Primary Market

Capital formation was a record \$467 billion, compared with the previous record of \$248 billion established in 1997.

A total of 90 companies made initial public offerings (IPO), comprising 43 on the Main Board which raised \$117 billion and 47 on the Growth Enterprise Market (GEM) which raised \$15 billion. Post issue fund raising also reached a record level of \$335 billion.

Capital formation by H shares and red chips through IPO and post issue fund raising was a record \$346 billion, representing 74 per cent of total funds raised during the year.

The 12-month period under review marked the first full year's operation by GEM, in which it established itself as one of the most successful markets of its type in Asia in terms of funds raised.

GEM serves predominantly small and medium sized companies. Only 11 of the 47 GEM listed companies raised more than \$300 million each in their IPO. GEM's liquidity is comparable with that of other second markets.

The United States Securities Exchange Commission recognised GEM as a designated offshore securities market in August. As a result, all GEM-listed shares may generally be resold both in and outside the US without restriction, to US and non-US persons.

During the year, we saw the listing of MTR Corporation Limited, the first HKSAR government privatisation, which received a favourable response from the market.

#### **Listing Policies and Rules**

We are working with the Securities and Futures Commission (SFC) to complete amendments to the GEM Listing Rules, following a market consultation. We expect to publish the amendments during the second quarter of 2001.

Together with the SFC, HKEx is conducting a review of the Main Board Listing Rules. It is intended that the Main Board and GEM Listing Rules be combined into a single set of rules with market specific chapters for the two markets. This will make it easier for market practitioners to understand and apply the rules while maintaining the Main Board and GEM as separate markets.

As a contribution to environmental protection, we are working on various initiatives to reduce the volume of printed documents generated by issuers as a result of compliance with the Listing Rules. For example, the Listing Rules have been amended to allow the single language distribution of listing documents of new listing applicants.

#### **Cash – Secondary Market**

Market turnover for the year was \$3,132 billion, the second highest on record after \$3,789 billion in 1997. And the Hang Seng Index established a new record on 28 March when it closed at 18302.

According to a recent survey, the number of individual investors in Hong Kong has passed the one-million mark. This is believed to be attributable to the success and popularity of the Tracker Fund of Hong Kong and the MTR Corporation issues.

We launched AMS/3, the third generation of our Automatic Order Matching and Execution System, in October. It has a wide range of new functionalities and higher trading capacity. AMS/3 is Internet enabled and some Exchange Participants are already providing Internet access to their clients through their Broker Supplied Systems.

HKEx also introduced Order Routing System (ORS) as part of the AMS/3 project in February 2001. ORS enables investors to input orders electronically which will be automatically routed to Exchange Participants for approval and submission to the market. It allows various types of electronic access, including the Internet, mobile phone and other electronic devices.

AMS/3 also allows multi-market operations, which give us more flexibility in introducing new products and services.



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In the middle of this year, HKEx plans to introduce regional Exchange Traded Funds (ETF) to its market. We also plan to start trading more locally developed ETF. Like the Tracker Fund of Hong Kong, ETF are open-ended mutual funds or unit trusts traded on the Stock Exchange - but without front-end commission or redemption fees. Only normal brokerage fees, Transaction Levy and Stamp Duty apply to transactions in listed ETF.

ETF offer investment opportunities in local or foreign countries or market sectors by investing in index funds based on those markets or sectors. They also offer instant diversification as ETF invest in a portfolio of securities.

We are investigating the feasibility of offering central back-office facilities to Exchange Participants and have invited market players including system vendors, service providers and Exchange Participants groups to submit proposals.

We are reviewing our registrar, depository, nominee and custodian services with a view to competing more effectively with other service providers.

### **Derivatives**

The stock options market, formerly operated by the Stock Exchange, was incorporated in the Derivatives Business Unit following the merger. Stock options trading increased by 91 per cent to 4,188,702 contracts, from 2,197,972 in 1999 and was the major contributor to the 9 per cent increase in derivatives trading in overall terms.

Trading in most other derivatives products registered decreases, with Hang Seng Index Futures recording a 22 per cent decrease in turnover from 5,132,332 in 1999 to 4,023,138 last year. This can be attributed in part to market uncertainty in the months prior to the full implementation of Hong Kong Futures Automated Trading System (HKATS) for the trading of derivative products.

