

2002 Annual Report



HKE<sub>x</sub>  
香港交易所



Hong Kong Exchanges and Clearing Limited is committed to:

- raising the quality and reputation of its markets through the swift and impartial enforcement of regulations which are fair and effective;
- improving the robustness of its markets through prudent risk management measures which are focused and comprehensive;
- enhancing the efficiency of its markets through the use of outstanding and user-friendly technology which brings speed and transparency;
- increasing the breadth and depth of its markets through the development of products and services which are innovative and responsive to market needs.



On this firm foundation, HKEx works hand-in-hand with the dynamic and resourceful financial community of Hong Kong to contribute to the economic growth of Hong Kong and the Mainland of China by providing a centre for capital raising, securities trading and risk management which is on par with the highest international standards.

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# Financial Highlights

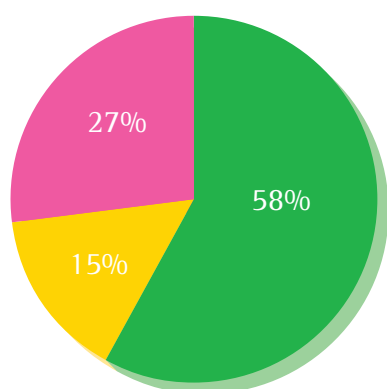
(Financial figures are expressed in Hong Kong dollars)

	2002	2001	Change
<b>KEY MARKET STATISTICS</b>			
Average daily turnover value on the Stock Exchange	<b>\$6.7 billion</b>	\$8.2 billion	(18%)
Average daily number of derivatives contracts traded on the Futures Exchange	<b>30,038</b>	27,192	10%
Average daily number of stock options contracts traded on the Stock Exchange	<b>15,203</b>	16,567	(8%)
	<b>\$ million</b>	\$ million	
<b>RESULTS</b>			
Income	<b>1,808</b>	1,998	(10%)
Operating expenses	<b>1,164</b>	1,176	(1%)
	<b>644</b>	822	
Share of profits less losses of associated companies	<b>6</b>	–	–
Profit before taxation	<b>650</b>	822	(21%)
Taxation	<b>(57)</b>	(82)	(31%)
Profit attributable to shareholders	<b>593</b>	740	(20%)
Shareholders' funds	<b>5,496</b>	5,235	5%
Total assets *	<b>14,035</b>	13,745	2%
Earnings per share	<b>\$0.57</b>	\$0.71	(20%)
Interim dividend per share	<b>\$0.08</b>	\$0.08	0%
Final dividend declared per share	<b>\$0.43</b>	\$0.25	72%
	<b>\$0.51</b>	\$0.33	55%
Dividend payout ratio	<b>90%</b>	46%	

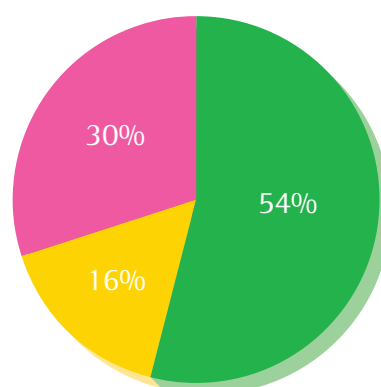
\* The Group's total assets include the margin funds received from Participants on futures and options contracts.

# Financial Highlights

## BY BUSINESS SEGMENT\*

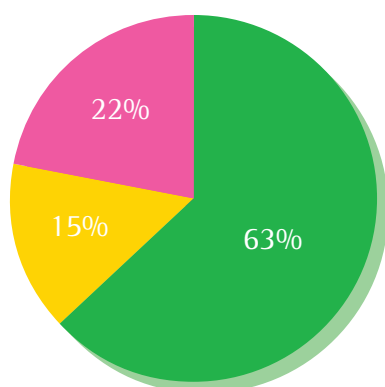


2002 Income

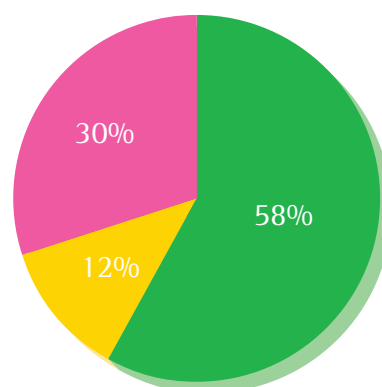


2001 Income

- Cash market
- Clearing business
- Derivatives market



2002 Segment results before tax



2001 Segment results before tax

\* Please refer to note 2 to the accounts on pages 79 to 81 for details. The business segments above exclude the Others Segment.



# Five-Year Statistics

## FIVE-YEAR STATISTICS

(Financial figures are expressed in Hong Kong dollars)

	2002 \$ million	2001 \$ million	As restated 2000 \$ million	As restated 1999 \$ million	As restated 1998 \$ million
<b>Results*</b>					
Income#	1,814	1,998	2,312	1,815	2,115
Profit attributable to shareholders	593	740	874	514	620
<b>Assets and liabilities</b>					
Non-current assets	1,889	1,819	2,221	2,163	1,587
Current assets	12,146	11,926	11,948	12,293	10,013
Current liabilities	(7,939)	(7,890)	(8,672)	(9,756)	(7,353)
Net current assets	4,207	4,036	3,276	2,537	2,660
Total assets less current liabilities	6,096	5,855	5,497	4,700	4,247
Non-current liabilities	(600)	(620)	(618)	(596)	(626)
Shareholders' funds	5,496	5,235	4,879	4,104	3,621

\* Following the adoption of certain new Statements of Standard Accounting Practice issued by the Hong Kong Society of Accountants in 2001, certain comparatives previously reported have been restated to conform to the new policies.

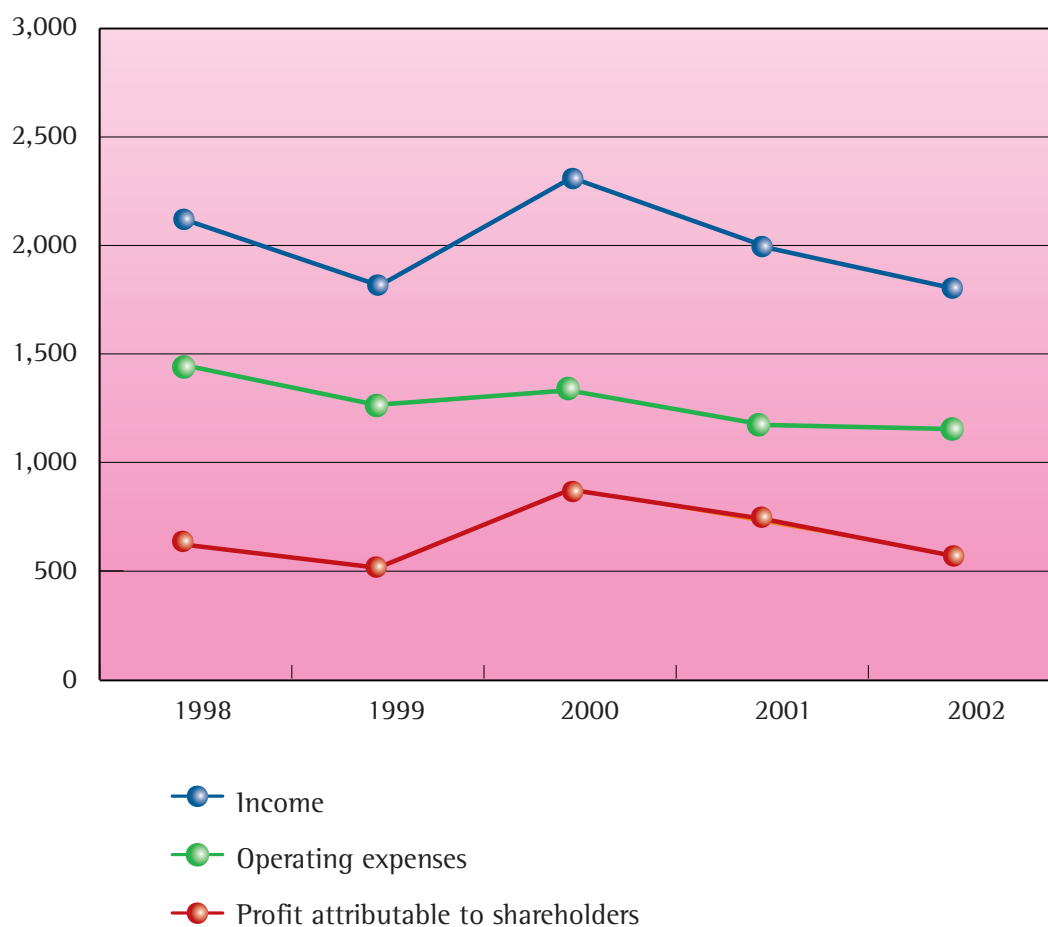
# Income includes share of profits less losses of associated companies



# Five-Year Statistics

## FIVE-YEAR RESULTS

(\$ million)





# Corporate Information



	8	9	10	11	12	13	14	15
1	2	3	4	5	6	7		

## BOARD OF DIRECTORS

### Non-executive Chairman

- 4 LEE Yeh Kwong, Charles GBS, JP\*

### Executive Director, Chief Executive

- 3 KWONG Ki Chi GBS, JP

### Non-executive Directors

- 2 CHAN Cho Chak, John GBS, JP\*  
6 FAN Chor Ho, Paul JP  
1 FRESHWATER, Timothy George\*  
13 KWOK Chi Piu, Bill  
11 LEE Jor Hung, Dannis BBS  
12 LEE Kwan Ho, Vincent Marshall  
10 LEONG Ka Chai JP\*  
7 LIU Jinbao\*  
5 LO Ka Shui JP\*  
14 SETO Gin Chung, John  
9 STRICKLAND, John Estmond GBS, JP\*  
8 WARD, Rodney Gordon\*  
15 YUE Wai Keung

## AUDIT COMMITTEE

- STRICKLAND, John Estmond (Chairman)  
FAN Chor Ho, Paul (Deputy Chairman)  
FRESHWATER, Timothy George  
LEONG Ka Chai  
YUE Wai Keung

## EXECUTIVE COMMITTEE

- LEE Yeh Kwong, Charles (Chairman)  
GREDE, Frederick John  
KWONG Ki Chi  
LEONG Ka Chai  
SETO Gin Chung, John

## INVESTMENT ADVISORY COMMITTEE

- FRESHWATER, Timothy George (Chairman)  
SETO Gin Chung, John (Vice Chairman)  
CLARKE, Peter  
SUN, David  
SUN, Patrick

\* Public Interest Directors

# Corporate Information

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## **NOMINATION COMMITTEE**

LEE Yeh Kwong, Charles (Chairman)  
FAN Chor Ho, Paul  
LO Ka Shui

## **REMUNERATION COMMITTEE**

CHAN Cho Chak, John (Chairman)  
LEE Jor Hung, Dannis  
WARD, Rodney Gordon

## **RISK MANAGEMENT COMMITTEE**

(a committee established under  
Section 9 of the Exchanges and  
Clearing Houses (Merger) Ordinance)

LEE Yeh Kwong, Charles (Chairman)  
CHAN Cho Chak, John\*\*  
(up to 5 March 2003)  
DICKENS, Mark\*\*  
(appointed on 6 March 2003)  
KWOK Chi Piu, Bill  
LAM Kin\*\*  
LAU, James H. Jr\*\*  
(appointed on 6 March 2003)  
LEONG Ka Chai\*\*  
(appointed on 6 March 2003)  
SHENG Len Tao, Andrew\*\*  
(up to 5 March 2003)  
STRICKLAND, John Estmond  
WONG Tung-shun, Peter\*\*  
YAM Chi Kwong, Joseph\*\*  
(up to 5 March 2003)

\*\* Appointed by the Financial Secretary under  
Section 9 of the Exchanges and Clearing Houses  
(Merger) Ordinance

## **COMPANY SECRETARY**

MAU Kam Shing, Joseph

## **AUTHORISED REPRESENTATIVES**

KWONG Ki Chi  
MAU Kam Shing, Joseph

## **AUDITORS**

PricewaterhouseCoopers

## **LEGAL ADVISORS**

Allen & Overy

## **REGISTERED OFFICE**

12th Floor  
One International Finance Centre  
1 Harbour View Street  
Central  
Hong Kong

## **WEBSITE**

<http://www.hkex.com.hk>

## **E-MAIL ADDRESS**

[info@hkex.com.hk](mailto:info@hkex.com.hk)

## **REGISTRAR AND TRANSFER OFFICE**

Hong Kong Registrars Limited  
1712-1716, 17th Floor  
Hopewell Centre  
183 Queen's Road East  
Wanchai  
Hong Kong

# Corporate Information

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## FINANCIAL CALENDAR

### Information on Interim and Annual Results 2002

Announcement of 2002 interim results	15 August 2002
Payment date for interim dividend	12 September 2002
Announcement of 2002 final results	12 March 2003
Ex-dividend date for final dividend	8 April 2003
Book closing dates for final dividend	10-15 April 2003
Record date for final dividend	15 April 2003
Annual General Meeting for the year 2003	15 April 2003
Payment date for final dividend	on or about 25 April 2003

## SHARE INFORMATION

### Stock Code

Stock Exchange, Hong Kong	388
Access to Reuters	0388.HK
Access to Bloomberg	388 HK Equity

Board lot	2,000 shares
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### Price and Turnover History

2002	Price per Share		Turnover (in millions)	
	High (HK\$)	Low (HK\$)	Shares	HK\$
January	12.95	11.20	106.7	1,287.2
February	11.50	10.70	80.4	887.8
March	12.80	10.85	138.6	1,656.4
April	14.00	11.85	88.5	1,155.5
May	15.00	13.60	101.4	1,448.6
June	14.25	12.40	54.1	710.5
July	13.50	10.65	84.8	1,025.1
August	11.45	9.80	87.6	909.1
September	10.20	8.90	73.0	694.3
October	11.00	9.05	94.8	964.7
November	10.75	9.85	64.0	662.0
December	10.95	9.70	41.9	436.2

# Corporate Information

## Analysis of Shareholdings

Size of holding	Number of shareholders	% of shareholders	Number of shares ('000)	% of total issued capital
1 – 1,000	10	0.7%	6	0.0%
1,001 – 5,000	702	48.4%	1,966	0.2%
5,001 – 10,000	341	23.5%	2,804	0.3%
10,001 – 100,000	235	16.2%	7,366	0.7%
100,001 and above	163	11.2%	1,031,439	98.8%
Total	<u>1,451</u>	<u>100.0%</u>	<u>1,043,581</u>	<u>100.0%</u>

Shareholdings as at 31 December 2002

Category	Number of shares ('000)	% of total issued capital
Individual <sup>1</sup>	110,385	10.6%
<i>Local</i>	107,749	10.3%
<i>Overseas</i>	2,636	0.3%
Corporate <sup>2</sup>	16,493	1.6%
Institutions <sup>3</sup>	466,104	44.7%
<i>Local</i>	23,130	2.2%
<i>Overseas</i>	442,974	42.5%
Exchange Participants <sup>4</sup>	317,015	30.4%
Other nominees/banks <sup>5</sup>	<u>133,544</u>	<u>12.7%</u>
Total	<u>1,043,541</u>	<u>100.0%</u>

Composition of shareholders according to a survey conducted as at the end of October 2002

<sup>1</sup> Shares registered in individual names other than those who are Exchange Participants

<sup>2</sup> Shares registered in company names other than those who are Exchange Participants and nominees/banks

<sup>3</sup> Institutional investors identified by the five largest custodians

<sup>4</sup> Exchange Participants include Stock Exchange Participants and Futures Exchange Participants

<sup>5</sup> Other nominees/banks excluding HKSCC Nominees Limited and the five largest custodians

# Chairman's Statement

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LEE Yeh Kwong, Charles  
Chairman





# Chairman's Statement

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(Financial figures are expressed in Hong Kong dollars)

I am pleased to present this annual report of Hong Kong Exchanges and Clearing Limited (HKEx) for the period from 1 January to 31 December 2002.

The following discussions should be read in conjunction with the Review of Operations which is presented by the Chief Executive to report on the details of the company's operations and development.

## Financial Results

HKEx recorded a profit before taxation of \$650 million in 2002, down 21 per cent from 2001. Profit attributable to shareholders was \$593 million, 20 per cent lower than 2001. The decline in profit is principally attributable to the continued fall in securities market activities and the low level of interest rates, which have caused a significant drop in trading fees, net interest income, income from sale of information, and clearing and settlement fees. (The Trading Fee was introduced in 2001 when the Stock Exchange of Hong Kong's portion of the Transaction Levy was removed.)

The Board has recommended payment of a final dividend of \$0.43 per share. Together with the interim dividend of \$0.08 per share, this will bring the total dividend distribution for the year to \$0.51 per share.

Operating expenses fell by one per cent to \$1,164 million, compared with \$1,176 million in 2001. This is the second consecutive year we recorded a drop in operating expenses, which fell by 12 per cent in 2001. The decline was mainly due

to effective cost control. Staff costs and related expenses decreased by 7 per cent to \$493 million, compared with \$528 million in 2001. This was achieved after offsetting the increase in expenses incurred by additional headcount in the market regulation and information technology operations of the Group. The increase in staff will help us to better meet our commitment to raise the standard of market regulation and enhance the capability and resilience of our information technology operations. Since the merger and integration of The Stock Exchange of Hong Kong, the Hong Kong Futures Exchange, and their clearing houses in 2000, staff costs and related expenses have been reduced by about \$106 million, representing a reduction of about 18 per cent.

Shareholders' funds as at the end of 2002 were \$5,496 million.

## Major International Centre for Capital Formation and the Trading of Securities and Derivatives

HKEx operates the securities and derivatives markets in Hong Kong and their clearing houses. In addition, the company provides a comprehensive range of pre- and post-trade investment services as well as market information services.



# Chairman's Statement

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Since the merger of the exchanges and clearing houses in 2000, HKEx has focused on integrating the various operating units. A new organisational structure was successfully implemented in 2002, in part to support the implementation of its new strategic plan. The structure enables HKEx to operate more efficiently and provide better service.

In the meantime, HKEx has also concentrated on initiatives that would foster long-term growth. For example, the trading and clearing systems are being upgraded; new products and services are being introduced, and other improvements to the market infrastructure are under consideration and development. Business development activities are continuing in Hong Kong, Mainland China, and overseas, and there are frequent discussions on mutually beneficial business co-operation with other exchanges.

HKEx has developed a profitable business model with diverse income sources. In 2002, increases in listing and derivatives income helped to offset income decreases in clearing and other areas. Operating expenses are tightly controlled. Continued investments in the market infrastructure are made to ensure that it remains robust, reliable, and competitive.

Despite adverse economic conditions and a challenging business environment, the Hong Kong stock market continues to serve as a major international capital formation centre in the region. In 2002, capital raised through Initial Public Offers and post-

listing activities on The Stock Exchange of Hong Kong amounted to \$110 billion (US\$14 billion), among the world's leaders. In the derivatives market, there was an increase in trading activity in 2002 and contract volume, at over 11 million, reached a record high.

These achievements reflected investors' confidence in the quality of Hong Kong's markets and the services of HKEx.

To further raise market quality, HKEx has modified some of the rules and procedures of the exchanges and clearing houses and proposed other changes. Chief among the modifications is a set of rule amendments that will strengthen the corporate governance requirements on issuers that list securities in Hong Kong. Studies have shown that investors are willing to pay a premium for the securities of issuers with good corporate governance practices. A separate set of proposals would tighten the listing eligibility requirements.

To enhance the competitiveness of the exchanges, the Board of Directors has agreed in principle to extend trading hours, subject to market readiness and regulatory approval. In addition, the Board has confirmed its earlier decision on minimum commission rates. With effect from 1 April 2003, commission rates will be freely negotiated between brokers and their clients. HKEx believes that making the rates freely negotiable is in the best interest of the investing public and the Hong Kong market.

# Chairman's Statement

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These developments and the new products and services discussed in the Review of Operations will reinforce the position of HKEx and Hong Kong in the international financial markets.

## Outlook

As a substantial portion of HKEx's income comes from trading fees, clearing and settlement fees, listing fees, and interest income, HKEx's performance is heavily influenced by market sentiment, the level of activity on the securities and derivatives markets, changes in interest rates, and other external factors.

Given the importance of external factors to HKEx's performance, the year ahead is likely to remain challenging, not least because of the risk of war in the Middle East, fear of terrorist activities worldwide, and uncertainties over the economic performance in the United States, Europe and Japan.

The uncertain external environment, coupled with the likely continuation of high unemployment, deflation, and weak property prices domestically would suggest that activity on the securities and derivatives markets is likely to remain subdued, at least in the first half of 2003, and this could have an adverse impact on HKEx's revenue. To meet the challenges ahead, HKEx is seeking to further raise the quality of its markets and ensure that its services remain competitive. New products and

services are being explored to broaden the revenue base; additional opportunities are being pursued in Mainland China and overseas; and expenses are being kept under tight control.

With unmatched ties to Mainland China, Hong Kong and its financial markets are well positioned to benefit from the continued growth of the Mainland economy.

I acknowledge with a deep sense of gratitude the contributions of my fellow Board members, the executives, and all staff members. HKEx's achievements would not have been possible without their dedicated efforts and they have my sincere thanks.

Mr Kwong Ki-chi, Chief Executive of HKEx, notified the Board last year of his intention not to seek renewal of his employment contract on its expiry on 6 March 2003. At the invitation of the Board, Mr Kwong agreed to stay on until the end of the Annual General Meeting in April 2003. On behalf of the Board, I thank Mr Kwong for his enormous contribution to HKEx. He will leave the Group in a strong position to build on the solid foundation he and his team have established.

LEE Yeh Kwong, Charles  
Chairman

12 March 2003

# Review of Operations

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KWONG Ki Chi  
Director and Chief Executive



# Review of Operations

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(Financial figures are expressed in Hong Kong dollars)

## Financial Review

Hong Kong's economy in 2002 was adversely affected by weakness in the leading economies around the world. This in turn resulted in depressed market sentiment and activity, and hence lower revenue for the Group as reflected in the financial results reported by the Chairman.

