

Review of Operations



Determination

(Financial figures are expressed in Hong Kong dollars)

Financial Review

Hong Kong's economy in 2001 was adversely impacted by the economic downturn in the leading economies around the world. This in turn resulted in depressed market sentiments and activities, and hence lower revenue for the company as reflected in the financial results reported by the Chairman.

Operational Review

During the year under review, HKEx launched a number of initiatives to improve the quality of the market and to broaden the range of products and services available to investors.

Listing, Regulation and Risk Management Affairs

In 2001, we considered 153 new listing applications – 64 for listing on the Main Board and 89 for listing on GEM. A total of 24 applicants had been listed on the Main Board and 43 on GEM as at 31 December 2001. As for the balance, 14 applications had been granted approval in principle but were not yet listed, four had been withdrawn, and 55 were being processed. Another 13 applications had lapsed and not progressed further.

We vetted approximately 6,300 and 1,300 announcements and circulars. Approximately 7,300 cases arising from monitoring share movements were examined and as a result approximately 2,500 clarifications were published by listed issuers.

During the same period, we handled approximately 150 complaints about issuers.



We processed approximately 140 cases of Listing Rules breaches in 2001 involving listed issuers and/or their directors. These led to eight published censures, eight public criticisms, and five private reprimands by the Disciplinary Committee. A further 117 cases were dealt with by delivery of warning letters.

Listing Rule Amendments

There were eight updates of the Main Board Listing Rules and six updates of the GEM Listing Rules during 2001.

We published amendments to the GEM Listing Rules, following a comprehensive review and market-wide consultation. The amendments aimed at striking a balance between ensuring market competitiveness and maintaining the quality of the market and at supporting the long-term development of GEM.

In addition, the Listing Rules for derivative warrants were amended to streamline the listing procedures and to increase liquidity and transparency. Following the rule amendments, 240 derivative warrants were listed in the first two months of 2002, compared with 67 in the same period in 2001. Some further refinement to the rules to support the development of the market is being worked out in consultation with market participants. The aim is to reinforce Hong Kong's position as one of the world's leading derivative warrant market by turnover, after Switzerland and Germany.

We had also amended the requirements for share option schemes. Some restrictions, such as the number of options permitted to be granted, were relaxed to allow greater flexibility in the operation of share option schemes. At the same time, stricter requirements were introduced in other areas, such as the disclosure of information relating to options in annual and interim reports, to safeguard against possible abuses and to promote transparency.

To help protect the environment and to lessen the printing burden on listed issuers, we amended the Listing Rules to allow issuers to send corporate communications to their shareholders by electronic means, if they agree. Listed issuers can also send summary financial reports instead of full financial reports after they have ascertained the wishes of their shareholders.

We also issued guidelines for Main Board issuers with negative or negligible net tangible asset value to enable them to apply for a de-minimis concession and/or a modification in the calculation of the assets test and consideration test for the purposes of classifying notifiable transactions. The guidelines also apply to any modifications in connection with Practice Note 13, which clarifies the calculation or test set out in Chapter 14 in relation to notifiable transactions. The guidelines were made to allow listed issuers, with negative or negligible net tangible asset value, the flexibility to carry on their business activities, and to provide

the market with sufficient information to appraise the position of the issuers.

We made arrangements for listed issuers to ensure compliance with the Main Board and GEM Listing Rules as a result of the amendments to the mandatory offer provisions of the Hong Kong Code on Takeovers and Mergers.

We completed a guide on the disclosure of price-sensitive information that was released in January 2002. The principles and elaboration in the guide reflect some of the criteria that the Exchange will consider in its interpretation of the Listing Rules to determine whether certain information is price-sensitive and when an announcement should be made. The guide does not form part of the Listing Rules and does not amend or vary an issuer's obligations under the Listing Rules. It only aims to help issuers and directors understand their disclosure obligations under the Listing Rules.

This year, we will consider the response of the market to the consultation on corporate governance and decide on rule changes. We will complete our review of the listing procedures and introduce changes to streamline the process. In addition, we will examine our delisting procedures and consider rules for listing of companies registered in overseas jurisdictions.

Regulation

HKEx signed a Memorandum of Understanding (MOU) with the Securities

and Futures Commission (SFC) in February 2001 that clarified our roles in the regulation of Exchange Participants.