The comparative success of the traded options market can be attributed to a long-term investor education programme initiated by the Stock Exchange and continued following the merger.

The derivatives market became fully electronic following the migration of Hang Seng Index Futures to HKATS in June. In the same month, the US Commodity Futures Trading Commission approved the placing in the US of HKATS terminals and automated order routing systems connected to HKATS.

Trading in Hong Kong Interbank Offered Rate (HIBOR) Futures Strips began in September, enabling market participants to trade consecutive futures contracts in a single transaction.

In October, trading in a smaller Hang Seng Index Futures contract, known as mini-HSI Futures, was introduced. The contract meets the requirements of, and has been well received by, retail investors. It also provides market participants with the means to fine-tune their trading and risk management activities.

We will seek to introduce a wider range of products this year. We have signed an agreement with MSCI to develop futures and options contracts based on the MSCI China Free Index. We are also exploring other opportunities in international benchmark financial derivatives.

### **Clearing and Settlement**

Average daily settlement efficiency of continuous net settlement stock positions was 99.39 per cent on settlement day, rising to 99.96 per cent on the following day.

HKEx introduced an Internet Initial Public Offering (iIPO) service in September which allows individual investors to apply for new issues through the Internet. The service eliminates the need to queue up at collection points to submit applications, and helps brokers to eliminate manual work in public share subscriptions. We anticipate that the service will become increasingly popular, as has been the experience elsewhere.

The MTR Corporation was the first IPO for which the service was available.

At the same time, the electronic Initial Public Offering (eIPO) service became increasingly popular with 20 per cent of all applications for a single issue being received through the service.

The service allows Investor Participants to subscribe for new issues through Central Clearing and Settlement System (CCASS) terminals or the CCASS phone system without completing application forms or issuing cheques.

Payments are by electronic debit of Investor Participants' designated bank accounts and share allotments are credited to their CCASS accounts. Refunds are by electronic payment instructions.

We have completed development work to allow CCASS to handle securities transactions denominated in foreign currencies. In August, the US dollar became the first foreign currency in which clearing services were available.

We are upgrading CCASS as part of our commitment to applying advanced technology in our market systems. Development for the upgraded system, CCASS/3, is underway and we plan to modularise its system architecture, introduce an open access layer and new functions for risk management and investor protection.

We are also planning to integrate the stock options and futures market infrastructure into a single trading and clearing system. This will eliminate duplication of data centres, networks, system and market operations.

### **Risk Management**

During the year, a group level Market Contingency Plan was completed which integrates the contingency plans of the cash and derivatives markets as well as the clearing houses. An external consultant was appointed to perform a comprehensive review on risk management of HKEx's markets and functions and a report is expected in the second quarter of 2001. HKEx decided to adopt the Common Risk Management and Common Collateral Management system infrastructure with a view to enhancing its ability to better monitor and manage cross-market risks. The infrastructure is expected to be ready by the second quarter of 2002.



## REVIEW OF OPERATIONS

### **E-Business and Information Services**

Income from sale of information rose by 54 per cent to \$352 million from \$229 million in 1999. The number of real-time information vendors increased from 49 in 1999 to a record of 80. Real-time data services provided by these vendors increased by 63 per cent to 286; and delayed data services increased by 77 per cent to 92 during 2000.

The two major areas recording significant growth were Snapshot Per Quote Service and delivery of market data over public Internet, for which there was a surge in subscriptions in advance of the introduction of AMS/3 in October last year.

In August, we devised a special marketing programme designed to encourage provision of real-time market data services in the Mainland which allows a reduced data charge rate to residents on the Mainland.

Working with our information vendors, we introduced an Internet “Framing Quotation Service” in December, which allows Exchange Participants and other web site operators to offer stock quotation services on their websites without the burden of taking up the business and technical commitments as an authorised information vendor. And since January this year, we have been working with some TV operators to offer an On-screen Ticker Display on television screens.

### **Corporate Treasury**

The Corporate Treasury manages funds in the region of \$10 billion, derived from three main sources - accumulated operating profit, clearing house funds and margin funds. Investment income represents approximately 20 per cent of HKEx’s total revenue.

We use the latest risk management techniques to identify, analyse, quantify and manage risk. Funds are invested in a manner that satisfies liquidity requirements, safeguards financial assets and optimises return on investments.