## Operational Review

During the year, HKEx launched a number of products and initiatives to continue to raise the quality of our markets and services.

## Listing, Regulation, and Risk Management Activities

### Listing and Regulation

In 2002, we vetted a total of 275 listing applications – 118 for listing on the Main Board and 157 for listing on the Growth Enterprise Market (GEM). These included 70 applications submitted in 2001 but the vetting of which was carried over into 2002. Of these 275 listing applications, 117 had been approved and subsequently 60 issuers had listed on the Main Board and 57 issuers had listed on GEM as at 31 December 2002. Of the rest, nine applications had been granted approval in principle but the approvals had since lapsed as the companies had not been listed by the respective expiry dates of the approval; one application was rejected; three had been withdrawn; 24 applications had not progressed further and had lapsed; and 121 were being processed.

During the year under review we vetted some 8,200 listed company announcements and approximately 1,600 circulars. About 5,800 cases were examined in the light of share price movements and as a result approximately 1,600 clarifications were published by listed issuers.

During the same period, we handled approximately 320 complaints about issuers. Most complaints required no further action after our enquiries; about 20 per cent resulted in further disclosure by issuers, further investigation, or referral to the Securities and Futures Commission (SFC).

We completed examination of 161 cases of breaches of the Listing Rules of the Main Board and GEM in 2002 involving listed issuers and/or their directors. This led to six public censures, one public criticism, and seven private reprimands by the Disciplinary Committee. A further 147 cases relating to minor breaches were dealt with by the issue of warning letters.

We published several consultation papers in 2002 on issues related to the Listing Rules of the Main Board and GEM. They included the January 2002 Consultation Paper on Proposed Amendments to the Listing Rules Relating to Corporate Governance Issues; the July 2002 Consultation Paper on Proposed Amendments to the Listing Rules Relating to Initial Listing and Continuing Listing Eligibility and Cancellation of Listing

# Review of Operations

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Procedures; and the November 2002 Consultation Paper on Continuing Listing Criteria and Related Issues, which supplemented the July paper. We also published a consultation paper in March 2002 on proposed changes to practices on the dissemination of listed issuers' announcements.

We published the Consultation Conclusions on Proposed Amendments to the Listing Rules Relating to Corporate Governance Issues in January 2003. We are working on the implementation of those conclusions in the course of 2003. The conclusions on the other consultations will be announced in due course.

A panel appointed by the Government conducted an independent inquiry into the circumstances relating to the preparation and release of the July 2002 consultation paper after an adverse market reaction to some of the proposals in the consultation paper. We have implemented, as appropriate, the recommendations of the panel's report and in particular made changes to our consultation process to enhance sounding of the market prior to the issue of consultation papers.

Also, to improve liaison between the SFC and the Stock Exchange, a High Level Group, comprising the chairmen of HKEx and the SFC, senior officials from the two organisations, and the chairmen of the listing committees and the Takeovers Panel, has been established to review systemic and policy issues concerning listing-related matters.

There were several amendments to the Listing Rules of the Main Board and GEM in 2002.

Amendments to the Listing Rules of the Main Board and GEM that took effect on 15 February 2002 were aimed at reducing the printing cost burden on listed issuers while helping to protect the environment. Subject to certain conditions and with shareholders' approval, listed issuers are permitted to send corporate communications by electronic means or make them available to shareholders in English or Chinese only.

On 17 February 2002, we announced amendments to the Listing Rules of the Main Board and GEM allowing listed issuers to distribute summary financial reports in place of a full annual report, provided that they ascertain the wishes of shareholders and comply with the legal requirements of their own jurisdictions and provisions of their own memorandum and articles of association.

Amendments to the Main Board Listing Rules which took effect on 8 April 2002 reflect the use of our websites rather than the Teletext system for the dissemination of news on listed issuers. The first listing on GEM in November 1999 marked the beginning of a shift towards the use of our websites, rather than the Teletext system and paid announcements, as the main channel for the dissemination of news on listed issuers. News posted on our websites



# Review of Operations

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is available to more market participants than news posted on the Teletext system. We expect to make a further announcement on paid advertisements later in 2003.

In June 2002, we announced amendments to the Main Board Listing Rules to allow a wider range of derivative products, including Equity Linked Instruments (ELI), to be listed on the Stock Exchange. The changes became effective on 1 July 2002. In addition, the listing application procedures for structured products have been streamlined, and structured product issuers are now required to publish their announcements on the HKEx website only. Paid advertisements are no longer required. Taken together, the amendments have broadened the range of products that may be introduced to meet market demand.

We announced amendments relating to Financial Disclosure provisions in the Main Board and GEM Listing Rules in August 2002. The changes cover the treatment of revalued assets in a listed issuer's first annual accounts published after listing and the content requirements for financial statements. The amendments were designed to foster greater transparency.

To help listed issuers and their directors meet their obligations to keep the market informed under the Listing Rules of the Main Board and GEM, we published a Guide on Disclosure of Price-sensitive Information at the beginning of 2002. The

principles and elaboration in the Guide reflect the main criteria that the Stock Exchange considers in its interpretation of the Listing Rules of the Main Board and GEM to determine whether certain information is price-sensitive and when an announcement should be made.

We proposed new organisational structures for listing matters in May 2002, which were subsequently modified in July 2002 to take account of market feedback. The proposals were designed to provide a streamlined and more effective administrative framework for listing matters, with the necessary checks and balances. We will finalise the detailed arrangement in the light of the report by the Expert Group, expected in March 2003.

We also announced several separate initiatives in July 2002 to streamline the listing process and strengthen the procedures for vetting listing applications. They included reorganisation of the Listing Division such that the vetting would be carried out by integrated teams under the direction of senior and experienced staff. The reorganisation is nearly complete and, from April 2003, each Corporate Finance team will be responsible for all aspects of the listing vetting, including accountancy matters, prospectus vetting, and authorisation for the purpose of Companies Ordinance registration. This integrated approach should make the vetting of listing applications and other transactions more efficient.

# Review of Operations

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The Listing Division will shortly issue guidance on its revised approach to the vetting of listing applications and will require the sponsors of listing applicants to adhere strictly to the documentation requirements of the Listing Rules of the Main Board and GEM. The new approach is based on the premise that listing applicants, sponsors, and professional advisors are responsible for ensuring compliance with all legal requirements and all stipulations in the Listing Rules of the Main Board and GEM as well as the standard and quality of their prospectuses.

## Recent Development

The Government appointed a panel – the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure – in September 2002 to review the roles of the Government, the SFC and HKEx on matters relating to the listing of securities and the governance of listed issuers. We welcomed the appointment of the Expert Group and had made detailed submission to it. The Expert Group is expected to submit its report to the Government in March 2003. We look forward to the publication of the Expert Group's report and discussion with the Government on its findings and recommendations.

On 28 January 2003, the Stock Exchange signed a new Memorandum of Understanding (MOU) with the SFC

governing listing matters. The MOU became effective immediately and replaced the memorandum, its addendum, and supplements signed between the two organisations in March and August 2000. The new MOU sets out, as in its predecessor, the roles and responsibilities of the two organisations along with their supervisory relationship.

In preparation for the commencement of the Securities and Futures Ordinance (SFO), which will come into effect on 1 April 2003, the new MOU also details the administrative arrangements for implementing the dual filing regime provided by the Securities and Futures (Stock Market Listing) Rules under the SFO. The dual filing of listing applications and disclosure documents with the Stock Exchange and the SFC will enable the SFC to exercise its powers under the SFO to investigate and, as appropriate, prosecute listing applicants and listed companies which intentionally or recklessly provide false or misleading information.

Within the framework of the new MOU, we also signed a Deed with the SFC under which the Stock Exchange agrees to pay the SFC \$20 million a year, for three years commencing from the date the dual filing regime comes into effect, to help the SFC to defray its costs of administering and taking enforcement action under the regime.



# Review of Operations

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## Risk Management

HKEx participated in a market-wide rehearsal for the financial services sector in January 2002 to test its market contingency plans and inter-organisation communication in case of high impact contingency events, in particular those with cross-market implications, that could undermine the financial stability of Hong Kong. The rehearsal involved several other financial regulators and was led by the Financial Services Bureau (now the Financial Services and Treasury Bureau). Further updates and improvements on the HKEx market contingency plans will be made as and when necessary, based on the results of rehearsals, which will be conducted regularly.

## Securities Market

Total funds raised in 2002 amounted to \$110 billion.

A total of 117 companies were listed in 2002, comprising 60 on the Main Board (of which two were the transfer of listings from GEM), and 57 on GEM. Total funds raised in the initial public offerings (IPO) amounted to \$52 billion, of which \$45 billion were on the Main Board and \$7 billion on GEM. Post-issue fund raising totalled an additional \$58 billion, made up of \$56 billion on the Main Board and \$2 billion on GEM.

Total funds raised by H-share and red chip companies through IPO and post-issue fund raising amounted to \$70.8 billion in 2002, representing 64 per cent of total funds raised.

The derivative warrant market expanded in 2002 as a result of streamlined listing procedures that became effective in December 2001, the introduction of liquidity providers in January 2002, and a reduction in the listing fees for derivative warrants launched on or after 2 April 2002. There were 644 new derivative warrants listed on the Main Board during the year under review, compared with 181 in 2001. Warrant turnover on the Main Board increased by 7 per cent in 2002 compared with that in 2001 and represented more than 7 per cent of total Main Board turnover in 2002.

The first batch of ELI was listed on the Main Board in August 2002. Subsequent activity resulted in a total of 25 listings for the year under review. We posted an ELI calculator on the HKEx website in January 2003 to promote better understanding of the pricing of the instruments. Stock Exchange Participants are permitted to make the calculator available through their websites via hyperlinks.

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. In the first nine months of 2002, GEM was ranked first among its regional peers in terms of funds raised.

Total market turnover for the year under review was \$1,643 billion, compared with \$1,990 billion in 2001. H shares and red chips represented approximately 28 per cent of total turnover in 2002.

# Review of Operations

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We introduced a 30-minute pre-opening session and an index basket order trading mechanism in March 2002. The pre-opening session helps to determine a fair opening price and reduces the loading of the trading system at the commencement of the morning session. The index basket order trading mechanism enables market participants to buy or sell a group of designated stocks with a single order. The mechanism also complements our index products. Between introduction and the end of 2002, there was an average of more than 540 auction and pre-open trades per day during the pre-opening session, with an average transaction value of \$270 million per day.

In December 2002, we completed an upgrading of the network of AMS/3, the Third Generation Automatic Order Matching and Execution System. With the upgraded network, Stock Exchange Participants can increase the order throughput (or throttle rate) of their Open Gateways (OG) to AMS/3 on a user-pays basis. Participants can also install additional OG at their own cost. As at 31 December 2002, 10 Stock Exchange Participants had subscribed for additional throttle rates.

## Derivatives Market

Futures and Options turnover in the year under review rose 4.5 per cent from 2001 to 11,029,404 contracts, a record high.

Hang Seng Index (HSI) Futures' trading volume of 4,802,422 contracts led the market, followed by Hong Kong stock options, with 3,724,705 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. HSI Options volume rose more than 49 per cent in 2002 from the previous year, while Mini-HSI Futures volume rose nearly 44 per cent. Both contracts set one-day volume records in the year under review along with Three-month HIBOR Futures. In addition, Mini-HSI Futures, Hong Kong stock options, Hong Kong stock futures, and Three-year Exchange Fund Note Futures set open interest records in 2002.

In March 2002, the Futures Exchange was granted exempt futures market status in Australia, which allows it to offer its Remote Trading Access (RTA) programme in that country. The RTA programme allows Futures Exchange Participants who are also HKFE Clearing Corporation Participants to offer their qualified clients direct access to HKATS, the Hong Kong Futures Automated Trading System, for the purpose of trading on the Futures Exchange. The RTA programme can also be offered to qualified market participants in the United Kingdom and the United States.

# Review of Operations

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The Block Trade Facility introduced in October 2001 under a six-month pilot programme became a standing facility in April 2002. The facility extends HKEx's services by bringing transactions to its markets that may otherwise be executed in the over-the-counter market. More than 865,000 contracts were traded through the Block Trading Facility during the year under review.

In May 2002, the Bulletin Board function on HKATS became available for the trading of Hong Kong stock options. It had already been available for the trading of HSI Futures and Options. The Bulletin Board function increases market efficiency and gives market participants additional flexibility in their trading strategies.

We also introduced Dow Jones Industrial Average (DJIA) Futures in May 2002. DJIA Futures expanded our range of international benchmark products and enabled us to establish a business relationship with another leading index provider. Average daily volume in 2002 was 41 contracts and an open interest high of 306 contracts was recorded on 7 November 2002.

The two other product changes in May 2002 involved interest rate and currency futures. To meet the needs of the marketplace, we increased the size of the HIBOR futures contracts. The revisions were based on market participants'

comments and designed to strengthen the competitiveness of HIBOR products. In addition, we delisted the One-day Rolling Currency Futures or Rolling Forex contracts after reviewing our products to ensure that they continue to meet the needs and demands of the marketplace in a cost efficient manner.

In July 2002, we gave market participants more choice by introducing three new Hong Kong stock futures contracts and three new Hong Kong stock option classes. Total volume for the six new products in 2002 was nearly 29,000 contracts.

New contingency procedures to clarify the trading arrangement in the event of an interruption in market operations became effective on 1 August 2002. The new procedures were decided upon following consultation with market participants.

We introduced Mini-HSI Options in November 2002 – our second mini contract – to meet the needs of individual investors and other market participants. Mini-HSI Options allow investors to participate in the stock index options market on a small scale and they complement Mini-HSI Futures and our other HSI products. In the first full month of trading, average daily volume for Mini-HSI Options was 246 contracts. Open interest reached a high of 3,115 contracts on 27 December 2002.

# Review of Operations

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## Clearing and Settlement

Average daily settlement efficiency of continuous net settlement stock positions stood at 99.65 per cent on settlement day, rising to 99.96 per cent on the following day.

We introduced the first and second phases of CCASS/3, the new generation Central Clearing and Settlement System, in 2002. We plan to introduce the third and final phases during the first half of 2003. Upon full implementation, CCASS/3 will be capable of supporting multiple markets with different settlement cycles and extended operating hours. CCASS/3 will also facilitate ISO 15022 compliant message exchange to facilitate straight-through-processing (STP).

We introduced new features to our Stock Segregated Account with Statement Service in June 2002. As a result, investors can now receive statements at mailing addresses outside Hong Kong and brokers or custodians can use computer diskettes and CD ROM to send completed application details to us for processing. The use of computer diskettes and CD ROM improves efficiency, especially when a large number of application forms are submitted at one time. The Stock Segregated Account with Statement Service is designed to enable investors to reconcile their stockholdings and trading records with their brokers or custodians against stockholdings and trading record statements issued by the

Hong Kong Securities Clearing Company, a wholly-owned subsidiary of HKEx. At the end of the year under review, there were 1,624 Stock Segregated Accounts with Statement Service.

In July 2002, we consulted the market on third party clearing (TPC) for the securities market. The TPC model under consideration would give Stock Exchange Participants the option to outsource to a third party clearing and settlement of their Stock Exchange trades. In light of market feedback, the model and timing of this initiative will be considered further.

We are evaluating with the market, the SFC, and the Government a number of clearing and settlement initiatives aimed at improving the operating environment of the Hong Kong securities market.

The introduction of the new Derivatives Clearing and Settlement System (DCASS) was rescheduled to end 2003 while the upgrading of HKATS is being pursued separately. DCASS will replace the two systems currently used for the clearing and settlement of contracts traded on HKATS.

## E-Business and Information Services

At the end of the year under review, there were 70 real-time information vendors for the securities market, a decrease of 13 from the end of 2001, and 35 for the derivatives market, a decrease of three. The

# Review of Operations

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total real-time data services provided by these vendors rose to 331 from 290, while the total delayed data services remained at 94.

HKEx Information Services, a wholly-owned subsidiary of HKEx, was appointed in June 2002 as an agent to provide real-time market information from the Shenzhen Stock Exchange (SSE) outside Mainland China. The arrangement enables HKEx and SSE to better meet the growing demand from overseas for securities market information from the Mainland. It also further strengthens HKEx's ties with the stock exchanges in the Mainland.

In July 2002, we signed an agreement with Standard & Poor's (S&P) for the creation of a new series of equity indices covering stocks listed on our Stock Exchange. The S&P/HKEx LargeCap Index, comprising 25 large-cap stocks and representing about 75 per cent of the Main Board's market cap, and the S&P/HKEx GEM Index were introduced on 3 March 2003. The remaining three indices, the S&P/HKEx MidCap, SmallCap, and Composite indices, will be introduced later in 2003. The indices are free-float adjusted, and are calculated and managed by S&P. S&P will seek to license financial products based on the indices. It will also promote the indices as benchmarks for asset managers.

We introduced a new information service in September 2002 to enable market participants to subscribe for price depth information in the derivatives market via information vendors. The service provides aggregated five best bid and ask prices with full volume for all instruments trading on the derivatives market. Previously, the information was only available to Exchange Participants through HKATS.

## IT/Systems

In June 2002, we announced short and medium term measures to address the power failure problems experienced at the primary data centre of the derivatives market on 28 May 2002 that led to the suspension of derivatives trading. The measures, which were recommended by an independent consultant commissioned to review the causes of the power failure, have all been implemented.

There were also several initiatives throughout 2002 to further strengthen our information technology (IT) systems and operations. They included the establishment of a quality development standard to reinforce quality control and assurance of IT outsourcing projects or IT systems/services provided by the vendors of key software. We commissioned an external review of our IT requirements and environment as well as the need for a quality management and certification framework for IT system development and

# Review of Operations

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management. The recommendations from these reviews are being implemented. In addition, we had also begun comprehensive reviews of AMS/3, HKATS, and their satellite systems.

## 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 15 to 20 per cent of HKEx's total income.

Investments are kept sufficiently liquid to meet operating and possible requirements of the Clearing House Funds and margin funds. As at 31 December 2002, 55 per cent of funds were invested in highly liquid investment-grade bonds, 44 per cent in cash or bank deposits, and 1 per cent in global equities. The maturity profile of the investments as at 31 December 2002 was as follows:

	>Overnight	>1 month	>1 year		
Overnight	to 1 month	to 1 year	to 3 years	>3 years	
35%	5%	14%	36%	10%	

Credit exposure was well diversified. In view of uncertain corporate profitability and the negative impact of corporate scandals in the United States, credit quality of the investments was maintained at a high level to minimise credit losses. As at 31 December 2002, all bonds held were of

high-grade and had a weighted average credit rating of Aa2 and a weighted average maturity of 2.1 years. Deposits were placed only with the note-issuing banks in Hong Kong and authorised institutions with a credit rating of A3 or above.

Investment and fund management is governed by guidelines approved by the Board, aimed at optimising return, safeguarding assets and satisfying liquidity requirements. A professional Treasury team in Corporate Treasury is dedicated to the day-to-day management and investment of the funds. External fund managers have also been appointed to manage part of the Corporate Funds.

An Investment Advisory Committee, comprised of non-Executive Directors of the Board and external members from the financial community, advises the company on portfolio management and monitors the risk and performance of our investments. To enhance 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. In 2002, the overall portfolio risk, as measured by VaR methodology, recorded an average, maximum and minimum VaR of \$20 million, \$25 million, and \$16 million respectively.

# Review of Operations

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## China and International Development

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 Mainland China, we also organised listing promotion conferences in Nanjing, Jinan, Hangzhou, Shanghai, and Shenzhen. The conferences attracted representatives from approximately 1,080 Mainland enterprises. In addition, we collaborated with the local governments of a number of the provinces and cities in the Mainland in organising 41 seminars to promote listing in Hong Kong. More than 7,300 people attended these seminars.

The new listings in 2002 included 44 private enterprises which have their main business operations in Mainland China. In addition, there were four red chip and four H-share companies listed on the Main Board, and 12 H-share companies listed on GEM. The total capital raised by these 64 companies amounted to \$43 billion, representing 83 per cent of the total capital raised by IPOs in 2002 in Hong Kong.

We will continue to focus our marketing efforts in Mainland China in 2003, further develop our ties with the Mainland exchanges, and expand our business network in the Mainland through promotional and educational activities. We will also continue to explore possible business co-operation and alliances with other exchanges.

## Business and Market Development

In May of 2002, we entered into a Memorandum of Understanding with the London Stock Exchange (LSE) with a view to facilitating, inter alia, the dual listing of companies in Hong Kong and the United Kingdom. The programme is designed in particular to attract issuers who are seeking greater access to the capital markets in both Europe and Asia.

In April 2002, we acquired 14.47 per cent interest in BondsInAsia, one of Asia's leading platforms for the trading of fixed income instruments. The strategic partnership will enable us to participate in the development of the region's bond markets. It will also provide an opportunity for us to leverage the development of a trading facility for both fixed income securities and interest rate futures contracts, which could generate additional business for HKEx and its participants.

Our share registration operations were sold and merged with Computershare's Hong Kong share registration operations in May 2002. We received 18 per cent of the issued share capital of the merged operations, Computershare Hong Kong Investors Services (CHIS), as consideration for the sale. At the same time, we acquired a further 6 per cent of the issued share capital of CHIS with cash. CHIS has a major position in the market for share registration services in Hong Kong. Its clients include about two-thirds of the 33 constituent companies in the HSI and all of the H-share companies that comprise the Hang Seng China Enterprise Index. The



# Review of Operations

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merger helped us streamline our operations and reduce costs while acquiring a significant interest in a strong company with good growth prospects.

In May 2002, we also formed a joint venture with ADP Wilco, a wholly-owned subsidiary of Automatic Data Processing, to provide transaction-processing services for the securities market. The joint venture will offer Brokers' Electronic Support Services (BESS) to our Stock Exchange Participants. The services will have cross-border capability as well as the capacity for seamless STP.

## Review of Rules of Clearing House Guarantee and Reserve Funds

The Group is currently reviewing the rules of the Clearing House Guarantee and Reserve Funds with the SFC with a view to clarifying the rules to remove any possible ambiguity in interpretation and standardising them across the three funds.

## Exchange Participants

At the end of 2002, there were 509 Stock Exchange Participants and 133 Futures Exchange Participants. There were also 34 holders of Stock Exchange Trading Rights and 59 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.