During the year under review, we signed MOU on the sharing of regulatory information with the Stock Exchange of Thailand, the Luxembourg Stock Exchange and the Kuala Lumpur Stock Exchange. HKEx was also admitted as an affiliate of the Intermarket Surveillance Group, an organisation founded in 1983 for the sharing of market surveillance information among participating exchanges.

Risk Management

A rehearsal was held in May 2001 to test the procedures of HKEx's market contingency plans. The plans will be updated as and when necessary and rehearsals will be conducted regularly.

We also implemented improvements to our risk management policies and procedures following a comprehensive review by external consultants.

Equities - Primary Market

Total funds raised in 2001 amounted to \$64.4 billion.

A total of 88 companies made initial public offerings (IPO), comprising 31 on the Main Board, which raised \$21.6 billion, and 57 on the GEM, which raised \$4.1 billion. In addition, iShares MSCI China Tracker - an Exchange Traded Fund (ETF) - was listed on the Main Board. Post-issue fund raising

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totalled an additional \$38.7 billion, made up of \$37 billion on the Main Board and \$1.7 billion on the GEM.

Total funds raised by H share and red chip companies through IPO and post-issue fund raising amounted to \$25.9 billion in 2001, representing 40 per cent of total funds raised during the year.

GEM, which serves predominantly start-up companies and growth-oriented enterprises, continued to be one of the most successful markets of its type in Asia in terms of funds raised and market liquidity. In the first 11 months of 2001, GEM was second behind its South Korean counterpart in funds raised and third among its regional peers in market turnover.

Equities – Secondary Market

Market turnover for the year was \$1,990 billion. This represents a substantial drop from the high level of \$3,132 billion in 2000, but is broadly comparable to the level of \$1,920 billion in 1999.

According to the annual survey conducted during the year, the Hong Kong stock market continued to attract both local and overseas investors. For the 12 months ended September, local investors' market share in value terms was 56 per cent, while that of overseas investors, mainly institutions, was 40 per cent. There was a good balance between overseas institutions, with a market share of 38 per cent, local

individuals (36 per cent) and local institutional investors (19 per cent). The remainder of the market was divided between Stock Exchange Participants trading for their own account (4 per cent) and overseas individuals (3 per cent).

To give Stock Exchange Participants more flexibility, we introduced revised trading parameters along with Enhanced Limit Orders and Special Limit Orders to our Automatic Order Matching and Execution System (AMS/3), in February 2001.

In May 2001, the first two regional ETF were introduced for trading. ETF provide more investment choices and increase the attractiveness and competitiveness of Hong Kong as an international financial centre.

We issued a consultation paper in September 2001 on extension of trading hours for stocks and Hong Kong stock-related futures and options. The response to the consultation indicates that many market participants support longer trading hours. We are now finalising the details and will announce the new trading hours shortly.

The Board of Directors decided on 20 February this year to defer the abolition of minimum brokerage commissions for one year until 1 April 2003. HKEx continues to believe that making commissions freely negotiable is the best way forward for Hong Kong. However, given the poor

economic environment and unemployment situation, a deferral for one year was considered justified. The Board believes that, in the current market condition, the deferral will not have any significant impact on market turnover, and hence revenue of HKEx.

We plan to introduce trading facilities for Equity Linked Notes this year and will seek to add other new products. We also plan to offer central back-office facilities to Stock Exchange Participants this year to help them further automate their operations.

Other initiatives to be implemented in the course of 2002 include the introduction of a pre-market opening session and an index basket order trading mechanism. The pre-opening session will help to determine an optimum opening price for stocks and to reduce the peaked loading of AMS/3 when morning trading begins. The new index basket order trading mechanism will make it easier for Exchange Participants to conduct index arbitrage and hedging activities.

We will also consult the market on the current board lot system and consider the introduction of remote trading access for the stock market.

Futures and Options

Futures and Options turnover rose nearly 14 per cent to 10,549,552 contracts, a record high.

Hang Seng Index (HSI) Futures' trading volume of 4,400,071 contracts led the market, followed by stock options, with 4,001,014 contracts traded. Mini-HSI Futures, HSI Options and Three-month HIBOR (Hong Kong Interbank Offered Rate) Futures were also among the top products in terms of trading volume. Three-month HIBOR Futures volume rose more than 93 per cent from the previous year and the contract set one-day volume and open interest records in the second half of 2001. One-month HIBOR Futures and Mini-HSI Futures set one-day volume and open interest records in the first half of the year, and stock options set a one-day open interest record in February 2001.

Stock options trading moved to the Hong Kong Automated Trading System (HKATS) in August 2001, resulting in the consolidation of all futures and options trading on a single platform.