An Investment Advisory Committee comprising experts from the investment community, industry and professional practices advises on portfolio management and monitors the risk and performance of our investments.

### **Regulatory Rationalisation**

Following the merger, HKEx remains the front line regulator of listed companies. However, the SFC regulates HKEx as a listed company following its listing.

### **International Development**

In May, we introduced a pilot programme for trading seven NASDAQ-listed stocks in Hong Kong. The programme allows us to offer some foreign-listed securities for trading in Hong Kong, but does not require harmonisation of our rules and regulations with NASDAQ’s. We are continuing discussions with NASDAQ on ways to increase trading liquidity in the seven stocks, and other forms of cooperation.

In addition, we participated in discussions with nine other major exchanges on the feasibility of a Global Equity Market.

The proposed market will inter-connect the participating exchanges' trading systems and develop a market structure based on common principles, such as transparency.

In December, we signed a Memorandum of Understanding with the Australian Stock Exchange for the purpose of sharing market surveillance information. We have signed similar memoranda with seven other stock exchanges and 32 derivatives exchanges and believe this helps the exchanges ensure market integrity in the increasing globalisation of the financial markets.

In January this year, we entered a strategic initiative with the Sydney Futures Exchange to explore the development of a range of new derivative trading and clearing services for the Asia Pacific exchange-traded and over-the-counter market places.

Details of the first phase of this strategic initiative are expected to be agreed by May and are expected to include a derivatives clearing link for transactions in the Hong Kong and Australian markets.

#### **China**

During the year we continued to develop strongly as an international capital formation and securities trading centre for China. We expect this to continue during the current year. With the setting up of a liaison office in Beijing, we will strengthen our liaison with the authorities and companies in the Mainland. We will also increase our marketing activities in China.

#### **Exchange Participants**

On 31 December 2000, there were 515 Stock Exchange Participants and 139 Futures Exchange Participants. In addition, there were 46 holders of Stock Exchange Trading Rights and 56 holders of Futures Exchange Trading Rights. They were former members of the two exchanges who have not activated their brokerage businesses and have not registered as Exchange Participants.

On 17 May 2000, the Board of Directors endorsed a proposal to remove the minimum brokerage commission rates for stock and futures transactions with effect from 1 April 2002. In addition, transactions on new products under the Pilot Programme for trading US securities and similar pilot programmes before the effective date are exempt from the minimum commission rule.

HKEx handed over responsibility for the Securities Industry Examinations to the Hong Kong Securities Institute on 16 May 2000.

#### **Community Involvement**

HKEx raised more than \$25 million for the Community Chest through balloting for stock codes on the Main Board and GEM. This is in addition to amounts raised by the staff through their participation in events such as dress casual days.

Our public educational programme this year included 50 investor seminars and 10 roadshows. We also organised an Inter-university Investment Challenge Cup for university students to encourage them to learn how to apply their knowledge of investment strategies in stock options trading. A total of 58 teams from the seven universities registered to participate. And more than 9,000 people participated in a public Internet investment game.



## REVIEW OF OPERATIONS

Hong Kong Registrars Limited, a member of the HKEx Group, was elected vice-president of the Federation of Share Registrars Limited. This will strengthen our ability to work with the securities registration industry to improve services to listed companies and the investing community.