The two-year moratorium established at the time of the merger on the issue of new Trading Rights (save for such rights as may be issued in respect of alliances with other

stock exchanges or futures exchanges) has been lifted. Since 6 March 2002, each new Stock Exchange Trading Right and Futures Exchange Trading Right can be issued for no less than \$3 million and \$1.5 million respectively. There will be no restrictions on HKEx to issue new Trading Rights from 6 March 2004. During the year under review, no applications for new Trading Rights had been received.

## Websites

There was increasing use of the HKEx websites during the year under review. There were 9,200,520 visits to the HKEx website and the linked GEM website in 2002, compared with 5,852,293 in 2001. Page views in 2002 increased to 97,938,829 from 65,899,244 in 2001.

The HKEx website was upgraded in 2002 with the addition of on-line questionnaires for our consultation papers. We also added more frequent updates of data from the derivatives market and a Continuous Professional Training section that provides easy access to course details, schedules, and application forms.

In August 2002, we started posting Exchange News on the HKEx and GEM websites immediately after its dissemination through AMS/3. The initiative was part of our on-going efforts to improve market transparency. Exchange News covers a wide range of market information, such as short selling turnover, new options series, manual transactions for Equity Linked Instruments and derivative warrants, Exchange Fund Note data, closing bid and ask quotes for

# Review of Operations

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Hong Kong stocks traded in London, and last sale prices of Hong Kong stocks traded in the United States. Previously, Exchange News was posted on our websites after the close of the securities market.

## 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. The staff contributed to the Community Chest by participating in Dress Casual Day and the \$10 Donation Drive.

We continued to provide a wide range of public education programmes in 2002. We organised 34 investor seminars and participated in Hong Kong's Information Infrastructure Expo as well as other seminars and conferences run by professional and international bodies. The highlights included a continuing professional development forum in October 2002 for directors of listed companies. The event was organised by the Hong Kong Institute of Directors and the Hong Kong Securities Institute, and sponsored by HKEx and the SFC. We also continued to provide briefings on our operations for teachers from Hong Kong's secondary schools, business students, journalists, and other important visitors.

## Staff

Our achievements during the year under review would not have been possible without the dedication and hard work of our staff. Their efforts have helped to improve the quality of the market, better our products and services, and keep our costs down. I thank them for their contributions. I am confident that with their continued efforts and dedication, HKEx will have another successful year in 2003.

I decided not to seek renewal of my contract with the Group upon its expiry in March 2003. As a result, I will step down from my post as the Chief Executive of HKEx after the annual general meeting in April. I am honoured for having the privilege of serving as the first chief executive of HKEx. I appreciate the support I have received from the Board of Directors and the staff, and I wish the group and the people associated with the group all the best in the future.

**KWONG Ki Chi**

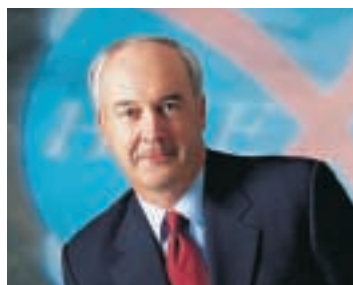
Director and Chief Executive

12 March 2003



# Senior Management

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**Frederick Grede**  
Chief Operating Officer



**Lawrence Fok**  
Deputy Chief Operating Officer



**David Cheung**  
Chief Financial Officer



**Karen Lee**  
Head - Listing, Regulation and  
Risk Management



**Walter Reisch**  
Head - Clearing



**Stephen Law**  
Head - IT/Systems



**Roger Lee**  
Head - E-Business and  
Information Services

# Senior Management

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**Jimmy Ho**  
Head - Corporate Strategy



**Coven Hui**  
Head - Group Internal Audit



**Mary Kao**  
Head - Legal and  
Secretarial Services



**Henry Law**  
Head - Corporate Communications



**Brenda Yen**  
Head - Human Resources



**Joseph Mau**  
Company Secretary

# Management Discussion and Analysis

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(Financial figures are expressed in Hong Kong dollars)

## OVERALL PERFORMANCE

The Group recorded a profit attributable to shareholders of \$593 million for the year, compared with \$740 million for 2001. The 20 per cent drop in profit was mainly attributable to the continued decline in stock market activities and low level of interest rates, which have caused a significant drop in income from sale of information, clearing and settlement fees and net interest income.

### Income

Total income (including share of profits less losses of associated companies) for the year decreased by 9 per cent to \$1,814 million (2001: \$1,998 million).

The slow growth in the global economy, decline in consumer confidence, the accounting and corporate governance scandals affecting major corporations in the US, and the risk of war against Iraq kept investors away from the market in 2002. Closer to home, prolonged high unemployment, deflation and decline in property prices in Hong Kong have caused investor sentiment to deteriorate further, leading to a 18 per cent drop in the average daily turnover on the Stock Exchange to \$6.7 billion in 2002 (2001: \$8.2 billion). Although the average daily number of derivatives contracts traded on the Futures Exchange increased by 10 per cent, the decline in cash market activities and the 8 per cent reduction in the average daily number of stock options contracts traded have caused total trading fees, transaction levy and trading tariff to drop by 6 per cent to \$332 million (2001: \$351 million).

Despite the poor market conditions, 60 new companies joined the Main Board and 57 the Growth Enterprise Market (GEM) during the year, raising \$52 billion of new capital. Listing fee income rose by 16 per cent to \$320 million (2001: \$275 million), as a result of higher number of listed securities and new listings of derivatives warrants. As at 31 December 2002, there were 812 companies listed on the Main Board and 166 on GEM (31 December 2001: 756 and 111 respectively).

In line with the 18 per cent decline in cash market activities, clearing and settlement fee income dropped by 15 per cent to \$181 million (2001: \$214 million). Depository, custody and nominee services fee income also fell by 7 per cent to \$211 million (2001: \$228 million) mainly due to lower scrip fee income for the year. Similarly, income from sale of information declined by 13 per cent to \$294 million (2001: \$337 million) as the demand for stock information decreased.

Investment income decreased by 31 per cent to \$285 million (2001: \$414 million), primarily due to a decline of 32 per cent in net interest income to \$261 million (2001: \$382 million), as the full-year impact of the successive interest rate cuts in 2001 was felt which led to mark-to-market and realised losses on our investment portfolio. Interest rates fell further in the fourth quarter of 2002 as Hong Kong followed suit after the US Federal Reserve reduced the Fed Funds Rate to a 41-year low. During the two years under review, the average 6-month Hong Kong Exchange

# Management Discussion and Analysis

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Fund Bill rate dropped from 3.41 per cent in 2001 to 1.70 per cent in 2002, and the average 90-day US Treasury Bill rate declined from 3.47 per cent to 1.62 per cent.

For the year ended 31 December 2002, the Group achieved a positive return on investments of 3.10 per cent (2001: 5.09 per cent). The portfolio recorded a spread of 140 basis points above the 6-month Hong Kong Exchange Fund Bill yield (2001: 168 basis points).

The average amount of funds available for investment shrank by 1 per cent to \$9.1 billion, primarily due to a drop in margin funds received as margin requirements for various derivative products were reduced in line with volatility movements during the year. As at 31 December 2002, 44 per cent of the funds were invested in cash or bank deposits, 55 per cent in high-grade bonds with an average credit rating of Aa2, and 1 per cent in global equities.

## Operating Expenses

Total operating expenses decreased by 1 per cent to \$1,164 million (2001: \$1,176 million).

Staff costs and related expenses were further reduced by \$35 million to \$493 million (2001: \$528 million), principally due to a 7 per cent cut in salary and benefit costs.

Due to the Group's commitment to constantly enhance the capability and resilience of its trading and settlement systems, information technology and

computer maintenance expenses rose by 14 per cent from \$231 million to \$263 million, mainly attributable to expenditures incurred on the upgraded Central Clearing and Settlement System (CCASS/3) during the year.

Legal and professional fees for the year decreased by 36 per cent from \$62 million to \$39 million, primarily owing to professional fees incurred for several one-off consulting projects in 2001.

Depreciation and amortisation costs increased by 7 per cent to \$163 million (2001: \$153 million), mostly due to the additional depreciation charge arising from the rollout of the first and second phases of CCASS/3 during 2002.

Other operating expenses rose by 4 per cent from \$87 million to \$91 million largely on account of restructuring costs incurred.

## Taxation

The Group's taxation charge in 2002 declined by 31 per cent to \$57 million (2001: \$82 million), predominantly caused by the lower profit reported for the year.

## Liquidity, Financial Resources, Gearing and Capital Commitments

Working capital increased by 4 per cent to \$4,207 million at 31 December 2002 (2001: \$4,037 million) mainly due to current year profit retained. Bank balances and time deposits of corporate funds fell by \$615 million primarily due to the settlement of other payables and accruals.



# Management Discussion and Analysis

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Although the Group has consistently been in a very liquid position, credit facilities have nevertheless been put in place for contingency purposes. As at 31 December 2002, the Group's total available credit facilities amounted to \$2,763 million (2001: \$2,875 million), of which \$1,500 million were repurchase facilities to augment the liquidity of the margin funds and \$1,100 million were for meeting obligations of HKSCC in the Central Clearing and Settlement System (CCASS) in circumstances where CCASS Participants default on their payment obligations. Borrowings of the Group have been very rare and, if required, are mostly event driven, with little seasonality. As at 31 December 2002, the only facility drawn down was a fixed rate bank loan of SGD11 million (equivalent to HK\$49 million) with a maturity of less than one year which was used for the purpose of hedging the currency exposure of the Group's investment in Singapore (2001: SGD11 million, equivalent to HK\$46 million). The loan will be renewed annually.

As at 31 December 2002, the Group's gearing ratio, measured on the basis of total borrowings as a percentage of total shareholders' equity, was less than 1 per cent (2001: less than 1 per cent).

The Group's capital expenditure commitments, largely in respect of its ongoing investments in facilities and technology, amounted to \$94 million as at 31 December 2002 (2001: \$317 million). The Group has adequate financial resources to fund its commitments on capital expenditures from its existing cash resources and cash flows generated from its operations.

As at 31 December 2002, 99.8 per cent of the Group's cash and cash equivalents (comprise cash on hand, bank balances and time deposits within three months of maturity when acquired) were denominated in Hong Kong dollars (HKD) and United States dollars (USD).

## **Charges on Assets**

As at 31 December 2001, the Group had a \$10 million overdraft facility with a bank in Hong Kong, which was secured by a pledge of the Group's time deposits of an equivalent amount at that bank. This overdraft facility was not utilised and was terminated in 2002. The Group did not have any charges on assets as at 31 December 2002.

## **Significant Investments Held and Material Acquisitions and Disposals of Subsidiaries**

The Group has been holding 1 per cent (10 million shares) of the issued ordinary share capital of Singapore Exchange Limited since November 2000.

On 2 April 2002, the Group acquired 3.6 million shares (14.47 per cent as at 31 December 2002) of the issued ordinary share capital of BondsInAsia Limited, an unlisted company incorporated in Hong Kong which provides an electronic trading platform for bond markets in Asia.

On 15 May 2002, the Group and Wilco International Limited, a wholly-owned subsidiary of Automatic Data Processing, Inc., formed a new joint venture, Wilco International Processing Services Limited, to provide Brokers' Electronic Support Services to Stock Exchange Participants.



# Management Discussion and Analysis

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On 31 May 2002, the share registration operations of the Group's clearing business, Hong Kong Registrars Limited (HKRL), a wholly-owned subsidiary, were sold and merged with those of Central Registration Hong Kong Limited, which has been renamed as Computershare Hong Kong Investor Services Limited (CHIS). The Group received 18 per cent of the issued share capital of CHIS as consideration for the sale of HKRL. On the same date, the Group increased its holding in CHIS to 24 per cent by acquiring a further 6 per cent of the issued share capital of CHIS by cash.

## **Exposure to Fluctuations in Exchange Rates and Related Hedges**

When seeking to optimise returns on its funds available for investment, the Group may invest in non-HKD securities from time to time. Forward foreign exchange contracts or foreign currency credit facilities may be used to hedge the currency exposure of the Group's non-HKD investments to mitigate risks arising from fluctuations in exchange rates. As at 31 December 2002, aggregate net open foreign currency positions amounted to HK\$1,924 million, of which HK\$200 million were non-USD exposures (2001: HK\$1,947 million, of which HK\$72 million were non-USD exposures). The Group's foreign currency liabilities, in the form of margin deposits or collateral received, are hedged by investments in the same currencies.

## **Contingent Liabilities**

The Unified Exchange Compensation Fund (Compensation Fund) is a fund set up under the Securities Ordinance (SO) for the

purpose of compensating any person dealing with a Stock Exchange Participant (other than another Stock Exchange Participant) for any pecuniary losses suffered as a result of a default of the Stock Exchange Participant. According to section 109(3) of the SO, the maximum compensation amount is \$8 million for each Stock Exchange Participant's default. Under section 113(5A) of the SO, the Stock Exchange may, upon satisfying certain conditions, with the approval of the Securities and Futures Commission (SFC), allow an additional payment to the successful claimants before apportionment. Under section 107(1) of the SO, the Stock Exchange has contingent liabilities to the Compensation Fund as it shall replenish the Compensation Fund upon the SFC's request to do so. The amounts to be replenished should be equal to the amount paid in connection with the satisfaction of the claims, including any legal and other expenses paid or incurred in relation to the claims but capped at \$8 million per default. As at 31 December 2002, there were outstanding claims received in respect of 14 defaulted Stock Exchange Participants (2001: 15).

Under the new compensation arrangements to be implemented on 1 April 2003 under the Securities and Futures Ordinance (SFO), a new Investor Compensation Fund would replace the existing Compensation Fund, the Commodity Exchange Compensation Fund and the Dealers' Deposit Schemes for non-exchange participant dealers. The new arrangements would not require Exchange Participants to make deposits to the Investor Compensation Fund. Existing

# Management Discussion and Analysis

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deposits would be returned to the Stock Exchange and the Futures Exchange in accordance with the provisions of the SFO. The arrangements would remove the requirement for the Stock Exchange to replenish the Investor Compensation Fund.

The Stock Exchange has undertaken to indemnify the Collector of Stamp Revenue against any loss of revenue resulting from any underpayment or default or delay in payment of stamp duty by its Participants, up to \$200,000 in respect of default of any one Participant. In the unlikely event that all of its 471 trading Participants as at 31 December 2002 (2001: 492) default, the maximum contingent liability of the Stock Exchange under the indemnity will amount to \$94 million (2001: \$98 million).

Pursuant to Section 21 of the Exchanges and Clearing Houses (Merger) Ordinance, HKEx gave an undertaking on 6 March 2000 in favour of HKSCC to contribute an amount not exceeding \$50 million in the event of HKSCC being wound up while it is a wholly-owned subsidiary of HKEx or within one year after HKSCC ceases to be a wholly-owned subsidiary of HKEx, for payment of the debts and liabilities of HKSCC contracted before HKSCC ceases to be a wholly-owned subsidiary of HKEx, and for the costs, charges and expenses of winding up.

HKEx has given a guarantee to secure banking facilities granted to HKSCC since 13 December 2000. These facilities, on a committed basis of an aggregate amount of \$1.1 billion, were granted to HKSCC by five banks to provide stand-by liquidity to

meet the obligations of HKSCC in CCASS in circumstances where the CCASS Participants default on their payment obligations. As at 31 December 2002 and 31 December 2001, none of these banking facilities was utilised.

HKEx has given a guarantee to secure banking facilities of SGD12 million to HKEx (Singapore) Limited for financing its investments since 16 April 2001. As at 31 December 2002, SGD11 million (equivalent to HK\$49 million) of the facility was drawn down (2001: SGD11 million, equivalent to HK\$46 million). The loan will mature within one year and has a fixed rate of interest.

## Employees

HKEx has developed its human resources policies and procedures based on performance and merit. The Group ensures that the pay levels of its employees are competitive and employees are rewarded on a performance-related basis within the general framework of the Group's salary and bonus system.

Share options may be granted to Executive Directors and employees of the Group to subscribe for shares in HKEx in accordance with the terms and conditions of the Share Option Schemes approved by the shareholders of HKEx at an extraordinary general meeting held on 31 May 2000.

Following the merger of the businesses of the Stock Exchange Group, the Futures Exchange Group and the HKSCC Group in 2000, HKEx has succeeded in streamlining its workforce and the number of employees

# Management Discussion and Analysis

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fell from 1,052 prior to the merger to 797 as at 31 December 2002. Total employees' cost was reduced by \$106 million or 18 per cent from \$599 million in 2000 to \$493 million in 2002.

## Prospects

As a substantial part of HKEx's income is derived from trading fees, clearing and settlement fees, listing fees and interest income, the performance of the Group is heavily influenced by external factors including, in particular, market sentiment, the level of activities on the Stock Exchange and Futures Exchange, as well as movements in interest rates.

Given the importance of external factors to HKEx's performance, the year ahead is likely to remain challenging, not least because of the risk of war in the Middle East, fear of terrorist activities worldwide, and uncertainties over the economic performance in the United States, Europe and Japan.

The uncertain external environment, coupled with the likely continuation of high unemployment, deflation, and weak property prices domestically would suggest that activity on the securities and derivatives markets is likely to remain subdued, at least in the first half of 2003, and this could have an adverse impact on revenues.

To meet the challenges ahead, HKEx will seek to further raise the quality of its markets and ensure that its services remain competitive. It will pursue initiatives to attract more investors and capital raising companies to Hong Kong. To develop a

more diverse income base, the Group will further introduce new financial products. It will seek additional opportunities for business co-operation and alliances with exchanges and clearing houses on the Mainland China and overseas. Stringent cost control will be maintained over the Group's operating costs.

Following China's accession to the World Trade Organisation, the pressure on both public and private enterprises to upgrade themselves in the face of market liberalisation would increase. Thus, it can be anticipated that these private enterprises from the Mainland would be contemplating raising capital in the securities market, including listing in Hong Kong. By virtue of its unrivalled geographic proximity and ties with the Mainland, Hong Kong is well positioned to benefit from this. In forging closer economic co-operation with the Mainland, the Hong Kong Government and the private sector are taking initiatives to expedite the economic integration with the rapidly growing economy of the Pearl River Delta. Discussions on a Closer Economic Partnership Arrangement between the Mainland and Hong Kong are expected to come to fruition with agreement on the main parts by June 2003. These are expected to boost capital formation activities in Hong Kong. The Group will closely monitor economic and capital market developments on the Mainland. It will continue to focus its marketing efforts in the Mainland and strive to strengthen Hong Kong's position as the primary international capital raising centre for Mainland companies.



# Report of the Directors

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The Directors submit their report together with the audited accounts of Hong Kong Exchanges and Clearing Limited (HKEx) and its group of companies (collectively, the Group) for the year ended 31 December 2002.

## PRINCIPAL ACTIVITIES

HKEx is a recognised exchange controller under the Exchanges and Clearing Houses (Merger) Ordinance (Merger Ordinance). It owns and operates the only stock exchange and futures exchange in Hong Kong and their related clearing houses, namely Hong Kong Securities Clearing Company Limited (HKSCC), HKFE Clearing Corporation Limited (HKCC) and The SEHK Options Clearing House Limited (SEOCH).

The Stock Exchange of Hong Kong Limited (the Stock Exchange) has the exclusive right under the Stock Exchanges Unification Ordinance to operate and maintain a stock market in Hong Kong and Hong Kong Futures Exchange Limited (the Futures Exchange) is licensed under the Commodities Trading Ordinance to establish and operate a commodity exchange. HKSCC, SEOCH and HKCC are the recognised clearing houses for the purposes of the Securities and Futures (Clearing Houses) Ordinance.

The Group's revenue is derived solely from business activities in Hong Kong. An analysis of the Group's income and

contribution to operating profit for the year ended 31 December 2002 is set out in note 2 to the accounts.

## RESULTS AND APPROPRIATIONS

The results of the Group for the year are set out in the consolidated profit and loss account on page 61.

An interim dividend of \$0.08 per share, amounting to a total of about \$83 million, was paid to shareholders during the year.

The Directors recommend the payment of a final dividend of \$0.43 per share to shareholders on the register of members on 15 April 2003, which together with the interim dividend payment amounts to a total of about \$532 million, and the retention of the remaining profit for the year.

The share register will be closed from Thursday, 10 April 2003 to Tuesday, 15 April 2003, both dates inclusive, during which period, no transfer of shares will be registered. Dividend warrants will be despatched to shareholders on or about Friday, 25 April 2003. In order to qualify for the final dividend, all properly completed transfer forms accompanied by the relevant share certificates must be lodged with HKEx's registrar, Hong Kong Registrars Limited, at Rooms 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong not later than 4:00 p.m. on Wednesday, 9 April 2003.

# Report of the Directors

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## DIVIDEND POLICY

The Directors have adopted a dividend policy of providing shareholders with regular dividends at a target payout ratio of 90 per cent. The Group will continue to actively and regularly review and manage its capital structure to ensure optimal capital structure and shareholder returns, considering:

- the future capital requirements of the Group and capital efficiency;
- the need to retain capital to support the Group's stability, growth and maintain prudent risk management;
- prevailing and projected profitability;
- prevailing market dividend yields;
- projected operating cash flow and the extent to which this will be sufficient to meet projected capital expenditure; and projected strategic investment opportunities.

## RESERVES

The distributable reserves of HKEx as at 31 December 2002, calculated under section 79B of the Companies Ordinance, amounted to \$3,554 million (2001: \$3,286 million).

The movements in reserves of the Group and HKEx during the year are set out in notes 26 to 29 to the accounts.

## GROUP FINANCIAL SUMMARY

A summary of the results and the assets and liabilities of the Group for the past five financial years is set out on pages 4 and 5.

## FIXED ASSETS

Particulars of the movements during the year in the fixed assets of the Group are set out in note 13 to the accounts.

## SHARE CAPITAL

Details of the share capital during the year are set out in note 25 to the accounts.