We established a remote trading access programme for the Futures Exchange and signed agreements with GL Trade and Radianz to expand the distribution of our products over their networks in order to increase market liquidity.

New contracts introduced in 2001 included MSCI China Free Index Futures and Three-year Exchange Fund Note Futures. We also introduced International Stock Futures and Options, which include contracts based on leading shares listed in South Korea and

Taiwan. In addition, we standardised our existing Hong Kong stock futures and stock options contracts and introduced new Hong Kong stock futures and stock options contracts.

To extend our services, we established a Block Trade Facility in late October 2001 under a six-month pilot programme. Through the facility, we can bring transactions to our markets that may otherwise be executed over the counter.

We also introduced Tick Rule amendments in 2001, aimed at improving market liquidity by reducing the risk to index arbitrageurs and market makers under volatile market conditions. This should ultimately benefit the market as a whole.

We plan to introduce Dow Jones Industrial Average Futures and Options in 2002, and are examining other opportunities for introducing new derivative products and services. In addition, we will implement scheduled upgrades and enhancements to HKATS in the course of 2002.

Clearing and Settlement

Average daily settlement efficiency of continuous net settlement stock positions was 99.59 per cent on settlement day, rising to 99.96 per cent on the following day.

We have continued the development work on the upgrade of CCASS, the Central Clearing and Settlement System, to CCASS/3. CCASS/3 has a multi-market

structure and is able to accommodate variable settlement cycles and extended trading hours. It also offers users several access options. We are aiming to launch CCASS/3 in the third quarter this year.

We have also worked with the OM Group of Sweden (the same company that provided the software for our futures and options trading platform) on the new Derivatives Clearing and Settlement System, or DCASS, which will integrate all futures and options clearing on a single platform. DCASS is scheduled to be launched in the fourth quarter of this year. .

In addition to implementing CCASS/3 and DCASS this year, we will examine further consolidation of our clearing operations and third party clearing for stocks.

E-Business and Information Services

The number of real-time information vendors increased to 83, from 80 in 2000. The real-time data services provided by these vendors rose to 290 from 286. Two delayed data services were added, raising the total to 94.

We introduced the Online Trading Service (OTS) in February 2001 which offers investors secure Internet trading through our Stock Exchange Participants with the use of digital certificates. OTS provides automatic order and trade notification by e-mail and allows investors to modify, cancel or enquire about their orders online.

In November 2001, HKEx, the Shanghai Stock Exchange and the Shenzhen Stock Exchange jointly launched the China Stock Markets Web. The China Stock Markets Web was added to the three organisations' websites to provide information on the securities markets in Hong Kong, Shanghai and Shenzhen and companies listed on the three exchanges in convenient single access points. The service was designed to satisfy investors' growing demand for information on the three markets. It is also a reflection of the close working relationship among the three exchanges.

In February 2002, we signed a Statement of Intent with Standard & Poor's for the creation of a new series of equity indices covering stocks listed on our Stock Exchange. The series will be co-branded the S&P-HKEx index series and will include indices that track the Main Board's large-cap, mid-cap and small-cap stocks and the stocks listed on GEM.

Corporate Treasury

The Corporate Treasury manages funds amounting to about \$9 billion, comprising mainly accumulated operating profits, Clearing House Funds and margin funds received. Investment income represents approximately 20 per cent of HKEx's total income.

In the year under review, investments were kept sufficiently liquid to meet operating requirements and demands of the Clearing House Funds and margin funds. As of 31 December 2001, 50 per cent of the funds

were invested in highly liquid marketable bonds, 49 per cent in cash or bank deposits, and 1 per cent in equity. The maturity profile of the portfolio as at 31 December 2001 was as follows:

Overnight	> Overnight to 1 month	> 1 month to 1 year	>1 to 3 years	>3 years
34%	12%	17%	32%	5%

Credit exposure was well diversified. All bonds held were of investment grade and had a weighted average credit rating of Aa3. Deposits were placed only with Hong Kong dollar note issuing banks or authorised institutions with a minimum credit rating of A3 or equivalent.

Investment and fund management are governed by guidelines approved by the Board, with the aim to optimise return, safeguard assets and satisfy liquidity requirements. A professional treasury team is dedicated to the day-to-day management and investment of the funds. Since the second half of 2001, external fund managers have also been used to manage part of the corporate funds.