### **Staff**

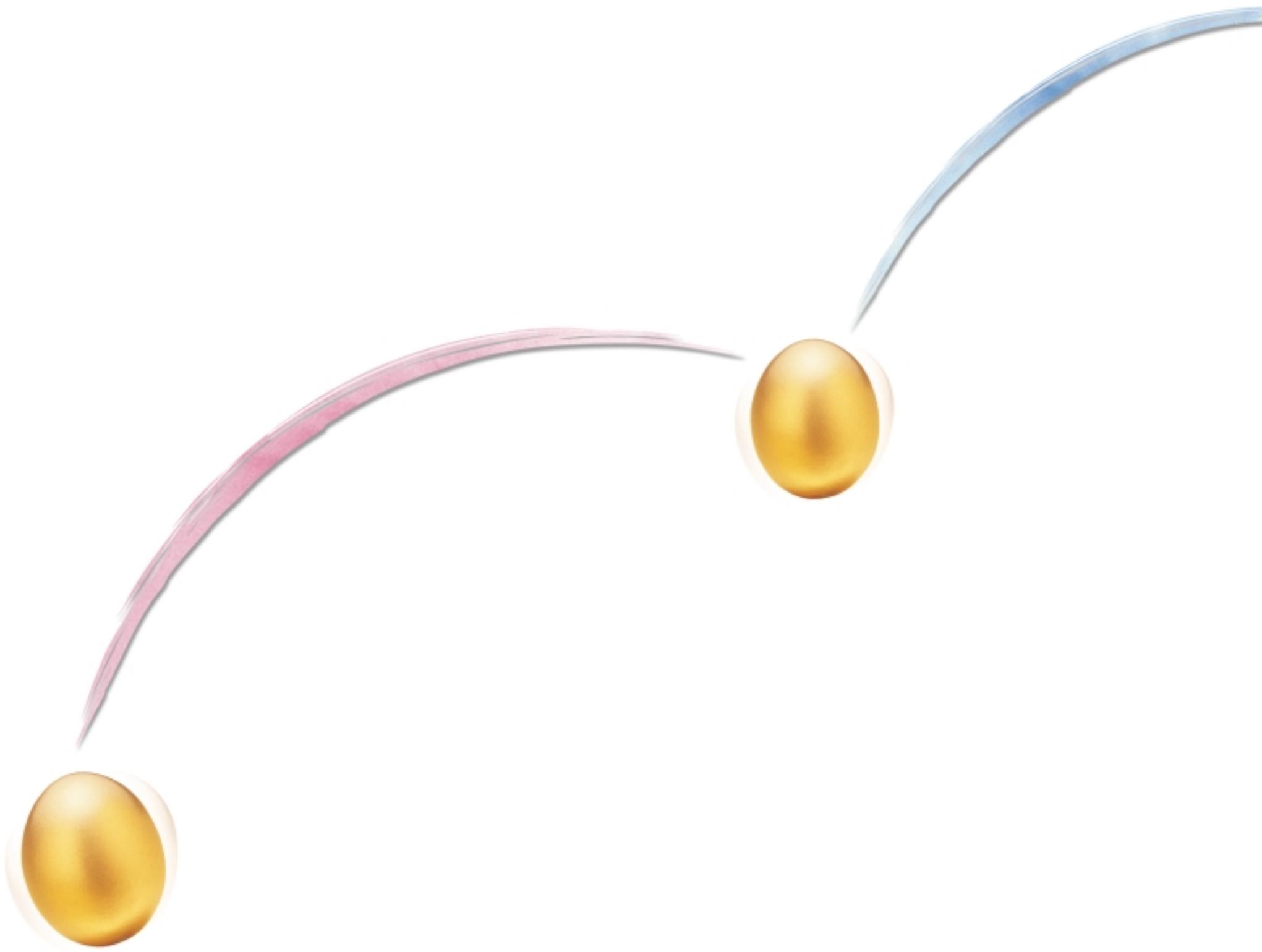
Nothing that we have achieved this year could have been realised without the whole-hearted and enthusiastic hard work and cooperation of our staff.

I thank all of them for their efforts, and am sure that together we will achieve another successful year this year.

**KWONG Ki Chi**

*Director, Chief Executive*

13 March 2001





## **THE WAY FORWARD**

**Our way forward will be built on the rationalisation and strengthening of market regulation, and continued development of our market infrastructure.**

**We will pursue a programme of product and services development, expand registrar, nominee and related services, and strengthen investor information services.**

**We will increase cooperation with Mainland exchanges, develop our business network, and carry out promotional and educational activities through our liaison office in Beijing.**



*upper row (from left)*

**Frederick Grede**

Chief Operating Officer

**Lawrence Fok**

Deputy Chief Operating Officer

**Walter Reisch**

Head - Clearing

**David Cheung**

Chief Financial Officer

**Bryan Chan**

Head - Risk Management

**Matthew Harrison**

Head - Planning & Research

**Coven Hui**

Head - Internal Audit



*lower row (from left)*

**Mary Kao**

Head - Legal & Secretarial Services

**Henry Law**

Head - Corporate Communications

**Karen Lee**

Head - Listing Regulation & Risk Management

**Roger Lee**

Head - E-Business & Information Services

**Joseph Mau**

Company Secretary

**Richard Peng**

Head - China & International Development