## SHARE OPTION SCHEMES

### Pre-Listing Share Option Scheme (Pre-Listing Scheme)

The Pre-Listing Scheme was adopted by HKEx on 31 May 2000. Share options were granted to employees of HKEx or its subsidiaries in accordance with the terms of the Pre-Listing Scheme on 20 June 2000. No further options can be, or have been, issued under the Pre-Listing Scheme from 27 June 2000, the date of listing of HKEx on the Stock Exchange. The key terms of the Pre-Listing Scheme are summarised herein below:

- (i) The participants of the Pre-Listing Scheme include any employee (including any executive director) of HKEx or its subsidiaries.

# Report of the Directors

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- (ii) The total number of shares available for issue is 23,245,020 which represents 2.2 per cent of the existing issued share capital of HKEx as at the date of this report.
  - (iii) The maximum entitlement of any one participant, when aggregated with shares issued and issuable under all options granted to him, must not exceed 25 per cent of the aggregated number of shares for the time being issued and issuable under the Pre-Listing Scheme.
  - (iv) An option granted is exercisable subject to a vesting scale which shall commence on 6 March 2002 in tranches of 25 per cent and reaching 100 per cent from 6 March 2005, and in any event shall end not later than 30 May 2010, subject to the provisions for early exercise and/or termination contained in the Pre-Listing Scheme.
  - (v) A non refundable remittance of \$1 by way of consideration for the grant of an option is required to be paid by each grantee upon acceptance of the option.
  - (vi) The subscription price for a share in HKEx in respect of any particular option granted is determined based on a formula:  $P=80\% (A \times B)$ , where “P” is the subscription price; “A” is 18.81, a price/earnings multiple determined by reference to the price/earning multiples of various financial companies listed on the Stock Exchange and/or overseas; and “B” is the earnings of the Group, based on its audited combined results for the year ended 31 December 1999 as if the current group structure of HKEx had been in existence throughout the year divided by 1,040,664,846 shares in issue.
  - (vii) The life of the Pre-Listing Scheme is until 30 May 2010.
- Share options were granted to continuous contract employees of HKEx or its subsidiaries on 20 June 2000. Share options granted are exercisable between 6 March 2002 to 30 May 2010, in tranches of 25 per cent each reaching 100 per cent as from 6 March 2005 at a subscription price (calculated on the basis of the formula described above) of \$7.52 per share.
- The number of shares issuable under the share options outstanding as at 1 January 2002 and 31 December 2002 were 27,267,384 shares and 23,253,020 shares respectively. During the year, 2,916,000 shares were issued upon the exercise of options, and the weighted average closing price immediately before the dates on which the options were exercised was about \$12.24. A total of 1,098,364 shares issuable under the options had lapsed during the year due to the resignation of option holders.



# Report of the Directors

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As at 1 January 2002, 1,454,126 shares were issuable under an option granted to a Director of HKEx, of which 362,000 shares were subscribed during the year, and 1,092,126 shares remain issuable as at 31 December 2002. The closing price immediately before the date on which the option was exercised was \$12.00. Please refer to the section of “Directors’ interests in Shares and Options” for more information.

## Post-Listing Share Option Scheme (Post-Listing Scheme)

The Post-Listing Scheme was amended on 17 April 2002 to comply with the new requirements of Chapter 17 of the Listing Rules effected on 1 September 2001. No share option has so far been granted under the Post-Listing Scheme since its adoption on 31 May 2000. The key terms of the Post-Listing Scheme are summarised herein below:

- (i) The purpose of the Post-Listing Scheme is to attract and retain high calibre employees of HKEx or its subsidiaries.
- (ii) The participants of the Post-Listing Scheme include any employee (including any executive director) of HKEx or its subsidiaries.
- (iii) The total number of shares available for issue is 77,897,464 which represents 7.5 per cent of the existing issued share capital of HKEx at the date of this report.
- (iv) Unless approved by shareholders in general meeting, no employee shall be granted an option if the total number of shares issued and to be issued upon exercise of the options granted and to be granted to such employee in any 12-month period up to the date of the latest grant would exceed 1 per cent of the issued share capital of HKEx from time to time.
- (v) An option may be exercised in accordance with the terms of the Post-Listing Scheme at any time during a period to be notified by the Board to each grantee. Such period may commence on the second anniversary of the date on which the option is offered in tranches of 25 per cent and reaching 100 per cent from the fifth anniversary of the date on which the option is offered, and in any event shall end not later than 10 years from the date upon which the option is granted and accepted, subject to the provisions for early exercise and/or termination as contained in the Post-Listing Scheme.
- (vi) A non refundable remittance of \$1 by way of consideration for the grant of an option is required to be paid by each grantee upon acceptance of the option.

# Report of the Directors

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(vii) The subscription price of a share in respect of any particular option granted shall be at least the higher of (a) the closing price of HKEx shares on the Stock Exchange, as stated in the Stock Exchange's daily quotations sheet on the relevant offer date in respect of such option; or (b) the average of the closing prices of HKEx shares on the Stock Exchange on the five trading days immediately preceding the date of offer of the option; or (c) the nominal value of a share in HKEx.

(viii) The life of the Post-Listing Scheme is until 30 May 2010.

## SUBSIDIARIES

Particulars of HKEx's subsidiaries, as at 31 December 2002 are set out in note 24 to the accounts.

## DIRECTORS' EMOLUMENTS

Particulars of the Directors' emoluments disclosed pursuant to Section 161 of the Companies Ordinance and Appendix 16 of the Listing Rules are set out in note 8 to the accounts.

## DIRECTORS' SERVICE CONTRACT

No Director has any existing or proposed service contract with any member of the Group (excluding contracts expiring or determinable by the employer within one year without payment of compensation (other than statutory compensation)).

## DIRECTORS

The Directors of HKEx during the year and up to the date of this report were:

### Non-executive Chairman

LEE Yeh Kwong, Charles

### Executive Director and Chief Executive

KWONG Ki Chi

### Non-executive Directors

CHAN Cho Chak, John

FAN Chor Ho, Paul

FRESHWATER, Timothy George

KWOK Chi Piu, Bill

LEE Jor Hung, Dannis

LEE Kwan Ho, Vincent Marshall

LEONG Ka Chai

LIU Jinbao

LO Ka Shui

SETO Gin Chung, John

STRICKLAND, John Estmond

WARD, Rodney Gordon

YUE Wai Keung

As at 31 December 2002, the Board consisted of fifteen Directors. Messrs. LEE Yeh Kwong, Charles, CHAN Cho Chak, John, Timothy George FRESHWATER, LEONG Ka Chai, LIU Jinbao, LO Ka Shui, John Estmond STRICKLAND and Rodney Gordon WARD were appointed by the Financial Secretary of the HKSAR in the interest of the investing public or in the public interest (Public Interest Directors). Messrs. FAN Chor Ho, Paul, KWOK Chi Piu,

# Report of the Directors

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Bill, LEE Jor Hung, Dannis, LEE Kwan Ho, Vincent Marshall, SETO Gin Chung, John and YUE Wai Keung, were elected by shareholders at an extraordinary general meeting held on 27 March 2000. The Chief Executive of HKEx is an *ex-officio* member of the Board. The Board recommended Mr LEE Yeh Kwong, Charles to serve as non-executive Chairman and his appointment was approved by the Chief Executive of the HKSAR.

The term of services of all Non-executive Directors will expire at the conclusion of the forthcoming annual general meeting to be held on 15 April 2003 (2003 AGM). Shareholders will be invited to elect up to six Non-executive Directors at the 2003 AGM to fill the vacancies of the six retiring Directors who were elected by shareholders in 2000. Details of the proposed candidates standing for election are set out in the circular sent together with this annual report.

Under Section 20(2) of the Merger Ordinance, the number of Public Interest Directors immediately following the 2003 AGM and thereafter, shall not be more than the maximum number of other members of the Board (but excluding the Chief Executive).

The employment contract of Mr Kwong Ki Chi, Chief Executive and Executive Director, with HKEx has expired on 6 March 2003 but Mr Kwong has agreed to stay on until the conclusion of the 2003 AGM.

The Securities and Futures Commission (SFC) had, on 8 June 2000, confirmed the independence of all non-executive Directors.

## BIOGRAPHY OF DIRECTORS AND SENIOR MANAGEMENT Directors

### (a) Non-executive Chairman

LEE Yeh Kwong, Charles, GBS, JP, aged 66, has been the Chairman of HKEx since 6 March 2000. Mr Lee is the Chairman of the Mandatory Provident Fund Schemes Authority, and one of the founders of the solicitors' firm of Woo, Kwan, Lee & Lo in Hong Kong. He is a former member of the Council of the Stock Exchange (1988 to 1994) and a former Chairman of the Stock Exchange (1992 to 1994). He has held a number of Government appointments, including member of the Executive Council of Hong Kong (1997 to 2002), Secretary to the Companies Law Revision Committee (1968 to 1973), member of the Governor's Business Council (1992 to 1997), Hong Kong Affairs Adviser (1993 to 1997), and member of the Selection Committee of the Hong Kong Special Administrative Region of the People's Republic of China in 1996. Mr Lee is also actively involved in numerous community activities, and is a member of the Equal Opportunities Commission of Hong Kong, Chairman of the Council of the Open University of Hong Kong, a member of the Court of the Hong Kong Polytechnic University, a member of the Council of the Hong Kong University of Science and Technology, and the Vice-Patron of the Community Chest. He is

# Report of the Directors

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admitted as a solicitor in both Hong Kong and England & Wales, and is also a qualified accountant and chartered secretary. He has over 30 years of experience in the securities industry.

## (b) Executive Director

**KWONG Ki Chi, GBS, JP**, aged 51, has been the Executive Director and Chief Executive of HKEx since 6 March 2000. Mr Kwong is also the chairman and director of various subsidiaries of HKEx. Prior to joining HKEx on 6 March 2000, Mr Kwong served in the Government from September 1972 to March 2000. His postings in the Government included the positions of Secretary for Information Technology and Broadcasting (May 1998 to March 2000) and Secretary for the Treasury (April 1995 to April 1998). He holds a Bachelor of Science degree from the University of Hong Kong, a Master of Philosophy degree from the University of Cambridge and a Diploma in Management Studies from the Chinese University of Hong Kong.

## (c) Non-executive Directors

**CHAN Cho Chak, John, GBS, JP**, aged 59, has been a Non-executive Director of HKEx since 3 April 2000. Mr Chan is the Managing Director of The Kowloon Motor Bus Holdings Limited (KMB) and the Chairman of RoadShow Holdings Limited. He is a former Chairman of HKSCC, and a non-executive director of Hang Seng Bank

Limited and Guangdong Investment Limited. Mr Chan holds various community appointments, including being Deputy Chairman of the Hong Kong Jockey Club, Council Chairman of the Hong Kong University of Science and Technology, and Board Member and Executive Committee Vice Chairman of The Community Chest. Prior to joining KMB, Mr Chan served in the Government for two periods, from 1964 to 1978 and from 1980 to 1993. Among the key posts he held over the years were those of Private Secretary to the Governor, Deputy Secretary (General Duties), Director of Information Services, Deputy Chief Secretary, Secretary for Trade and Industry and Secretary for Education and Manpower. He also served as a member of the Executive Council from 1992 to 1993. Mr Chan was Executive Director and General Manager of Sun Hung Kai Finance Company Limited from 1978 to 1980. He was awarded the Gold Bauhinia Star in July 1999. He holds a Bachelor of Arts degree, a Diploma in Management Studies and an Honorary Doctor of Business Administration degree. He has about 10 years of experience in the securities industry.

**FAN Chor Ho, Paul, JP**, aged 61, has been a Non-executive Director of HKEx since 3 April 2000. Mr Fan is the Chairman of Paul Fan Securities Limited. He was the former Chairman of the Hong Kong Stockbrokers Association and a member of the Council

# Report of the Directors

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of the Stock Exchange from 1990 to 1993. He was a member of the Advisory Committee to the SFC from 1993 to 1997 and again serving in the same capacity from 2001. Mr Fan is a director of the Hong Kong Securities Institute and holds many appointments on other Government boards and committees including the Chairman of the Hong Kong Awards for Young People. He is also actively involved in community activities particularly with the Lions Clubs. Mr Fan was awarded with Her Majesty The Queen's Badges of Honour in 1991. Mr Fan graduated from King's College, Hong Kong before starting his career in financial and banking industry. Mr Fan has over 30 years of experience in the securities and futures industry.

**FRESHWATER, Timothy George**, aged 58, has been a Non-executive Director of HKEx since 3 April 2000. Mr Freshwater is Chairman-Corporate Finance (Asia) of Goldman Sachs (Asia) L.L.C. Before that, he was Chairman of Jardine Fleming (1999), with regional responsibility for the Jardine Fleming group's businesses in 14 countries in the Asia-Pacific region. He was a member of the Hong Kong Takeovers Panel from 1997 to 1999 and is currently a member of the Hong Kong Securities and Futures Appeals Panel. Mr Freshwater is admitted as a solicitor in England & Wales and in Hong Kong. After obtaining Bachelor of Laws and Master of Arts degrees at the

University of Cambridge he joined the international law firm Slaughter and May in 1967 and remained with them for 29 years before joining the Jardine Fleming group in 1996. He became a partner in Slaughter and May in 1975 and worked in their Hong Kong office for seven years between 1978 and 1985. He was a member of the Council of the Law Society of Hong Kong from 1981 to 1985 and President of the Law Society of Hong Kong in 1984/5. He returned to London in late 1985 and was head of Slaughter and May's worldwide corporate practice from 1993 until 1996. He has over 30 years of experience in the securities industry.

**KWOK Chi Piu, Bill**, aged 50, has been a Non-executive Director of HKEx since 3 April 2000. Dr Kwok is the Managing Director of Wocom Holdings Limited. He is currently a director of the Hong Kong Securities Institute and serves on the Government's Advisory Committee on Human Resources Development in the Financial Services Sector. He is a member of the Professional Advisory Board of the Asian Institute of International Financial Law at the University of Hong Kong. He is also a director of Wing On International Holdings Limited and Wing On Company International Limited. He was the Chairman of the Hong Kong Securities Institute from 1999 to 2001, a director of the Futures Exchange from 1991 to 2000 and a Vice

# Report of the Directors

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Chairman from 1997 to 2000. He was also a member of the Financial Services Advisory Committee of the Hong Kong Trade Development Council from 1996 to 2002. Dr Kwok holds a Bachelor of Science (Chemistry) degree and a Bachelor of Arts (Economics) degree from Stanford University as well as a Doctor of Philosophy (Biochemistry) degree from the University of Chicago. He has about 20 years of experience in the securities and futures industry.

**LEE Jor Hung, Dannis, BBS**, aged 48, has been a Non-executive Director of HKEx since 3 April 2000. Mr Lee is the Chairman of DL Brokerage Limited and a Non-executive Director of Stockmartnet Holdings Limited. He is a member of the Appeals Panel to the SFC. Mr Lee is a Permanent Honorable President of the Hong Kong Stockbrokers Association and was the Chairman of that Association from 1997 to 1999. Mr Lee is a former member of the Advisory Committee to the SFC and a former member of the Council of the Stock Exchange (1991 to 1997 and Vice Chairman 1994/1995) and a former director of HKSCC (1992 to 1997 and Vice Chairman 1995 to 1997). Mr Lee holds a Bachelor degree in Business Administration and Commerce and a Master Degree in Business Administration, and a fellow of the Hong Kong Institute of Directors. He has about 20 years of experience in the securities industry.

**LEE Kwan Ho, Vincent Marshall**, aged 47, has been a Non-executive Director of HKEx since 3 April 2000. Mr Lee is the Managing Director of the Tung Tai Group of Companies (securities and finance companies) and a Vice Chairman of the Institute of Securities Dealers Limited. He has extensive experience in banking, corporate and real estate transactions in Hong Kong, Mainland China, the United States and Canada. While engaged as a senior banker with the HSBC group in Hong Kong and Vancouver, and as a Certified Public Accountant with Coopers and Lybrand in Los Angeles and Boston, Mr Lee executed a wide variety of investment transactions, including corporate acquisitions, financing, divestitures, real estate transactions, share offerings and commodities trading. He is actively involved in numerous community activities, including being a Founding Member (as well as past Governor) of the Canadian International School Foundation Limited. He graduated Magna Cum Laude in Accounting and Finance from the University of Southern California and received a Master degree in Economics from the London School of Economics and Political Science and has received numerous academic awards and recognition. He has over 20 years of experience in the securities and futures industry.



# Report of the Directors

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LEONG Ka Chai, JP, aged 53, has been a Non-executive Director of HKEx since 3 April 2000. Mr Leong has 20 years of experience in the securities and derivatives business. He is a dealing director of Roctec Securities Company Limited and Roctec Futures Trading Company Limited, and an investment adviser of Roctec Investment Limited. Mr Leong was a director of the Futures Exchange from 1989 to 2000 and was the Chairman of the Futures Exchange from 1992 to 1995.

Dr LIU Jinbao, aged 50, has been a Non-executive Director of HKEx since 3 April 2000. Dr Liu is the Vice Chairman of Bank of China, Vice Chairman and Chief Executive of BOC Hong Kong (Holdings) Limited, Vice Chairman and Chief Executive of Bank of China (Hong Kong) Limited and Chairman of Nanyang Commercial Bank Limited. He is a member of the Hong Kong Monetary Authority Exchange Fund Advisory Committee, Member of the Banking Advisory Committee, Vice Chairman of the Hong Kong Association of Banks, Director of Hong Kong Note Printing Limited and Hong Kong Interbank Clearing Limited. He is a member of the Board of Airport Authority Hong Kong, Director of Shanghai Commercial Bank Limited, Chairman of the Hong Kong Chinese Enterprises Association and General Committee member of the Hong Kong General Chamber of Commerce. Dr Liu is also a member of the Commission

on Strategic Development of the Hong Kong Special Administrative Region, Director of BOCHK Charitable Foundation, Vice President of the Chinese Red Cross Foundation, Managing Director of China Youth Federation Committee and member of the Hong Kong Red Cross Advisory Board. He has over 25 years of experience in the banking and financial industries.

LO Ka Shui, JP, aged 56, has been a Non-executive Director of HKEx since 3 April 2000. Dr Lo is the Deputy Chairman and Managing Director of Great Eagle Holdings Limited. He is presently the Chairman of the GEM Listing Committee and was Chairman of the Listing Committee of the Stock Exchange from 1992 to 1996. He is a non-executive Director of The Hongkong and Shanghai Banking Corporation Limited, Shanghai Industrial Holdings Limited, Phoenix Satellite Television Holdings Limited and China Mobile (Hong Kong) Limited. He is also actively involved in community activities, including being a Vice President of The Real Estate Developers Association of Hong Kong, a trustee of the Hong Kong Center for Economic Research and a member of the Council of Advisors on Innovation and Technology. Dr Lo holds a Bachelor of Science (Biophysics) degree from McGill University and a M.D. from Cornell University, certified in Cardiology. He has over 20 years of experience in the property, hotel and financial industries.

# Report of the Directors

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**SETO Gin Chung, John**, aged 54, has been a Non-executive Director of HKEx since 3 April 2000. Mr Seto is the Chairman and non-executive director of Stockmartnet Holdings Limited. He is also the non-executive director of Kowloon Development Company Limited. He was the Chief Executive of HSBC Broking Services (Asia) Limited. From 1997 to 2000, he was the first Vice Chairman of the Stock Exchange and a director of HKSCC. He was also a member of the Council of the Stock Exchange from 1994 to 2000. Mr Seto holds a Master of Business Administration degree from New York University. He has about 30 years of experience in the securities and futures industry.

**STRICKLAND, John Estmond, GBS, JP**, aged 63, has been a Non-executive Director of HKEx since 3 April 2000. Mr Strickland is a former Chairman of The Hongkong and Shanghai Banking Corporation Limited and is a director of the Airport Authority Hong Kong and Esquel Holdings Inc. He is active in numerous community organisations. He has been awarded honorary Doctorate degrees from City University of Hong Kong and Hong Kong Polytechnic University.

**WARD, Rodney Gordon**, aged 58, has been a Non-executive Director of HKEx since 1 April 2001. Mr Ward is the Chairman of UBS Warburg, Asia. He joined

one of the firm's predecessors, S.G. Warburg, in 1972 and was actively involved in building the firm's business in the U.S. and Canada. In 1990, he was appointed Joint Head of the Corporate Finance Division. In 1994, he moved to Hong Kong as Chairman of S.G. Warburg's operations in Asia Pacific and, following its acquisition by Swiss Bank Corporation, became Chairman of the combined group's business in Asia Pacific and a member of the Group Executive Board of the Bank. In 1997, he was appointed Chairman of the Group's business in Eastern Europe, the Middle East and Africa. From 1998 until December 1999, he was Vice Chairman and Director of Republic Bank of New York and Republic New York Corporation. He rejoined UBS Warburg in his current position in February 2000. He was educated at Cambridge University and attended Yale Law School before joining Simmons & Simmons, the international law firm, which he left in 1972 to join S.G. Warburg. He has over 30 years of experience in the securities industry.

**YUE Wai Keung**, aged 50, has been a Non-executive Director of HKEx since 3 April 2000. Mr Yue is a dealing director of Luen Fat Securities Company Limited, a vice chairman and a non-executive director of Stockmartnet Holdings Limited, a non-executive director of Prosper eVision Limited as well as a director of numerous other

# Report of the Directors

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privately held securities or financial companies. He was a member of the Council of the Stock Exchange from 1993 to 2000 and the Deputy Chairman of HKSCC from 1997 to 2000. Mr Yue was also a member of the Departmental Advisory Board of Guangdong Academy of Social Science in 1997. Mr Yue has been an Honorary Advisor of the Chamber of Hong Kong Listed Companies Limited since September 2002. He is also a Director of the Hong Kong Stockbrokers Association and has about 30 years of experience in the securities and futures industry.

## Senior Management

**CHEUNG Kwok Wai, David**, aged 53, is the Chief Financial Officer of HKEx. Prior to joining HKEx in April 2000, he was the Chief Financial Officer of Standard Chartered Bank, Hong Kong and North East Asia. He is a member of the American Institute of Certified Public Accountants. Mr Cheung has over 22 years of international experience in the banking and securities industries, including postings as Vice President, First Interstate Bank, London and Controller, Standard Chartered Bank, New York. He has completed the Advanced Management Programme, Templeton, University of Oxford and holds a Bachelor of Science (Accounting) degree and a Master of Business Administration (Finance) degree from the University of Southern California.