An Investment Advisory Committee, comprised of experts from the financial community, advises the company on portfolio management and monitors the risk and performance of our investments. To improve risk management, a risk control group closely monitors and analyses all investment activities.

Risk management techniques, such as Value-at-Risk (VaR) and portfolio stress testing, are used to identify, measure, monitor and control market risks. The average, maximum and minimum VaR recorded in 2001 since the appointment of external fund managers in July 2001 were \$13 million, \$17 million and \$12 million.

China

We have continued our efforts to strengthen Hong Kong's position as the international capital formation centre for China. Apart from regular marketing visits to the Mainland, we have also organised four GEM conferences in Beijing (at the Zhongguancun Science Park), Chengdu, Chongqing and Shanghai.

We will continue to focus our marketing efforts in China this year, further develop our ties with the Mainland exchanges and expand our business network in the Mainland through promotional and educational activities.

We are awaiting final approval for our representative office in Beijing and plan to open the office as soon as possible.

International Development

HKEx hosted the Asia-Pacific regional meeting of International Securities Services Association in May 2001. We also sponsored major conferences in Hong Kong on indexing and derivatives.

This year, we will continue to explore possible business cooperation and alliances with other exchanges.

Exchange Participants

At the end of last year, there were 507 Stock Exchange Participants, 135 Futures Exchange Participants. In addition, there were 34 holders of Stock Exchange Trading Rights and 56 holders of Futures Exchange Trading Rights. They are former members of the two exchanges who have not activated their brokerage businesses and are not registered as Exchange Participants.

On 29 November 2001, the SFC's Academic and Accreditation Advisory Committee approved HKEx as a recognised institution for providing Continuous Professional Training (CPT). As a result, Exchange Participants and their representatives are now able to satisfy their CPT requirements by attending HKEx CPT programmes.

In late January 2002, the Stock Exchange invited claims against the Unified Exchange Compensation Fund in respect of the default of a Stock Exchange Participant. The period for lodging claims will close on 29 April 2002. The claims received so far have exceeded the \$8 million limit of compensation per Stock Exchange Participant under the Securities Ordinance by a substantial amount, and an application has been made to the SFC to increase the compensation limit by adopting the \$150,000 per claim limit used in major default cases in 1998 and 2000.

Website

According to the figures for December last year, there were 539,740 visits to the HKEx website and the linked GEM website during the month, with 5,432,419 page views.

Since May 2001, Main Board-listed companies have been required to submit a soft copy of their announcements for posting on our website. GEM-listed companies' announcements have been posted in the GEM section of the website since the market was introduced in November 1999.

We have continued to enrich and upgrade the content and functionality of our website to provide better service to our customers. For example, the OTS which we introduced in 2001 to facilitate online trading of securities can also be accessed via our website.

Community Involvement

HKEx raised more than \$15 million for the Community Chest through balloting of special stock codes for new listed companies on the Main Board and GEM. In addition, the staff contributed to charities through their participation in the Chest's Dress Casual Day.

We run a wide-range of public education programmes. In 2001, we organised 22 investor seminars and participated in Money World Asia and Information Infrastructure Expo and other seminars and conferences run by professional and international bodies.

We also continued to provide briefings on our operations for Hong Kong secondary school teachers, journalists and other prominent visitors.

Staff

Nothing we accomplished last year would have been possible without the hard work and dedication of our staff. They have embraced our core values of commercial focus, competitive technology, fairness and integrity, customers matter, innovation, people count and team collaboration. They have also worked to improve the quality of the market, and helped to develop new products and services, while keeping costs down.

I thank them for their efforts, and I am confident that together we will have another fruitful year towards achieving our vision.

KWONG Ki Chi

Director and Chief Executive

13 March 2002



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| 1 | Frederick Grede | Chief Operating Officer |
| 2 | Lawrence Fok | Deputy Chief Operating Officer |
| 3 | David Cheung | Chief Financial Officer |
| 4 | Karen Lee | Head – Listing, Regulation and Risk Management |
| 5 | Walter Reisch | Head – Clearing |
| 6 | Stephen Law | Head – IT/Systems |
| 7 | Roger Lee | Head – E-Business and Information Services |



Teamwork



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| 8 | Jimmy Ho | Head – Corporate Strategy |
| 9 | Coven Hui | Head – Group Internal Audit |
| 10 | Mary Kao | Head – Legal and Secretarial Services |
| 11 | Henry Law | Head – Corporate Communications |
| 12 | Brenda Yen | Head – Human Resources |
| 13 | Joseph Mau | Company Secretary |