**FOK Kwong Man, Lawrence**, aged 53, is the Deputy Chief Operating Officer of HKEx and is the Chief Executive of the Stock Exchange. Mr Fok joined the Stock Exchange in February 1992 as an Assistant Director of the Listing Division. He was appointed Executive Director of the Listing Division in February 1997 and Senior Executive Director of its Regulatory Affairs Group in November 1998. Mr Fok has over 21 years of experience in financial services and securities regulatory work. Before joining the Stock Exchange he worked for the SFC, the Office of the Commissioner for Securities and Commodities Trading of the Hong Kong Government and other private organisations in areas of corporate finance advisory work, securities dealing, venture capital investment, mainland China trade and investment management. He holds a Bachelor of Science in Engineering degree from the University of Hong Kong, a Master of Business Administration degree from Columbia University, and a Master of Arts (Economics) degree and a Master of Science (Statistics) degree from Stanford University.

**GREDE, Frederick John**, aged 50, is the Chief Operating Officer of HKEx and Chief Executive of the Futures Exchange. He also serves on HKEx's Executive Committee and Management Committee, and chairs the Company's IT Steering Committee. Additionally, he is a member of the SFC's

# Report of the Directors

On-Line Trading Working Group and Investor Education Advisory Committee. Before joining HKEx in April 2000, he was the Executive Vice President of Planning and Operations at the Chicago Board of Trade (CBOT). He joined CBOT in 1974 and during his term of employment held various executive positions in both the Administration and Planning Division(s) and the Office of Investigations and Audits. He holds a Bachelor of Science degree in Finance from the University of Illinois, a Master of Business Administration degree from the University of Chicago Graduate School of Business and a Juris Doctor degree from DePaul University School of Law.

REISCH, Walter Anton, aged 56, is Head of the Clearing Business Unit of HKEx and Chief Executive of HKSCC. He joined HKEx on 9 January 2001, after several years of consultancy in financial markets around the world. He was with London Clearing House (formerly ICCH) for 18 years where he held senior management and board positions in Sydney and London. He was subsequently with SunGard Futures in the capacity of Managing Director and with Austraclear in the position of Chief Operating Officer. He has some 29 years of experience in developing and operating exchange trading systems, clearing services, payments systems and back-office services for a number of financial markets.

## Company Secretary

MAU Kam Shing, Joseph, aged 44, is the Company Secretary of HKEx and its group of companies. Mr Mau is a Fellow Member of the Association of Chartered Certified Accountants and an Associate Member of the Hong Kong Society of Accountants. He holds a Master of Science (Business Administration) degree from the University of Bath.

## DIRECTORS' INTERESTS IN SHARES AND OPTIONS

### (i) Shares

As at 31 December 2002, the Directors and their respective associates had interests in the shares of HKEx, as recorded in the register maintained by HKEx pursuant to Section 29 of the Securities (Disclosure of Interests) Ordinance (SDI Ordinance) as follows:

Name of Director	Number of shares held		
	Personal Interests	Corporate Interests	Total
FAN Chor Ho, Paul	-	2,187,000 (note 1)	2,187,000
KWONG Ki Chi	362,000	-	362,000
LEE Jor Hung, Dennis	-	1,610,000 (note 2)	1,610,000
YUE Wai Keung	-	1,000 (note 3)	1,000

# Report of the Directors

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Notes:

1. 2,187,000 shares were owned by Compu-Chart Investment Adviser Limited, a private company in which Mr FAN Chor Ho, Paul holds a 99.99 per cent interest.
2. 1,610,000 shares were owned by DL Brokerage Limited, a private company beneficially wholly owned by Mr LEE Jor Hung, Dannis.
3. 1,000 shares were owned by Luen Fat Securities Company Limited, a private company in which Mr YUE Wai Keung holds a 47.66 per cent interest.

Saved as disclosed above, no interests were held or deemed or taken to be held under the SDI Ordinance by any Director or the Chief Executive of HKEx or their respective associates in any equity or debt securities of HKEx or any of its associated corporations which were required to be notified to HKEx and the Stock Exchange pursuant to Section 28 of the SDI Ordinance or pursuant to the Model Code for Securities Transactions by Directors of Listed Companies or which are required pursuant to Section 29 of the SDI Ordinance to be entered in the register referred to therein.

## (ii) Options

As at 31 December 2002, the outstanding number of shares issuable under a share option granted pursuant to the Pre-Listing Scheme to Mr KWONG Ki Chi, a Director of HKEx, was 1,092,126 shares (2001:

1,454,126 shares). The said option was granted on 20 June 2000, and is exercisable between 6 March 2002 to 30 May 2010 at a subscription price of \$7.52 per share. During the year, Mr Kwong had exercised the option and subscribed for 362,000 shares.

Apart from the aforesaid, at no time during the year was HKEx, or its subsidiaries, a party to any arrangement to enable the Directors of HKEx to acquire benefits by means of the acquisition of shares in, or debentures of, HKEx or any other body corporate, and neither the Directors nor the Chief Executive, nor any of their spouses or children under the age of 18, had any interest in, or had been granted, or exercised, any right to subscribe for the securities and options of HKEx and its associated corporation within the meaning of the SDI Ordinance, or had exercised any such rights.

## DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE

No contracts of significance in relation to the Group's business to which HKEx or any of its subsidiaries was a party, and in which a Director of HKEx had a material interest, whether directly or indirectly subsisted at the year end or at any time during the year.

# Report of the Directors

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## CONNECTED TRANSACTIONS

During the year ended 31 December 2002, the Group had the following connected transactions, details of which are set out below:

(A) For the year ended 31 December 2002, transactions between the following connected persons and HKEx or its subsidiaries arising from or in connection with the use of (i) the facilities provided by HKEx or its subsidiaries for the trading, clearing and/or settlement of securities and futures products and transactions and (ii) all services offered by HKEx or its subsidiaries which are ancillary, incidental or otherwise related to the foregoing:

- (1) Mr FAN Chor Ho, Paul, a Director of HKEx, was interested in the transactions entered into by Paul Fan Securities Limited, an Exchange Participant in which Mr Fan has a 99.99 per cent interest.
- (2) Mr LEE Jor Hung, Dannis, a Director of HKEx, was interested in the transactions entered into by DL Brokerage Limited, an Exchange Participant which is beneficially wholly owned by Mr Lee.
- (3) Mr LEONG Ka Chai, a Director of HKEx, was interested in the transactions entered into by Roctec

Securities Company Limited and Roctec Futures Trading Company Limited, Exchange Participants in which Mr Leong has a 30 per cent interest in each of the companies.

- (4) Mr YUE Wai Keung, a Director of HKEx, was interested in the transactions entered into by Luen Fat Securities Company Limited, an Exchange Participant in which Mr Yue has a 47.66 per cent interest.

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

(B) For the year ended 31 December 2002, transactions between the following connected persons and HKEx or its subsidiaries arising from or in connection with HKSCC's arrangement on behalf of a Clearing Participant of a Buy-in Transaction:

- (1) Mr FAN Chor Ho, Paul, a Director of HKEx, was interested in the transactions entered into by Paul Fan Securities Limited in which Mr Fan has a 99.99 per cent interest. For the year ended 31 December 2002, the total consideration of such transactions, which were transacted on normal commercial terms was \$3,873,650.11.



# Report of the Directors

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(2) Mr LEE Jor Hung, Dannis, a Director of HKEx, was interested in the transactions entered into by DL Brokerage Limited beneficially wholly owned by Mr Lee. For the year ended 31 December 2002, the total consideration of such transactions, which were transacted on normal commercial terms was \$237,980.65.

(3) Mr YUE Wai Keung, a Director of HKEx, was interested in the transactions entered into by Luen Fat Securities Company Limited in which Mr Yue has a 47.66 per cent interest. For the year ended 31 December 2002, the total consideration of such transactions, which were transacted on normal commercial terms was \$4,722,968.92.

Two independent Non-executive Directors who have not entered into any connected transactions with the Group have reviewed and confirmed that the connected transactions, as set out above had been entered into by the Group in accordance with the waiver conditions granted by the SFC that:

(a) the connected transactions disclosed above were in the ordinary and usual course of business of the relevant Group company and conducted on an arm's length basis;

(b) in respect of transactions other than Buy-in Transactions, 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 transactions which are 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 for and on behalf of HKSCC and at the standard commission rate payable by HKSCC in respect of all such Buy-in Transactions; and

(d) the connected transactions were in the opinion of the Directors fair and reasonable so far as the shareholders of HKEx are concerned.

The Auditors of HKEx have also confirmed that:

(a) the connected transactions disclosed above had received approval from the Directors; and

(b) the connected transactions were in accordance with the relevant rules and regulations of the relevant Group company governing fees for the

# Report of the Directors

applicable facilities, services or goods provided by, or to, the Group and where the rules and regulations did not govern the transaction 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.

## SUBSTANTIAL SHAREHOLDER

The Directors are not aware of any party who was directly or indirectly interested in 10 per cent or more of the issued share capital of HKEx as at 31 December 2002 as recorded in the register required to be kept by HKEx under Section 16(1) of the SDI Ordinance.

## MINORITY CONTROLLER

Under the Merger Ordinance, no person shall be or become a Minority Controller, i.e. a person who either alone or with any associate or associates, is entitled to exercise, or control the exercise of 5 per cent or more of the voting power at any general meeting of the recognised exchange controller, except with the approval in writing of the SFC after consultation with the Financial Secretary of the HKSAR.

As of 12 March 2003, two CCASS Participants are holding approximately 29.2 per cent and 11.8 per cent respectively of HKEx's issued share capital. (As of 13 March 2002: two CCASS Participants each held approximately 28.8 per cent and 12.1 per cent of HKEx's issued share capital.) The SFC had granted approval to these two CCASS Participants for being Minority Controllers of HKEx on the basis that the shares are held in custody for their clients.

## SHAREHOLDERS' STRUCTURE

An analysis of the shareholders' structure of HKEx for the respective year ended December 2002 and 2001 are set out below:

	No. of Shareholders	%	Aggregated Shareholders	%
As at 31 December 2002				
Corporate	109	7.5	986,639,253	94.5
Individual	1,342	92.5	56,941,593	5.5
Total	<u>1,451</u>	<u>100</u>	<u>1,043,580,846</u>	<u>100</u>
As at 31 December 2001				
Corporate	120	11.5	983,533,103	94.5
Individual	925	88.5	57,131,743	5.5
Total	<u>1,045</u>	<u>100</u>	<u>1,040,664,846</u>	<u>100</u>

# Report of the Directors

The respective holdings by the top ten shareholders that appeared on the Register of Members of HKEx as at 31 December 2002 were:

Name	Number of shares	% of holding
HKSCC Nominees Ltd	865,294,586	82.92
Sun Hung Kai Investment Services Ltd	8,050,000	0.77
Roctec Futures Trading Co Ltd	5,574,000	0.53
The Bank of East Asia Ltd	4,830,000	0.46
Sun Hung Kai Commodities Ltd	4,180,500	0.40
Phillip Securities (H K) Ltd	4,025,000	0.39
Corporate Brokers Ltd	3,220,000	0.31
Tung Tak Securities (H K) Co Ltd	3,220,000	0.31
Phillip Commodities (H K) Ltd	2,787,000	0.27
Wocom Ltd	2,787,000	0.27

Further analysis of shareholdings as at 31 December 2002 is set out in “Corporate Information” section on page 9.

## MAJOR CUSTOMERS AND SUPPLIERS

Contracts with the HKEx’s five largest suppliers combined by value which are not of a capital nature, contributed to less than 30 per cent in value of supplies purchased during the year ended 31

December 2002. HKEx’s five largest customers combined by value contributed to less than 30 per cent in value of the income during the year ended 31 December 2002.

## PURCHASE, SALE OR REDEMPTION OF HKEx’S LISTED SECURITIES

During the year ended 31 December 2002, HKEx had not redeemed and neither HKEx nor any of its subsidiaries had purchased or sold any of HKEx’s listed securities.

## PROVIDENT FUND SCHEME

Particulars of the provident fund scheme of the Group are set out in note 10 to the accounts.

## AUDITORS

The accounts have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment at the 2003 AGM.

On behalf of the Board of Directors  
LEE Yeh Kwong, Charles  
Chairman

12 March 2003

# Corporate Governance

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HKEx believes that good corporate governance is in the interest not only of investors, but also of the company itself. HKEx is committed to the highest standards of corporate governance, and is the first listed company in Hong Kong to have an assessment of its corporate governance by an independent third party. Standard & Poor's (S&P) had, after evaluation, first assigned a corporate governance score of 8.3 out of a possible score of 10 to HKEx in 2001, and affirmed in 2002 the same score after having conducted a thorough review during the year. Although the S&P's scoring standards have been tightened, the overall score for HKEx remains unchanged—a reflection of HKEx's continued efforts in building upon its already strong corporate governance practices.

## The Board

The Directors listed on page 6 constituted the Board throughout the year. Among the 15 Board members, eight of them are Public Interest Directors appointed by the Financial Secretary, six of them were elected by shareholders (Elected Directors), and the Chief Executive is an *ex-officio* member of the Board. The Securities and Futures Commission (SFC) had confirmed that the Public Interest Directors and Elected Directors are all independent Directors. The Chief Executive is the only Executive Director who is responsible to the Board for the management of HKEx's business. The roles of the Chairman and the Chief Executive are distinctly segregated. The Chairman is an independent non-

executive, and his appointment was recommended by the Board and approved by the Chief Executive of the HKSAR.

Due to the unique business nature of HKEx as an exchange controller, the Board has to act in the interest of the investing public and give precedence to the public interest should there be a conflict of interest with the company's own commercial interest. A Director's Handbook has been issued to every Board member setting out the guidelines on conduct, under which Directors are required, *inter alia*, to declare any conflict of interests they may have and where necessary, to withdraw from any consideration of or abstain from voting on a matter in which they have a material interest. All Directors have access to the Company Secretary who is responsible for ensuring the Board procedures are complied with and for advising the Board on compliance matters. The Board has, at all times fully complied with the statutory and Listing Rules requirements governing disclosure of interests, the dealing in securities, and meeting procedures and practices.

The Board is responsible to shareholders for the strategic development of HKEx, and the management of the Group's assets with the objective of maximising long-term shareholders' value. The principal task of the Board is to formulate strategy, lay down policies, monitor and control operating and financial performance in pursuit of the Group's strategic objectives.

# Corporate Governance

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The Board meets regularly, normally once a month, and additional meetings would be arranged, if and when required.

The Board is supported by six committees and three advisory panels, each of which has defined terms of reference covering its duties, powers and functions. The chairmen of the respective committees and panels report regularly to the Board and, as appropriate, make recommendations on matters discussed. The list of members of the various committees are set out in the “Corporate Information” section on page 6.

In accordance with the Articles of Association, the six Elected Directors elected in 2000 shall retire at the conclusion of the annual general meeting to be held on 15 April 2003 (2003 AGM). The term of services of the eight Public Interest Directors will also expire at the conclusion of the 2003 AGM. Shareholders may, at the 2003 AGM, by ordinary resolution elect any person to be a Director, but the total number of Elected Directors must not at any time exceed six. In addition, the Exchanges and Clearing Houses (Merger) Ordinance (Merger Ordinance) provides that the number of Public Interest Directors to be appointed by the Financial Secretary immediately after the 2003 AGM shall not be more than the number of Elected Directors.

At every general meeting after the 2003 AGM, one-third of the Elected Directors shall be subject to retirement by rotation.

None of the Public Interest Directors and the Chief Executive shall, whilst holding office as such, be subject to retirement by rotation.

## Committees and Panels

**Executive Committee** consists of three non-executive Directors, the Chief Executive and the Chief Operating Officer appointed by the Board. It meets regularly, normally twice a month, and serves as an executive arm of the Board, in the formulation of policies for consideration of the Board, and in carrying out and implementing the policies laid down by the Board. The Executive Committee is delegated with the authority from the Board to administer, enforce, interpret and supervise compliance with those parts of the Rules, Regulations and Operational Procedures of its subsidiaries including conducting regular reviews of the same, recommending, advising on appropriate amendments which do not involve policy matters for the approval by the boards of the respective subsidiaries, and as appropriate by the SFC.

**Audit Committee**, comprising five non-executive Directors appointed by the Board, meets at least four times a year. It examines any matter relating to accounting principles and practices adopted by the Group, and discusses auditing, internal control issues, information systems and financial reporting matters. It also reviews the interim and the final results of the Group prior to recommending them to the Board for approval, recommends the

# Corporate Governance

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application of accounting policies, and changes to financial reporting requirements. Senior representatives of the external auditors, the Chief Executive and senior executives are invited to attend the meetings. The Audit Committee reviews the appointment of HKEx's external auditors, including the audit fees, on an annual basis, and, as a good corporate governance practice, sets restrictions on the employment of HKEx's external auditors for non-audit related activities.

**Investment Advisory Committee** consists of two non-executive Directors and three market professionals appointed by the Board. It meets at least four times a year, and provides market expertise and advice to the Board on the investments of HKEx, including advice on investment policies, asset allocation and selection of fund managers and custodians.

**Nomination Committee**, comprising three non-executive Directors appointed by the Board, meets at least once a year, and is responsible for the formulation of the nomination policy, determination of the selection criteria for the nomination of candidates for election to be non-Public Interest Directors, make recommendations to shareholders on new candidates standing for election, provide sufficient biographical details of candidates to enable shareholders to make an informed decision on the election, and where necessary, nominate candidates to fill casual vacancies of Elected Directors.

**Remuneration Committee** consists of three non-executive Directors appointed by the Board. It meets at least once a year, and formulates the remuneration and succession policies, and the guidelines for the recruitment and the remuneration of Directors, including the Chief Executive who is an Executive Director. The Remuneration Committee ensures that the remuneration offered is appropriate for the duties and in line with market practice. The Board has approved the recommendation of the Remuneration Committee of remunerating non-executive Directors, subject to shareholders' approval at the 2003 AGM. This serves as a recognition of the time and effort contributed by non-executive Directors to HKEx. Appropriate remuneration of non-executive Directors is considered by S&P as a good corporate governance practice.

**Risk Management Committee** is chaired by the Chairman of the Board, and consists of seven other members of whom five were appointed by the Financial Secretary and two were appointed by the Board. The Risk Management Committee was established under Section 9 of the Merger Ordinance on 3 March 2000 to formulate policies on risk management matters relating to the activities of HKEx and the exchanges and clearing houses of which HKEx is the controller.



# Corporate Governance

Cash Market Consultative Panel, Clearing Consultative Panel and Derivatives Market Consultative Panel provide 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, Clearing business and Derivatives market respectively, and act as sounding boards for policy recommendations, strategic initiatives, and major investments. Each panel consists of two non-executive Directors and eight members from among the respective market participants and industry experts. Executives are invited to attend the panel meetings.

## Attendance Record

The following is the attendance record of meetings held by the Board and various committees/panels in 2002:

	Number of meetings held in 2002	Average Attendance
Board	12	86%
Audit Committee	4	80%
Executive Committee	22	92%
Investment Advisory Committee	4	90%
Nomination Committee	1	100%
Remuneration Committee	2	100%
Risk Management Committee	10	90%
Cash Market Consultative Panel	4	68%
Derivatives Market Consultative Panel	5	74%
Clearing Consultative Panel	4	67%

## Internal Control

The Board has the ultimate responsibility for the Group's internal control system and for reviewing its effectiveness. The system, which includes a defined management structure with specified limits of authority, is designed to safeguard assets against unauthorised use or disposition, ensure the maintenance of proper accounting records for the provision of reliable financial information, and ensure compliance with relevant legislation and regulations. The Group Internal Audit Functional Unit provides the Board with assurance that the internal control systems of the Group are effective, and assists the Board in the exercise of its governance functions by conducting independent reviews of HKEx's activities. The reviews include financial, operational, compliance and information technology related audits and evaluations. The Group Internal Auditor reports directly to the Audit Committee, and is authorised to communicate directly with the Chairman of the Board and other Board members. The frequency of reviews is scheduled according to an internal audit programme approved by the Audit Committee.

# Corporate Governance

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## Shareholders

The Board is committed to providing clear and updated performance information of the Group to all shareholders, as soon as it is available. The Board has, in March 2003, approved the release of quarterly reports in order to provide more up-to-date information to shareholders. Effective from 2003, the first and the third quarter results will be announced in May and November respectively, whilst the interim results will be released in August, and the full year results will be published in March of the following year. In addition to sending circulars, notices, interim and annual reports to shareholders, as required under the Listing Rules, other initiatives undertaken by HKEx to promote shareholders' relations include the setting up of an Investor Relations Corner as part of the HKEx website <[www.hkex.com.hk](http://www.hkex.com.hk)> to provide information to shareholders about the Group, and the quarterly publication of the "Exchange" to provide shareholders and the public with up-to-date information on HKEx's policies, products, and services.

The annual general meeting not only deals with the formal business of HKEx but also acts as a forum for direct dialogue with shareholders at which shareholders may ask questions on HKEx's operations or financial information. The Chairman, the Chief Executive, the Chief Financial Officer and other senior executives maintain a dialogue with institutional investors and analysts, where appropriate.

## Guidelines on Conduct

HKEx and its major subsidiaries are designated public bodies listed in the Schedules of the Prevention of Bribery Ordinance. All employees of HKEx, including Directors and committee members, are considered public servants for the purposes of that Ordinance. Guidelines on Conduct for the persons concerned have been worked out in consultation with the Independent Commission Against Corruption, and set out in the Human Resources Manual issued to every employee of the Group.

## Succession Policy

The Board has a primary role in ensuring that adequate thought is given to planning for succession to executive director and senior management positions. Management development programmes are in place for staff members, which include staff exchange programmes set up with other exchanges.

## Environment

HKEx is committed to conducting its business in a manner which fosters the sustainable use of natural resources, and minimises any adverse impact on the environment. In addition to pursuing environmental protection measures internally, HKEx has, by amending the Listing Rules in February 2002, encouraged listed companies to send or make available corporate communications to holders of securities and to the Stock Exchange by electronic means.

# Corporate Governance

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## Changes to the Articles of Association

Pursuant to the changes in the Companies Ordinance and the Listing Rules, HKEx had, with the approval of shareholders at the annual general meeting in April 2002, and the subsequent approval of the SFC, amended Articles 2, 139, 141, 142, 145, 146 and 155 of the Articles of Association.

The amendments to Article 139 permit HKEx to send Summary Financial Reports in place of the Annual Report and Accounts to its shareholders, debenture holders and any other persons entitled for the purpose of a general meeting of the company. HKEx is also allowed to treat the publication of the Annual Report and Accounts and/or the Summary Financial Report on the computer network of the company as discharging its obligation under the Companies Ordinance.

The amendments to Article 2, 141, 142, 145 and 146 allow HKEx to send or otherwise make available corporate communications to holders of securities by electronic means.

In pursuit of better corporate governance, Article 155 was also amended such that the Auditor is excluded as a party entitled to be indemnified by HKEx against all costs, charges, losses, expenses and liabilities incurred by the Auditor in the execution and discharge of its duties.

## Compliance with the Code of Best Practice of the Listing Rules

HKEx has fully complied with the Code of Best Practice, as set out in Appendix 14 of the Listing Rules during the year.

By Order of the Board

**Joseph Mau**

Company Secretary

12 March 2003

# Auditors' Report

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## AUDITORS' REPORT TO THE SHAREHOLDERS OF HONG KONG EXCHANGES AND CLEARING LIMITED

(incorporated in Hong Kong with limited liability)

We have audited the accounts on pages 61 to 117 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

### Respective responsibilities of directors and auditors

The Hong Kong Companies Ordinance requires the directors to prepare accounts which give a true and fair view. In preparing accounts which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those accounts and to report our opinion to you.

### Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made

by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the circumstances of the company and the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the accounts are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts. We believe that our audit provides a reasonable basis for our opinion.

### Opinion

In our opinion the accounts give a true and fair view of the state of affairs of the company and of the Group as at 31 December 2002 and of the Group's profit and cash flows for the year then ended and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

**PricewaterhouseCoopers**  
Certified Public Accountants

Hong Kong, 12 March 2003

# Consolidated Financial Statements

## CONSOLIDATED PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2002

(Financial figures are expressed in Hong Kong dollars)

	Note	2002 \$'000	2001 \$'000
<b>INCOME</b>			
Trading fees, transaction levy and trading tariff	4	331,729	351,408
Stock Exchange listing fees		320,033	275,266
Clearing and settlement fees		181,424	214,015
Depository, custody and nominee services fees		211,413	227,970
Income from sale of information		293,735	337,189
Interest income	5	266,612	451,395
Interest expenses		(5,797)	(69,445)
Net interest income		260,815	381,950
Other income	6	208,941	211,015
	2	1,808,090	1,998,813
<b>OPERATING EXPENSES</b>			
Staff costs and related expenses		492,549	527,994
Information technology and computer maintenance expenses		262,700	231,064
Premises expenses		101,234	100,452
Product marketing and promotion expenses		14,728	15,516
Legal and professional fees		39,613	61,800
Depreciation and amortisation		163,139	152,669
Other operating expenses		90,694	86,872
		1,164,657	1,176,367
<b>SHARE OF PROFITS LESS LOSSES OF ASSOCIATED COMPANIES</b>	2	6,141	–
<b>PROFIT BEFORE TAXATION</b>	2/7	649,574	822,446
<b>TAXATION</b>	11(a)	(56,606)	(82,020)
<b>PROFIT ATTRIBUTABLE TO SHAREHOLDERS</b>	29	592,968	740,426
<b>DIVIDENDS</b>		532,220	343,419
Earnings per share	12	\$0.57	\$0.71
Dividends per share			
Interim dividend paid		\$0.08	\$0.08
Final dividend declared		\$0.43	\$0.25
		\$0.51	\$0.33
Dividend payout ratio		90%	46%

# Consolidated Financial Statements

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2002

(Financial figures are expressed in Hong Kong dollars)

	Note	2002 \$'000	2001 \$'000
Total equity at 1 Jan		5,235,407	4,878,956
Change in valuation of investment property	26	(1,500)	(4,200)
Change in valuation of other properties	26	(16,850)	(9,273)
Change in fair value of non-trading securities	26	14,548	1,886
Net deficit not recognised in the consolidated profit and loss account		(3,802)	(11,587)
Profit attributable to shareholders	29	592,968	740,426
Realisation of change in fair value of non-trading securities on maturity and disposal	26	(6,015)	(28,969)
Dividends paid	29	(344,094)	(343,419)
Proceeds from issue of shares under share option scheme	25	21,928	–
Total equity at 31 Dec		5,496,392	5,235,407

# Consolidated Financial Statements

## CONSOLIDATED BALANCE SHEET AT 31 DECEMBER 2002

(Financial figures are expressed in Hong Kong dollars)

	Note	2002 \$'000	2001 \$'000
<b>NON-CURRENT ASSETS</b>			
Fixed assets	13(a)	748,108	786,110
Investments in associated companies	14	35,536	–
Clearing House Funds	15	980,748	944,154
Compensation Fund Reserve Account	16	35,827	35,146
Cash and Derivatives Market Development Fund	17	914	914
Non-trading securities maturing over one year	18	87,604	52,366
		<u>1,888,737</u>	<u>1,818,690</u>
<b>CURRENT ASSETS</b>			
Margin funds on derivatives contracts	19	4,551,601	4,803,107
Accounts receivable, prepayments and deposits	20(a)	3,118,199	2,334,767
Taxation recoverable		1,774	5,857
Trading securities	21	3,490,046	3,182,527
Bank balances and time deposits pledged	36	–	10,000
Bank balances and time deposits		985,114	1,590,062
		<u>12,146,734</u>	<u>11,926,320</u>
<b>CURRENT LIABILITIES</b>			
Bank loans	33(b)(ii)	49,456	46,453
Margin deposits and securities received from			
Clearing Participants on derivatives contracts	19	4,551,601	4,803,107
Accounts payable, accruals and other liabilities	20(b)	3,007,392	2,733,306
Participants' admission fees received	22	3,350	14,550
Deferred revenue		269,774	246,827
Taxation payable		29,051	19,556
Provisions	23(a)	28,863	25,927
		<u>7,939,487</u>	<u>7,889,726</u>
<b>NET CURRENT ASSETS</b>		<u>4,207,247</u>	<u>4,036,594</u>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		<u>6,095,984</u>	<u>5,855,284</u>



# Consolidated Financial Statements

## CONSOLIDATED BALANCE SHEET (continued) AT 31 DECEMBER 2002

(Financial figures are expressed in Hong Kong dollars)

	Note	2002 \$'000	2001 \$'000
<b>NON-CURRENT LIABILITIES</b>			
Participants' admission fees received	22	86,800	91,500
Participants' contributions to Clearing House Funds	15	425,440	423,960
Deferred taxation	11(b)	67,253	75,275
Provisions	23(a)	20,099	29,142
		<u>599,592</u>	<u>619,877</u>
<b>NET ASSETS</b>		<u><b>5,496,392</b></u>	<u><b>5,235,407</b></u>
<b>CAPITAL AND RESERVES</b>			
Share capital	25	1,043,581	1,040,665
Share premium	25	19,012	–
Revaluation reserves	26	33,980	43,797
Designated reserves	27	727,811	692,016
Retained earnings	29	3,223,268	3,198,763
Proposed and declared dividend	29	448,740	260,166
<b>SHAREHOLDERS' FUNDS</b>		<u><b>5,496,392</b></u>	<u><b>5,235,407</b></u>

Approved by the Board of Directors on 12 March 2003

LEE Yeh Kwong, Charles  
Director

KWONG Ki Chi  
Director

# Consolidated Financial Statements

## HONG KONG EXCHANGES AND CLEARING LIMITED (HKEx)

### BALANCE SHEET

AT 31 DECEMBER 2002

(Financial figures are expressed in Hong Kong dollars)

	Note	2002 \$'000	2001 \$'000
<b>NON-CURRENT ASSETS</b>			
Fixed assets	13(b)	43,598	24,569
Investments in subsidiaries	24(a)	4,145,198	4,145,198
Other assets		5,729	3,089
		<u>4,194,525</u>	<u>4,172,856</u>
<b>CURRENT ASSETS</b>			
Accounts receivable, prepayments and deposits	20(a)	20,337	16,889
Amounts due from subsidiaries	24(b)	489,019	82,603
Bank balances and time deposits		10,139	81,629
		<u>519,495</u>	<u>181,121</u>
<b>CURRENT LIABILITIES</b>			
Accounts payable, accruals and other liabilities	20(b)	70,343	22,650
Amounts due to subsidiaries	24(b)	3,111	–
Provisions	23(b)	23,826	5,129
		<u>97,280</u>	<u>27,779</u>
<b>NET CURRENT ASSETS</b>		<u>422,215</u>	<u>153,342</u>
<b>NET ASSETS</b>		<u><b>4,616,740</b></u>	<u><b>4,326,198</b></u>
<b>CAPITAL AND RESERVES</b>			
Share capital	25	1,043,581	1,040,665
Share premium	25	19,012	–
Merger reserve	28	2,997,115	2,997,115
Retained earnings	29	108,292	28,252
Proposed and declared dividend	29	448,740	260,166
<b>SHAREHOLDERS' FUNDS</b>		<u><b>4,616,740</b></u>	<u><b>4,326,198</b></u>

Approved by the Board of Directors on 12 March 2003

LEE Yeh Kwong, Charles  
Director

KWONG Ki Chi  
Director

# Consolidated Financial Statements

## CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2002

(Financial figures are expressed in Hong Kong dollars)

	Note	2002 \$'000	2001 \$'000
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net cash outflow from operating activities	30(a)	(126,485)	(2,485,688)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Payments for purchases of fixed assets		(130,733)	(263,139)
Proceeds from sales of fixed assets		34	227
Net (increase)/decrease in non-trading securities		(32,305)	785,217
(Increase)/decrease in time deposits with original maturity more than three months		(57,060)	336,441
Net cash outflow from investments in associated companies and disposal of a subsidiary		(31,546)	–
Dividends received from non-trading securities		2,482	2,516
Interest received from non-trading securities		41,671	226,909
Net cash (outflow)/inflow from investing activities		(207,457)	1,088,171
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
New bank loans		–	46,453
Proceeds from issue of shares under share option scheme		21,928	–
Admission fees received less refunds to Participants		(15,900)	(4,200)
Dividends paid		(344,094)	(343,419)
Net cash outflow from financing activities		(338,066)	(301,166)
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>		<b>(672,008)</b>	<b>(1,698,683)</b>
Cash and cash equivalents at the beginning of the year		1,351,964	3,050,647
Cash and cash equivalents at the end of the year	30(b)	679,956	1,351,964

# Consolidated Financial Statements

## NOTES TO THE ACCOUNTS

(Financial figures are expressed in Hong Kong dollars)

### 1. PRINCIPAL ACCOUNTING POLICIES

#### (a) Statement of compliance

The accounts have been prepared in accordance with accounting principles generally accepted in Hong Kong and comply with accounting standards issued by the Hong Kong Society of Accountants (HKSA) and the applicable disclosure requirements of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (Listing Rules).

#### (b) Basis of preparation

The accounts have been prepared under the historical cost convention, as modified by the revaluation of certain land and buildings, investment properties and non-trading securities and the marking to market of trading securities and shares borrowed and receivable by Hong Kong Securities Clearing Company Limited (HKSCC) for the purpose of settlement under the Continuous Net Settlement (CNS) basis.

#### (c) Group accounting

##### (i) Consolidation

The Group has adopted merger accounting in the preparation of the consolidated accounts at the time of the merger of the Group in 2000. The consolidated accounts include the accounts of HKEx and all of its subsidiaries made up to 31 December. All material intra-group transactions and balances have been eliminated on consolidation.

In HKEx's balance sheet, investments in subsidiaries are stated at cost less provision, if necessary, for any impairment. The results of subsidiaries are accounted for by HKEx on the basis of dividends received and receivable.

# Consolidated Financial Statements

## 1. PRINCIPAL ACCOUNTING POLICIES (continued)

### (c) Group accounting (continued)

#### (ii) Associated companies

An associated company is a company, not being a subsidiary, in which an equity interest is held for the long-term and significant influence is exercised in its management.

Investments in associated companies are accounted for in the consolidated accounts under the equity method. The consolidated profit and loss account includes the Group's share of the post-acquisition results of associated companies for the year, and the consolidated balance sheet includes the Group's share of the net assets of associated companies and goodwill (net of accumulated amortisation) on acquisition.

### (d) Turnover

Turnover comprises trading fees, transaction levy and trading tariff from securities and options traded on The Stock Exchange of Hong Kong Limited (Stock Exchange) and derivatives contracts traded on Hong Kong Futures Exchange Limited (Futures Exchange), Stock Exchange listing fees, clearing and settlement fees, depository, custody and nominee services fees, income from sale of information, net interest income (including interest income net of interest expenses of Clearing House Funds) and other income, which are disclosed as **Income** in the consolidated profit and loss account.

### (e) Revenue recognition

Income is recognised in the profit and loss account on the following basis:

- (i) Trading fees, transaction levy and trading tariff on securities and options traded on the Stock Exchange are recognised on a trade date basis.
- (ii) Trading fees on derivatives contracts traded on the Futures Exchange are recognised on the day when the derivatives contracts are entered into.
- (iii) Settlement fees on derivatives contracts traded on the Futures Exchange are recognised on outstanding contracts at the official final settlement day.

# Consolidated Financial Statements

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## 1. PRINCIPAL ACCOUNTING POLICIES (continued)

### (e) Revenue recognition (continued)

- (iv) Fees for clearing and settlement of broker-to-broker trades in eligible securities transacted on the Stock Exchange are recognised in full on T + 1, i.e., on the day following the trade day, upon acceptance of the trades. Fees for settlement of other trades and transactions are recognised upon completion of the settlement.
- (v) Custody fees for securities held in the Central Clearing and Settlement System (CCASS) depository are calculated and accrued on a monthly basis. Income on registration and transfer fees on nominee services are calculated and accrued on the book close dates of the relevant stocks during the financial year.
- (vi) Income from annual listing fees is recognised on a straight-line basis over the period covered by the respective fees received in advance.
- (vii) Income from sale of information and other fees are recognised when the related services are rendered.
- (viii) Interest income represents gross interest income from bank deposits and investments and is recognised on a time apportionment basis, taking into account the principal outstanding and the applicable interest rates.
- (ix) Dividend income is recognised when the right to receive payment is established.
- (x) Rental income is recognised on an accrual basis.

### (f) Interest expenses

Interest expenses are recognised on a time apportionment basis, taking into account the principal outstanding and the applicable interest rates.

### (g) Employee benefit costs

#### (i) Employee leave entitlements

The cost of accumulating compensated absences is recognised as an expense and measured based on the additional amount that the Group expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date.

# Consolidated Financial Statements

## 1. PRINCIPAL ACCOUNTING POLICIES (continued)

### (g) Employee benefit costs (continued)

#### (ii) Equity compensation benefits

Share options under the Pre-listing Share Option Scheme have been granted to the Executive Director and employees. When the options are exercised, the proceeds received are credited to share capital (nominal value) and share premium. No costs in relation to the options are charged to the profit and loss account (note 25).

#### (iii) Retirement benefit costs

Contributions to the defined contribution provident funds regulated under the Occupational Retirement Schemes Ordinance (ORSO) and operated by the Group and the AIA-JF Premium MPF Scheme are expensed as incurred. Contributions to one of the two ORSO approved provident funds of the Group are offset by contributions forfeited in respect of employees who leave the provident fund before the contributions are fully vested. Forfeited contributions of another provident fund are not used to offset existing contributions but are credited to a reserve account of that provident fund. Reserves of the provident fund representing forfeited employer's contributions are available for distribution to the provident fund members at the discretion of the trustees. Assets of the provident funds and the AIA-JF Premium MPF Scheme are held separately from those of the Group and are independently administered.

### (h) Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the leasing company are accounted for as operating leases. Rentals applicable to such operating leases net of any incentives received from the leasing company are charged to the profit and loss account on a straight-line basis over the lease term.



# Consolidated Financial Statements

## 1. PRINCIPAL ACCOUNTING POLICIES (continued)

### (i) Fixed assets

Land and buildings, other than investment properties, are stated at valuation less accumulated depreciation. Fair value is determined by the Directors based on independent valuations which are performed periodically. The valuations are on an open market value basis related to individual properties and separate values are not attributed to land and buildings. The Directors review the carrying value of the land and buildings and adjustment is made where they consider that there has been a material change. Increases in valuation are credited to the other properties revaluation reserve. Decreases in valuation are first offset against increases on earlier valuations in respect of the same property and are thereafter charged to the profit and loss account. Any subsequent increases are credited to the profit and loss account up to the amount previously charged and thereafter to other properties revaluation reserve.

Other tangible fixed assets are stated at cost less accumulated depreciation.

Leasehold land is depreciated over the period of the lease while other tangible fixed assets are depreciated at rates sufficient to write off their cost over their estimated useful lives on a straight-line basis. The principal annual rates are as follows:

Leasehold land	0.1% to 0.8%
Buildings	4%
Leasehold improvements	20%
Computer trading and clearing systems	
– software	20%
– hardware	33.33%
Other computer hardware and software	33.33%
Furniture and equipment	20%
Motor vehicles	33.33%

Major costs incurred in restoring fixed assets to their normal working condition are charged to the profit and loss account. Improvements are capitalised and depreciated over their expected useful lives.

# Consolidated Financial Statements

## 1. PRINCIPAL ACCOUNTING POLICIES (continued)

### (i) Fixed assets (continued)

The carrying amounts of fixed assets are reviewed regularly by the Group to assess whether their recoverable amounts have declined below their carrying amounts. The Group has not discounted the expected future cash flows in determining the recoverable amounts.

Qualifying software system development expenditures are capitalised and recognised as a fixed asset in the balance sheet as the software forms an integral part of the hardware on which it operates. The expenditures comprise all qualifying direct and allocated expenses attributable to the development of distinct major computer systems.

Qualifying development expenditures incurred after the roll-out of a system are added to the carrying amount of the related assets when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the existing asset, will flow to the Group. All other subsequent expenditures are recognised as non-qualifying expenditures.

All non-qualifying expenditures and expenses incurred on other non-qualifying development activities are charged as expenses to the profit and loss account in the period in which such expenses are incurred.

Amortisation of the cost of capitalised software system development expenditures is provided from the dates when the systems become operational.

Upon the disposal of land and buildings, other than investment properties, the relevant portion of the revaluation reserve realised in respect of previous valuations is released from the other properties revaluation reserve to the profit and loss account.

The gain or loss on disposal of a fixed asset other than land and buildings is the difference between the net sale proceeds and the carrying amount of the relevant asset, and is recognised in the profit and loss account.

# Consolidated Financial Statements

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## 1. PRINCIPAL ACCOUNTING POLICIES (continued)

### (j) Investment properties

Investment properties are interests in land and buildings in respect of which construction work and development have been completed and which are held for their investment potential with any rental income being negotiated at arm's length.

Investment properties are carried in the balance sheet at valuations determined annually by independent valuers. The valuations are on an open market value basis and are incorporated in the accounts. Increases in valuation are credited to the investment properties revaluation reserve. Decreases in valuation are first set off against increases on earlier valuations on a portfolio basis and thereafter are charged to the profit and loss account. Any subsequent increases are credited to the profit and loss account up to the amount previously charged and thereafter to investment properties revaluation reserve.

Upon the disposal of investment properties, the relevant portion of the revaluation reserve realised in respect of previous valuations is released from the investment properties revaluation reserve to the profit and loss account.

### (k) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired company at the date of acquisition and is amortised on a straight-line basis over an estimated useful life not exceeding 20 years.

Where an indication of impairment exists, the carrying amount of goodwill is assessed and written down immediately to its recoverable amount.

### (l) Impairment of assets

At each balance sheet date, information from both internal and external sources is considered to assess whether there is any indication that assets are impaired. If any such indication exists, the recoverable amount of the asset is estimated and, where relevant, an impairment loss is recognised to reduce the asset to its recoverable amount. Such impairment losses are recognised in the profit and loss account except where the asset is carried at valuation and the impairment loss does not exceed the revaluation surplus for that same asset, in which case it is treated as a decline in revaluation.

# Consolidated Financial Statements

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## 1. PRINCIPAL ACCOUNTING POLICIES (continued)

### (m) Clearing House Funds/Cash and Derivatives Market Development Fund (CDMD Fund)

Income arising from bank deposits and investments comprising these funds and expenses incurred for these funds are dealt with in the profit and loss account. Annual investment income net of expenses of the Clearing House Funds is appropriated from retained earnings to the respective designated reserves of these funds. Investment income net of expenses of the CDMD Fund may be appropriated to the designated reserve of this fund at the discretion of the Board of Directors of HKFE Clearing Corporation Limited (HKCC). Changes in valuation of the non-trading securities comprising these funds are dealt with in the investment revaluation reserve.

Net assets of the Clearing House Funds, which are derived from contributions from CCASS Participants (other than investor participants), HKCC Participants and The SEHK Options Clearing House Limited (SECH) Participants (Clearing Participants) and the respective clearing houses, and the accumulated investment income net of expenses of these funds appropriated from retained earnings, are included in the balance sheet as non-current assets. Clearing Participants' contributions are treated as non-current liabilities in the balance sheet. Contributions from the respective clearing houses and the accumulated investment income net of expenses of these funds appropriated from retained earnings are included in the balance sheet as designated reserves.

Net assets of the CDMD Fund, which are derived from the accumulated investment income net of expenses of this fund appropriated from retained earnings, are included in the balance sheet as non-current assets. The accumulated investment income net of expenses of this fund appropriated from retained earnings is included in the balance sheet as a designated reserve.

# Consolidated Financial Statements

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## 1. PRINCIPAL ACCOUNTING POLICIES (continued)

### (n) Margin funds on derivatives contracts/margin deposits and securities received from Clearing Participants on derivatives contracts

Margin funds are established by deposits and securities received from SEOCH and HKCC Clearing Participants for their open positions in derivatives contracts.

The funds are refundable to the Clearing Participants of SEOCH and HKCC when they close their positions in derivatives contracts. As a result, the margin deposits and securities received are reflected as liabilities to the Clearing Participants of SEOCH and HKCC. These funds are held for the SEOCH and HKCC Clearing Participants' liabilities to the respective clearing houses and are held in segregated accounts of the respective clearing houses.

Income arising from bank deposits and investments comprising these margin funds and expenses incurred for these funds are dealt with in the profit and loss account. Changes in fair value of the securities comprising these margin funds are dealt with in the investment revaluation reserve. The Clearing Participants of SEOCH and HKCC are entitled to interest at a rate determined daily by SEOCH and HKCC on the margin deposits that they place with SEOCH and HKCC respectively.

### (o) Non-trading securities

Securities held by the Group for the Clearing House Funds, Compensation Fund Reserve Account, CDMD Fund, margin funds and its investments in non-trading securities are stated in the balance sheet at fair value. Changes in the fair value of individual securities are credited or debited to the investment revaluation reserve until a security is sold, matures, or is determined to be impaired. Upon disposal, the cumulative gain or loss representing the difference between the net sale proceeds and the carrying amount of the relevant security, together with any changes in fair value transferred from the investment revaluation reserve, is dealt with in the profit and loss account.

Individual securities are reviewed at each balance sheet date to determine whether they are impaired. When a security is considered to be impaired, the cumulative loss recorded in the investment revaluation reserve is taken to the profit and loss account. Cumulative losses transferred from the investment revaluation reserve to the profit and loss account as a result of impairment are written back to the profit and loss account when the circumstances and events leading to the impairment cease to exist.

# Consolidated Financial Statements

## 1. PRINCIPAL ACCOUNTING POLICIES (continued)

### (p) Trading securities

Trading securities are investments of the Group's corporate funds and are marked to market (i.e., carried at fair value). At each balance sheet date, the net unrealised gains or losses arising from the changes in fair value of trading securities are recognised in the profit and loss account. Profits or losses on disposal of trading securities, representing the difference between the net sales proceeds and the carrying amounts, are recognised in the profit and loss account as they arise.

### (q) Repurchase transactions

When securities are sold subject to a commitment to repurchase them at a predetermined price, they remain on the balance sheet and the consideration received is recorded as a liability.

### (r) Recognition of receivables and payables from/to HKSCC Clearing Participants on Stock Exchange trades settled on the CNS basis

Upon acceptance of Stock Exchange trades for settlement in CCASS under the CNS basis, HKSCC interposes itself between the HKSCC Clearing Participants as the settlement counterparty to the trades through novation. Final acceptance of Stock Exchange trades is confirmed on T + 1 by details contained in the final clearing statement transmitted to every HKSCC Clearing Participant.

The CNS money obligations due by/to HKSCC Clearing Participants on the Stock Exchange trades are recognised as receivables and payables when they are confirmed and accepted on T + 1.

For all other trades and transactions, HKSCC merely provides a facility for settlement within CCASS and does not interpose itself between the HKSCC Clearing Participants as the settlement counterparty to the trades. The settlement of these trades does not constitute money obligations and is excluded from the consolidated accounts of the Group.

# Consolidated Financial Statements

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## 1. PRINCIPAL ACCOUNTING POLICIES (continued)

### (s) Deferred taxation

Deferred taxation is accounted for at the current taxation rate in respect of timing differences between profit as computed for taxation purposes and profit as stated in the accounts to the extent that a liability or an asset is expected to be payable or recoverable in the foreseeable future.

### (t) Deferred revenue

Deferred revenue comprises annual listing fees received in advance, payments received for undelivered services in relation to the sales of stock market information and telecommunication line rentals for trading facilities located at brokers' offices.

### (u) Provisions, contingent liabilities and contingent assets

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the accounts. When a change in the probability of an outflow occurs so that outflow is probable, it will then be recognised as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Group.

Contingent assets are not recognised but are disclosed in the notes to the accounts when an inflow of economic benefits is probable. When inflow is virtually certain, an asset is recognised.



# Consolidated Financial Statements

## 1. PRINCIPAL ACCOUNTING POLICIES (continued)

### (v) Translation of foreign currencies

Transactions in foreign currencies are translated at exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated at rates of exchange ruling at the balance sheet date. Exchange gains and losses are dealt with in the profit and loss account.

### (w) Forward foreign exchange contracts

Forward foreign exchange contracts used to hedge the currency exposures of the Group's investments are marked to market (i.e., carried at fair value). The net unrealised gains or losses arising from the changes in fair value of the contracts (i.e., estimated amounts the Group would expect to receive or pay on the termination of the contracts) are recognised in the profit and loss account.

### (x) Cash and cash equivalents

Cash and cash equivalents are carried in the balance sheet at cost. For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand, bank balances and time deposits within three months of maturity when acquired.

### (y) Segment reporting

Segment assets consist primarily of fixed assets, assets of the Clearing House Funds, Compensation Fund Reserve Account, CDMD Fund and margin fund and receivables, and exclude investments in securities, corporate bank balances and time deposits, land and buildings and investment properties. Segment liabilities comprise operating liabilities and exclude items such as taxation and certain corporate borrowings. Capital expenditures comprise additions to fixed assets. Business segments have been used as the primary reporting format as all business activities are conducted in Hong Kong.

### (z) Dividends

Dividends disclosed in the consolidated profit and loss account represent interim dividends paid and final dividend declared (based on the issued share capital as at the balance sheet date) for the year.

# Consolidated Financial Statements

## 2. SEGMENT INFORMATION

The Group's income is derived solely from business activities in Hong Kong. An analysis of the Group's income, results, assets, liabilities and capital expenditures for the year by business segments is as follows:

	Cash Market 2002 \$'000	Derivatives Market 2002 \$'000	Clearing Business 2002 \$'000	Others 2002 \$'000	Elimination 2002 \$'000	Group 2002 \$'000
Income						
External	915,612	158,308	423,690	-	-	1,497,610
Inter-segment	6,571	-	137	-	(6,708)	-
Net interest and other income						
- segment	22,304	83,005	26,382	-	-	131,691
- unallocated	-	-	-	178,789	-	178,789
	944,487	241,313	450,209	178,789	(6,708)	1,808,090
Costs	409,734	119,111	261,696	-	(2,833)	787,708
Segment results	534,753	122,202	188,513	178,789	(3,875)	1,020,382
Unallocated costs						376,949
						643,433
Share of (losses)/ profits of associated companies	(103)	-	6,244	-		6,141
Profit before taxation						649,574
Taxation						(56,606)
Profit attributable to shareholders						592,968
Segment assets	583,407	4,615,050	4,008,776	-		9,207,233
Unallocated assets	-	-	-	4,828,238		4,828,238
Total assets						14,035,471
Segment liabilities	389,873	4,568,217	3,307,534	-		8,265,624
Unallocated liabilities	-	-	-	273,455		273,455
Total liabilities						8,539,079
Capital expenditures	11,877	24,232	85,729	24,832		146,670
Depreciation and amortisation	67,459	9,301	34,364	53,583		164,707
Other non-cash expenses	6	326	1,913	4		2,249

# Consolidated Financial Statements

## 2. SEGMENT INFORMATION (continued)

	Cash Market 2001 \$'000	Derivatives Market 2001 \$'000	Clearing Business 2001 \$'000	Others 2001 \$'000	Elimination 2001 \$'000	Group 2001 \$'000
Income						
External	927,601	147,620	469,397	–	–	1,544,618
Inter-segment	8,287	–	228	–	(8,515)	–
Net interest and other income						
– segment	7,786	123,227	50,678	–	–	181,691
– unallocated	–	–	–	272,504	–	272,504
	943,674	270,847	520,303	272,504	(8,515)	1,998,813
Costs	380,344	155,186	235,661	–	(2,410)	768,781
Segment results	563,330	115,661	284,642	272,504	(6,105)	1,230,032
Unallocated costs						407,586
Profit before taxation						822,446
Taxation						(82,020)
Profit attributable to shareholders						740,426
Segment assets	592,492	4,846,842	2,976,637	–		8,415,971
Unallocated assets	–	–	–	5,329,039		5,329,039
Total assets						13,745,010
Segment liabilities	409,813	4,826,622	2,855,981	–		8,092,416
Unallocated liabilities	–	–	–	417,187		417,187
Total liabilities						8,509,603
Capital expenditures	29,196	21,054	183,098	29,791		263,139
Depreciation and amortisation	73,882	12,238	12,666	53,883		152,669
Other non-cash expenses	2,830	15	2,321	–		5,166

# Consolidated Financial Statements

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## 2. SEGMENT INFORMATION (continued)

The **Cash Market** business mainly refers to the operations of the Stock Exchange, which covers all products traded on the cash market platforms, such as equities, debt securities, unit trusts, warrants and rights. Currently, the Group operates two cash market platforms, the Main Board and the Growth Enterprise Market. The major sources of income of the business are trading fees, transaction levy, trading tariff, listing fees and income from sale of information.

The **Derivatives Market** business mainly refers to the derivatives products traded on the Futures Exchange and the Stock Exchange, which includes the provision and maintenance of trading platforms for a range of derivatives products, such as equity, currency and interest rate futures and options. Its income mainly comes from the trading fees imposed and the net interest income on the margin funds received.

The **Clearing Business** refers mainly to the operations of HKSCC, which is responsible for clearing, settlement and custodian activities and the related risk management of cash market activities. Its income is derived primarily from the fees charged on providing clearing, settlement, depository and nominee services.

Net interest and other income under the **Others Segment** represents mainly net interest income derived from corporate funds, which is not directly attributable to any of the three business segments and is therefore not allocated to the business segments. Unallocated costs represent overheads which are not directly attributable to the above-mentioned business segments.

Inter-segment transactions are conducted at arm's length.

# Consolidated Financial Statements

## 3. DISPOSAL OF SUBSIDIARY

On 31 May 2002, the share registration operations of the Group's Clearing Business, Hong Kong Registrars Limited (HKRL), a wholly-owned subsidiary, were sold and merged with those of Central Registration Hong Kong Limited, which has been renamed as Computershare Hong Kong Investor Services Limited (CHIS). The Group received 18 per cent of the issued share capital of CHIS as consideration for the sale of HKRL. On the same date, the Group increased its holding in CHIS to 24 per cent by acquiring a further 6 per cent of the issued share capital of CHIS by cash.

The results of HKRL for the five months ended 31 May 2002 have been incorporated in the consolidated profit and loss account and are as follows:

	Five months ended 31 May 2002 \$'000	Year ended 31 Dec 2001 \$'000
Income	14,183	26,466
Operating expenses	(2,509)	(9,102)
Profit before taxation	11,674	17,364
Taxation	(1,064)	(3,367)
Profit after taxation	10,610	13,997

The net book value of the total assets and total liabilities of HKRL at the date of disposal was \$6,926,476 (31 December 2001: \$40,276,000) and \$6,926,456 (31 December 2001: \$8,084,000) respectively.

The disposal of HKRL for a 18 per cent holding in CHIS is considered an exchange of similar assets. As a result, no gain or loss arose from the transaction.

# Consolidated Financial Statements

## 4. TRADING FEES, TRANSACTION LEVY AND TRADING TARIFF

	2002 \$'000	2001 \$'000
Trading fees, transaction levy and trading tariff are derived from:		
Securities and options traded on the Stock Exchange	215,871	250,306
Derivatives contracts traded on the Futures Exchange	115,858	101,102
	<u>331,729</u>	<u>351,408</u>

## 5. INTEREST INCOME

	2002 \$'000	2001 \$'000
Interest income from:		
Bank deposits	96,372	189,073
Listed securities	41,013	52,725
Unlisted securities	129,227	209,597
	<u>266,612</u>	<u>451,395</u>

## 6. OTHER INCOME

	2002 \$'000	2001 \$'000
Stock Exchange network and terminal user fees	84,158	59,681
Participants' subscription and application fees	40,767	42,436
Share registration services fees	18,500	25,155
Income received from former clearing house	–	15,960
Non-interest investment income (note 7)	24,169	32,354
Miscellaneous income	41,347	35,429
	<u>208,941</u>	<u>211,015</u>

# Consolidated Financial Statements

## 7. PROFIT BEFORE TAXATION

	2002 \$'000	2001 \$'000
Profit before taxation is stated after crediting/(charging):		
Staff costs, excluding retirement benefit costs and Directors' emoluments	(437,407)	(468,160)
Retirement benefit costs, excluding Directors' emoluments	(47,195)	(51,357)
Auditors' remuneration	(1,438)	(1,914)
Interest on bank loans and overdrafts repayable within five years	(1,736)	(812)
Operating lease rentals		
– land and buildings	(64,716)	(66,347)
– computer systems and equipment	(72,275)	(76,900)
Non-interest investment income:		
Realised and unrealised (loss)/gain on investments		
– listed trading securities	(18,625)	15,945
– unlisted trading securities	16,092	18,555
– exchange difference	21,725	(4,775)
Dividend income		
– listed securities	4,977	2,516
– unlisted securities	–	113
Gross rental income	459	459
Amortisation of goodwill (included in share of profits less losses of associated companies)	(1,568)	–
Depreciation	(163,139)	(152,669)
Interest expenses payable to Participants	(4,061)	(69,445)
Loss on disposal of fixed assets	(3,149)	(1)

## 8. DIRECTORS' EMOLUMENTS

None of the fifteen Directors (2001: fifteen), except the Executive Director, received any emoluments during the year (2001: \$Nil). Total emoluments of the only Executive Director, excluding share option benefits, for the year amounted to \$7,947,000 (2001: \$8,477,000) of which \$7,072,000 (2001: \$7,075,000) was attributable to salaries, other allowances and benefits in kind. Employer's contribution to retirement scheme for the year amounted to \$875,000 (2001: \$875,000). No discretionary bonus was paid for 2002 (2001: \$527,000). No directors' fees were paid to any of the Directors (2001: \$Nil).



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## 8. DIRECTORS' EMOLUMENTS (continued)

In addition to the above emoluments, a Director was granted share options under HKEx's Pre-Listing Share Option Scheme. Details of this are disclosed under Directors' interests in shares and options in the Report of the Directors.

## 9. FIVE TOP-PAID EMPLOYEES

One (2001: one) of the five top-paid employees was a Director, whose emoluments are disclosed in note 8. Details of the emoluments of the other four (2001: four) top-paid employees are as follows:

	2002 \$'000	2001 \$'000
Salaries, other allowances and benefits in kind	19,309	16,702
Performance award	–	843
Retirement scheme contributions by employer	2,174	1,816
Compensation for loss of office	–	3,727
	<u>21,483</u>	<u>23,088</u>

The emoluments of these employees are within the following bands:

	2002 Number of employees	2001 Number of employees
\$4,000,001 – \$4,500,000	2	–
\$4,500,001 – \$5,000,000	–	2
\$5,000,001 – \$5,500,000	–	–
\$5,500,001 – \$6,000,000	1	1
\$7,000,001 – \$7,500,000	1	–
\$7,500,001 – \$8,000,000	–	1
	<u>4</u>	<u>4</u>

# Consolidated Financial Statements

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## 9. FIVE TOP-PAID EMPLOYEES (continued)

The employees, whose emoluments are disclosed above, include senior executives who were also Directors of the subsidiaries during the years. No Directors of the subsidiaries waived any emoluments.

## 10. RETIREMENT BENEFIT COSTS

The Group has sponsored two defined contribution provident fund schemes which are registered under ORSO and have obtained Mandatory Provident Fund (MPF) exemption. The two ORSO schemes, being the Hong Kong Exchanges and Clearing Provident Fund Scheme (the Plan) and the Hong Kong Futures Exchange Provident Scheme (the HKFE Scheme), are for all full-time permanent employees. Contributions to these two retirement schemes by the Group and employees are calculated as a percentage of employees' basic salaries. In compliance with the MPF Ordinance, HKEx has participated in a master trust MPF scheme, the AIA-JF Premium MPF Scheme (the MPF Scheme), to provide retirement benefits to full-time permanent employees who elect to join the MPF Scheme and all temporary or part-time employees who are not eligible for joining the defined contribution provident fund schemes approved by ORSO. Contributions to the MPF Scheme are in accordance with the statutory limits prescribed by the MPF Ordinance.

During the year, the HKFE Scheme's assets and liabilities were liquidated and the proceeds of \$9,742,912 were transferred to the Plan on 15 April 2002. All members have withdrawn from the HKFE Scheme and become members of the Plan. The HKFE Scheme was terminated on 15 July 2002.

The retirement benefit costs charged to the consolidated profit and loss account represent contributions paid and payable by the Group to the ORSO schemes and the MPF Scheme.

For the Plan, contributions during the year were not offset by contributions forfeited in respect of employees who left the Plan before the contributions were fully vested. Instead, forfeited contributions were credited to a reserve account of the Plan for the benefit of its members.

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## 10. RETIREMENT BENEFIT COSTS (continued)

	2002 \$'000	2001 \$'000
Forfeited contributions during the year and retained in the Plan	<u>2,981</u>	<u>2,154</u>

Contributions to the HKFE Scheme were offset by contributions forfeited in respect of employees who left the HKFE Scheme before the contributions were fully vested. Forfeited contributions totalling \$40,275 were utilised during the year. Upon the termination of the HKFE Scheme, the balance of \$5,480 of forfeited contributions was reimbursed to the Futures Exchange.

## 11. TAXATION

(a) Taxation in the consolidated profit and loss account represents:

	2002 \$'000	2001 \$'000
Provision for Hong Kong Profits Tax for the year	68,741	73,614
Overprovision in respect of prior years	<u>(5,422)</u>	<u>(1,131)</u>
	63,319	72,483
Deferred taxation (note 11(b))	<u>(8,022)</u>	<u>9,537</u>
	55,297	82,020
Share of taxation of associated companies	<u>1,309</u>	<u>–</u>
	<u>56,606</u>	<u>82,020</u>

Hong Kong Profits Tax has been provided for at 16 per cent (2001: 16 per cent) on the estimated assessable profit for the year.

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## 11. TAXATION (continued)

(b) Deferred taxation in the consolidated balance sheet represents:

	Group	
	2002 \$'000	2001 \$'000
At 1 Jan	75,275	65,738
Transfer (to)/from the consolidated profit and loss account (note 11(a))	(8,022)	9,537
At 31 Dec	67,253	75,275

The amount represents the tax effect of accelerated depreciation allowances on fixed assets.

The revaluation of investment property and land and buildings (note 13) does not constitute a timing difference for deferred taxation purposes as realisation of the revaluation surplus would not result in any tax liability.

There was no other material unprovided deferred taxation for the year.

## 12. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the profit attributable to shareholders of \$592,968,000 (2001: \$740,426,000) and the weighted average of 1,042,665,487 shares (2001: 1,040,664,846) in issue during the year.

The share options outstanding as set out in note 25 did not have a material dilutive effect on the basic earnings per share.

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## 13. FIXED ASSETS

### (a) Group

	Investment property under long- term lease in Hong Kong \$'000	Land and buildings under long- term lease in Hong Kong \$'000	Computer trading and clearing systems \$'000	Other computer hardware and software \$'000	Leasehold improvements, furniture, equipment and motor vehicles \$'000	Total \$'000
Cost or valuation						
At 1 Jan 2002	11,500	136,700	1,424,325	333,826	236,920	2,143,271
Additions	-	-	76,922	51,795	17,953	146,670
Revaluation	(1,500)	(19,700)	-	-	-	(21,200)
Disposals	-	-	(38,881)	(4,848)	(15,672)	(59,401)
At 31 Dec 2002	10,000	117,000	1,462,366	380,773	239,201	2,209,340
Representing						
At cost	-	-	1,462,366	380,773	239,201	2,082,340
At valuation						
- 31 Dec 2002	10,000	117,000	-	-	-	127,000
	10,000	117,000	1,462,366	380,773	239,201	2,209,340
Accumulated depreciation						
At 1 Jan 2002	-	-	949,262	253,931	153,968	1,357,161
Charge for the year	-	2,850	104,961	26,383	28,945	163,139
Revaluation	-	(2,850)	-	-	-	(2,850)
Disposals	-	-	(36,089)	(4,845)	(15,284)	(56,218)
At 31 Dec 2002	-	-	1,018,134	275,469	167,629	1,461,232
Net book value						
At 31 Dec 2002	10,000	117,000	444,232	105,304	71,572	748,108
At 31 Dec 2001	11,500	136,700	475,063	79,895	82,952	786,110

# Consolidated Financial Statements

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## 13. FIXED ASSETS (continued)

### (a) Group (continued)

The cost of investment property was \$8,229,000 (2001: \$8,229,000). The investment property was revalued as at 31 December 2002 on the basis of its open market value by Jones Lang LaSalle, an independent firm of qualified property valuers. A deficit of \$1,500,000 was charged to the investment properties revaluation reserve during 2002 (2001: deficit of \$4,200,000) (note 26).

Land and buildings were revalued as at 31 December 2002 on the basis of their open market value in existing use carried out by Jones Lang LaSalle, an independent firm of qualified property valuers. A deficit of \$16,850,000 was charged to other properties revaluation reserve during 2002 (2001: deficit of \$9,273,000) (note 26).

The total cost of land and buildings of the Group was \$101,087,000 (2001: \$101,087,000). The carrying value of these land and buildings as at 31 December 2002 would have been \$80,973,000 (2001: \$82,650,194) had they been carried at cost less accumulated depreciation.

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## 13. FIXED ASSETS (continued)

### (b) HKEx

	Other computer hardware and software \$'000	Leasehold improvements, furniture, equipment and motor vehicles \$'000	Total \$'000
<b>Cost</b>			
At 1 Jan 2002	18,020	11,189	29,209
Additions	26,284	744	27,028
Disposals	(75)	(40)	(115)
At 31 Dec 2002	44,229	11,893	56,122
<b>Accumulated depreciation</b>			
At 1 Jan 2002	2,616	2,024	4,640
Charge for the year	5,407	2,532	7,939
Disposals	(46)	(9)	(55)
At 31 Dec 2002	7,977	4,547	12,524
<b>Net book value</b>			
At 31 Dec 2002	36,252	7,346	43,598
At 31 Dec 2001	15,404	9,165	24,569

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## 14. INVESTMENTS IN ASSOCIATED COMPANIES

	2002 \$'000	Group 2001 \$'000
Share of net assets of associated companies	8,215	–
Goodwill on acquisition of shares in associated companies less amortisation (note a)	25,321	–
	33,536	–
Loan receivable from an associated company (note b)	2,000	–
	35,536	–

(a) Goodwill

	\$'000
<b>Cost</b>	
At 1 Jan 2002	–
Addition on acquisition of shares in associated companies	26,889
At 31 Dec 2002	26,889
<b>Accumulated amortisation</b>	
At 1 Jan 2002	–
Charge for the year (note 7)	1,568
At 31 Dec 2002	1,568
<b>Net book value</b>	
At 31 Dec 2002	25,321
At 31 Dec 2001	–

Goodwill is amortised on a straight-line basis over 10 years.



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## 14. INVESTMENTS IN ASSOCIATED COMPANIES (continued)

(b) Loan receivable from an associated company is unsecured with interest payable semi-annually at prime rate per annum and is repayable on 31 May 2004.

(c) Details of the unlisted associated companies as at 31 December 2002 are as follows:

Name	Place of incorporation	Principal activities	Particulars of shares held	Interest held
Computershare Hong Kong Investor Services Limited	Hong Kong	Provision of share registration services	5,854 Class A ordinary shares	24%
Wilco International Processing Services Limited	Hong Kong	Provision of transaction processing services to Stock Exchange Participants	6 Class B ordinary shares	30%

Wilco International Processing Services Limited has an accounting year end of 30 June, which is not coterminous with the Group's accounting year end.

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## 15. CLEARING HOUSE FUNDS

	Group	
	2002	2001
	\$'000	\$'000
Net asset values of the Clearing House Funds are as follows:		
HKSCC Guarantee Fund	372,352	367,888
SEOCH Reserve Fund	134,185	128,837
HKCC Reserve Fund	474,211	447,429
	<u>980,748</u>	<u>944,154</u>
Net assets of the Clearing House Funds are composed of:		
Unlisted non-trading securities, at fair value		
– debt securities	155,688	340,821
Contributions receivable from Broker Participants in CCASS	31,490	28,390
Bank balances and time deposits	806,401	590,304
	<u>993,579</u>	<u>959,515</u>
Less: Other liabilities	<u>(12,831)</u>	<u>(15,361)</u>
	<u>980,748</u>	<u>944,154</u>
The Clearing House Funds are funded by:		
Clearing Participants' contributions	425,440	423,960
Clearing houses' contributions	320,200	320,200
Accumulated investment income net of expenses attributable to:		
– Clearing Participants' contributions	176,643	157,975
– Clearing houses' contributions	58,465	42,019
	<u>980,748</u>	<u>944,154</u>

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## 15. CLEARING HOUSE FUNDS (continued)

Temporary fluctuations in fair value of investments are reflected in the assets and investment revaluation reserve of the Group. As at 31 December 2002, the aggregate cost and market value of the funds were \$980,748,000 and \$983,526,000 respectively (2001: \$944,154,000 and \$943,220,000 respectively).

The HKSCC Guarantee Fund provides resources to enable HKSCC to discharge the liabilities and obligations of defaulting Broker Participants in CCASS arising from their Stock Exchange trades accepted for settlement on the CNS basis and defective securities deposited into CCASS. The SEOCH Reserve Fund and the HKCC Reserve Fund were established for the exclusive purpose of supporting SEOCH and HKCC to fulfil their counterparty obligations in the event that one or more of their Clearing Participants fail to meet their obligations to SEOCH and HKCC respectively.

## 16. COMPENSATION FUND RESERVE ACCOUNT

The Securities and Futures Commission (SFC) is responsible for maintaining the Unified Exchange Compensation Fund (Compensation Fund). The Stock Exchange is required by the Securities Ordinance (SO) to deposit with the SFC and keep deposited \$50,000 in respect of each Stock Exchange Trading Right in the Compensation Fund. The Stock Exchange maintains an account known as the Compensation Fund Reserve Account for all receipts and payments in relation to the Compensation Fund under the Rules of the Exchange, in particular the following:

- (a) The interest received from the SFC on the statutory deposits paid in respect of each Stock Exchange Trading Right into the Compensation Fund maintained by the SFC;
- (b) Amounts received or paid out in relation to each of the Stock Exchange Trading Rights granted or revoked by the Stock Exchange respectively; and
- (c) Amounts reserved for the replenishment to the Compensation Fund.

The Compensation Fund is further explained in note 33(a)(i).

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## 17. CASH AND DERIVATIVES MARKET DEVELOPMENT FUND

	Group	
	2002 \$'000	2001 \$'000
Net asset value of HKCC's CDMD Fund	<u>914</u>	<u>914</u>
The Fund is composed of:		
Unlisted non-trading securities, at fair value		
– debt securities	<u>914</u>	<u>914</u>
The Fund represents:		
Accumulated investment income net of expenses		
appropriated from retained earnings	<u>914</u>	<u>914</u>

Temporary fluctuations in fair value of investments are reflected in the assets and investment revaluation reserve of the Group. As at 31 December 2002, the aggregate cost and market value of the fund were \$914,000 and \$948,000 respectively (2001: \$914,000 and \$933,000 respectively).

The CDMD Fund was established by the cash received from the Hong Kong Futures Guarantee Corporation Limited (the former clearing house of the Futures Exchange) for the purpose of providing funding for the development and betterment of the cash and derivatives markets in Hong Kong.

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## 18. NON-TRADING SECURITIES

	Group	
	2002	2001
	\$'000	\$'000
Analysis of non-trading securities:		
Current	–	–
Non-current	87,604	52,366
	<u>87,604</u>	<u>52,366</u>
Non-trading securities, at fair value:		
Equity securities		
– listed outside Hong Kong	55,301	52,366
– unlisted	32,303	–
	<u>87,604</u>	<u>52,366</u>

## 19. MARGIN FUNDS ON DERIVATIVES CONTRACTS

	Group	
	2002	2001
	\$'000	\$'000
The margin funds comprise:		
SEOCH Clearing Participants' margin funds	757,333	740,934
HKCC Clearing Participants' margin funds	3,794,268	4,062,173
	<u>4,551,601</u>	<u>4,803,107</u>
The assets of the margin funds comprise:		
Bank balances and time deposits	2,148,753	2,339,051
Listed securities deposited as alternatives to cash deposits, at market value	1,119,682	1,312,995
Margin receivable from Clearing Participants	3,198	–
Listed non-trading securities, at fair value		
– debt securities	173,907	68,208
Unlisted non-trading securities, at fair value		
– money market fund	162,484	229,127
– debt securities	943,577	853,726
	<u>4,551,601</u>	<u>4,803,107</u>
The Group's liabilities in respect of the margin funds are as follows:		
Margin deposits and securities received from SEOCH and HKCC Participants on derivatives contracts	<u>4,551,601</u>	<u>4,803,107</u>

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## 20. ACCOUNTS RECEIVABLE, PREPAYMENTS AND DEPOSITS/ ACCOUNTS PAYABLE, ACCRUALS AND OTHER LIABILITIES

### (a) Accounts receivable, prepayments and deposits

	Group		HKEx	
	2002	2001	2002	2001
	\$'000	\$'000	\$'000	\$'000
Receivable from Exchange and Clearing Participants:				
– CNS money obligations	2,647,591	1,727,190	–	–
– transaction levy, stamp duty and fee receivable	94,237	101,440	–	–
Other fees receivable	229,094	210,282	–	–
Interest receivable	61,598	48,157	–	–
Other receivables, prepayments and deposits	85,679	247,698	20,337	16,889
	<b>3,118,199</b>	<b>2,334,767</b>	<b>20,337</b>	<b>16,889</b>

### (b) Accounts payable, accruals and other liabilities

	Group		HKEx	
	2002	2001	2002	2001
	\$'000	\$'000	\$'000	\$'000
Payable to Exchange and Clearing Participants:				
– CNS money obligations	2,647,066	1,669,621	–	–
– cash collateral and others	30,994	27,872	–	–
– arising from stock option activities	577	57,868	–	–
Transaction levy payable to the SFC	16,146	19,420	–	–
Unclaimed dividends (note c)	105,574	94,880	6,085	–
Stamp duty payable	22,817	30,119	–	–
Deposits received	55,590	96,210	–	–
Other payables and accruals	128,628	737,316	64,258	22,650
	<b>3,007,392</b>	<b>2,733,306</b>	<b>70,343</b>	<b>22,650</b>

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## 20. ACCOUNTS RECEIVABLE, PREPAYMENTS AND DEPOSITS/ ACCOUNTS PAYABLE, ACCRUALS AND OTHER LIABILITIES (continued)

- (c) Unclaimed dividends for the Group represent dividends declared by listed companies which are held by HKSCC Nominees Limited but not yet claimed by shareholders of the companies concerned, and dividends declared by HKEx but not yet claimed by its shareholders.
- (d) CNS money obligations receivable represents 85 per cent (2001: 74 per cent) of the total accounts receivable, prepayments and deposits. CNS money obligations payable represents 88 per cent (2001: 61 per cent) of the total accounts payable, accruals and other liabilities. CNS money obligations mature within two days as they are due for settlement two days after the trade date. The majority of the remaining accounts receivable, prepayments, deposits, accounts payable, accruals and other liabilities will mature within three months.

## 21. TRADING SECURITIES

	Group	
	2002 \$'000	2001 \$'000
Equity securities, at fair value		
– listed in Hong Kong	40,775	11,547
– listed outside Hong Kong	66,251	94,688
	<u>107,026</u>	<u>106,235</u>
Debt securities, at fair value		
– listed in Hong Kong	99,182	103,419
– listed outside Hong Kong	982,757	695,491
	<u>1,081,939</u>	<u>798,910</u>
Unlisted debt securities, at fair value	<u>2,301,081</u>	<u>2,277,382</u>
	<u>3,490,046</u>	<u>3,182,527</u>

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## 22. PARTICIPANTS' ADMISSION FEES RECEIVED

The admission fees are non-interest bearing and may be repayable upon the expiry of seven years from the date of admission of a Participant or upon the termination of a Participant's participation in CCASS, whichever is later. HKSCC may, at its discretion, grant early refunds of admission fees to terminated Participants after six months from the date of termination of their participation in CCASS and to Broker Participants after six months from the date of sale of their Stock Exchange Trading Right.

## 23. PROVISIONS

### (a) Group

	Reinstatement costs \$'000	Employee benefit costs \$'000	Total \$'000
At 1 Jan 2002	31,243	23,826	55,069
Provision for the year	228	33,435	33,663
Amount used during the year	–	(31,063)	(31,063)
Unused amount reversed during the year	(6,190)	–	(6,190)
Amount paid during the year	(145)	(2,372)	(2,517)
At 31 Dec 2002	25,136	23,826	48,962
		2002 \$'000	2001 \$'000
Analysis of provisions:			
Current		28,863	25,927
Non-current		20,099	29,142
		48,962	55,069



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## 23. PROVISIONS (continued)

### (b) HKEx

	Employee benefit costs \$'000	
At 1 Jan 2002	5,129	
Transfer from subsidiaries (note c)	18,697	
Provision for the year	33,435	
Amount used during the year	(31,063)	
Amount paid during the year	(2,372)	
At 31 Dec 2002	23,826	
	2002 \$'000	2001 \$'000
Analysis of provisions:		
Current	23,826	5,129
Non-current	–	–
	23,826	5,129

- (c) The employment of all staff members of the Group was centralized under HKEx with effect from 1 April 2002. Consequently, all provisions for employee benefit costs were transferred from the subsidiaries to HKEx.

## 24. INVESTMENTS IN AND AMOUNTS DUE FROM/(TO) SUBSIDIARIES

### (a) Investments in subsidiaries

	HKEx	
	2002 \$'000	2001 \$'000
Investments in unlisted shares, at cost	4,145,198	4,145,198

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## 24. INVESTMENTS IN AND AMOUNTS DUE FROM/(TO) SUBSIDIARIES (continued)

### (b) Amounts due from/(to) subsidiaries

The amounts due from/(to) subsidiaries are interest-free and have no fixed terms of repayment.

### (c) Particulars of subsidiaries

HKEEx had direct or indirect interests in the following subsidiaries as at 31 December 2002, all of which are wholly-owned private companies incorporated and operating in Hong Kong except for HKEEx (China) Limited, which operates mainly in the PRC. Details of these companies are as follows:

Company	Issued and fully paid up share capital	Principal activities	Interest held
Direct subsidiaries:			
The Stock Exchange of Hong Kong Limited	A shares \$929	Operates the single, unified stock exchange in Hong Kong for the purposes of the Stock Exchanges Unification Ordinance	100%
Hong Kong Futures Exchange Limited	Ordinary \$19,600,000 Standard \$850,000	Operates a futures and options exchange	100%
Hong Kong Securities Clearing Company Limited	Ordinary \$2	Operates CCASS and the central securities depository and provides custody and nominee services for eligible securities listed in Hong Kong	100%
HKEC Nominees Limited	Ordinary \$2	Nominee services	100%
Hong Kong Financial Markets Development Limited	Ordinary \$2	Promotes the securities, futures and financial industry	100%

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## 24. INVESTMENTS IN AND AMOUNTS DUE FROM/(TO) SUBSIDIARIES (continued)

### (c) Particulars of subsidiaries (continued)

Company	Issued and fully paid up share capital	Principal activities	Interest held
Direct subsidiaries: (continued)			
HKEx (Singapore) Limited	Ordinary \$2	Investment holding	100%
HKEx (China) Limited	Ordinary \$2	Promotes HKEx products and services in the PRC	100%
Indirect subsidiaries:			
The SEHK Options Clearing House Limited	Ordinary \$1,000,000	Operates a clearing house for option contracts traded on the Stock Exchange	100%
HKEx Information Services Limited	Ordinary \$100	Sale of stock market information	100%
Prime View Company Limited	Ordinary \$20	Property holding	100%
The Stock Exchange Club Limited	Ordinary \$8	Property holding	100%
The Stock Exchange Nominee Limited	Ordinary \$2	Nominee services	100%

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## 24. INVESTMENTS IN AND AMOUNTS DUE FROM/(TO) SUBSIDIARIES (continued)

### (c) Particulars of subsidiaries (continued)

Company	Issued and fully paid up share capital	Principal activities	Interest held
Indirect subsidiaries: (continued)			
HKFE Clearing Corporation Limited	Ordinary \$1,000,000	Operates a clearing house for derivatives contracts traded on the Futures Exchange	100%
HKFE Clearing Linkage Limited	Ordinary \$2	Dormant	100%
HKSCC Nominees Limited	Ordinary \$20	Acting as common nominee in respect of securities held in the CCASS depository	100%
Many Profit Limited	Ordinary \$2	Investment holding	100%
Freestar Corporation Limited	Ordinary \$2	Investment holding	100%
Star Prime Limited	Ordinary \$2	Investment holding	100%
HK Conversion Agency Services Limited	Ordinary \$2	Conversion agency services	100%

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## 25. SHARE CAPITAL AND SHARE PREMIUM

		2002 \$'000	2001 \$'000
Authorised:			
2,000,000,000 shares of \$1 each		<u>2,000,000</u>	<u>2,000,000</u>
Issued and fully paid:			
	Number of shares of \$1 each	Share capital \$'000	Share premium \$'000
			Total \$'000
At 1 Jan and 31 Dec 2001	1,040,664,846	1,040,665	–
Shares issued under share option scheme	<u>2,916,000</u>	<u>2,916</u>	<u>19,012</u>
At 31 Dec 2002	<u>1,043,580,846</u>	<u>1,043,581</u>	<u>19,012</u>
			<u>1,062,593</u>

Under the Pre-Listing Share Option Scheme of HKEx, share options were granted to employees on 20 June 2000 which are exercisable between 6 March 2002 and 30 May 2010 at an exercise price of \$7.52 per share.

During the year, options were exercised to subscribe for 2,916,000 shares (2001: Nil) in HKEx at a consideration of \$7.52 per share, of which \$1.00 per share was credited to share capital and the balance of \$6.52 per share was credited to the share premium account.

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## 25. SHARE CAPITAL AND SHARE PREMIUM (continued)

Movements of the share options during the year were as follows:

Number of shares issuable under the share options outstanding as at 1 Jan 2002	Number of share options forfeited	Number of share options granted	Number of share options exercised	Number of shares issuable under the share options outstanding as at 31 Dec 2002
27,267,384	(1,098,364)	–	(2,916,000)	23,253,020

No specific accounting guidance has been issued by the Hong Kong Society of Accountants (HKSA) on the accounting for employee share options. In November 2002, the International Accounting Standards Board (IASB) published an exposure draft, ED2 – Share-based Payment, which covers the accounting treatment for employee share options. The exposure draft is expected to be finalized as an International Financial Reporting Standard (IFRS) sometime in 2003.

In line with other countries/regions (e.g., USA, European Union, etc), Hong Kong is working towards harmonizing its accounting standards with those issued by the IASB. The HKSA has announced that, following IASB's issuance of an IFRS on share-based payment, it intends to recommend the adoption of a new Hong Kong Statement of Standard Accounting Practice (SSAP) so that the SSAPs maintain conformity with the IASB standards.

When the Pre-listing share options are exercised and new shares are issued, the share capital is increased by the nominal value of the new shares issued and the share premium account is increased by the remainder of the proceeds. HKEx has not expensed the share options to the profit and loss account as the proposed international accounting standard ED2 does not recommend expensing options which were granted before the adoption of the new standard. Had all the outstanding Pre-listing options been fully exercised on 31 December 2002, the Group would have received \$174,862,710 in proceeds. The market value of the shares issued based on the closing price of \$9.80 per share on that date was \$227,879,596, and the employees concerned would have made a gain of \$2.28 per share, or, in aggregate, \$53,016,886.

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## 26. REVALUATION RESERVES

	Investment properties revaluation reserve \$'000	Group Other properties revaluation reserve \$'000	Investment revaluation reserve \$'000	Total \$'000
At 1 Jan 2001	7,471	42,906	33,976	84,353
Change in valuation of properties	(4,200)	(9,273)	–	(13,473)
Change in fair value of non-trading securities	–	–	1,886	1,886
Realisation of change in fair value of non-trading securities on maturity and disposal	–	–	(28,969)	(28,969)
At 31 Dec 2001	3,271	33,633	6,893	43,797
Change in valuation of properties (note 13(a))	(1,500)	(16,850)	–	(18,350)
Change in fair value of non-trading securities	–	–	14,548	14,548
Realisation of change in fair value of non-trading securities on maturity and disposal	–	–	(6,015)	(6,015)
At 31 Dec 2002	1,771	16,783	15,426	33,980

The revaluation reserves are segregated for their respective specific purposes.

# Consolidated Financial Statements

## 27. DESIGNATED RESERVES

	Group	
	2002	2001
	\$'000	\$'000
Clearing House Funds reserves (note a)		
– HKSCC Guarantee Fund reserve	255,912	254,428
– SEOCH Reserve Fund reserve	47,185	44,837
– HKCC Reserve Fund reserve	252,211	220,929
	<u>555,308</u>	<u>520,194</u>
Compensation Fund Reserve Account reserve (note b)	35,827	35,146
CDMD Fund reserve (note c)	914	914
Development reserve (note d)	135,762	135,762
	<u>727,811</u>	<u>692,016</u>

These reserves are segregated for their respective purposes. Details of the movements on the reserves during the year are as follows:

### (a) Clearing House Funds reserves

	HKSCC Guarantee Fund reserve \$'000	SEOCH Reserve Fund reserve \$'000	HKCC Reserve Fund reserve \$'000	Total \$'000
At 1 Jan 2001	241,861	35,132	197,162	474,155
Investment income net of expenses of Clearing House Funds transferred from retained earnings	<u>12,567</u>	<u>9,705</u>	<u>23,767</u>	<u>46,039</u>
At 31 Dec 2001	254,428	44,837	220,929	520,194
Investment income net of expenses of Clearing House Funds transferred from retained earnings	<u>1,484</u>	<u>2,348</u>	<u>31,282</u>	<u>35,114</u>
At 31 Dec 2002	<u>255,912</u>	<u>47,185</u>	<u>252,211</u>	<u>555,308</u>



# Consolidated Financial Statements

## 27. DESIGNATED RESERVES (continued)

### (b) Compensation Fund Reserve Account reserve

	\$'000
At 1 Jan 2001	31,107
Investment income net of expenses of Compensation	
Fund Reserve Account transferred from retained earnings	4,039
At 31 Dec 2001	35,146
Investment income net of expenses of Compensation	
Fund Reserve Account transferred from retained earnings	681
At 31 Dec 2002	35,827

### (c) CDMD Fund reserve

There were no movements in 2001 and 2002.

### (d) Development reserve

The reserve was set aside for systems development for the Stock Exchange. There were no movements in 2001 and 2002.

## 28. MERGER RESERVE

The Group has taken advantage of the merger relief available under section 48C of the Hong Kong Companies Ordinance and treated the premium created by the issuance of shares on 6 March 2000, the date HKEx became the holding company of the Stock Exchange and the Futures Exchange and their subsidiaries, as a merger reserve. In the consolidated balance sheet, the full amount of the merger reserve has been used to offset against the reserve arising on consolidation as explained in note 29(c).

# Consolidated Financial Statements

## 29. RETAINED EARNINGS

	Group		HKEx	
	2002 \$'000	2001 \$'000	2002 \$'000	2001 \$'000
At 1 Jan				
Retained earnings	3,198,763	2,851,834	28,252	(89,248)
Proposed and declared dividend	260,166	260,166	260,166	260,166
Profit for the year (note a)	592,968	740,426	612,708	460,919
Investment income net of expenses of Clearing House Funds transferred to Clearing House Funds reserves	(35,114)	(46,039)	–	–
Investment income net of expenses of Compensation Fund Reserve Account transferred to Compensation Fund Reserve Account reserve	(681)	(4,039)	–	–
Dividends paid:				
Interim dividend	(83,450)	(83,253)	(83,450)	(83,253)
2001/2000 final dividend	(260,166)	(260,166)	(260,166)	(260,166)
Dividend on shares issued for share options exercised after declaration of 2001 final dividend	(448)	–	(448)	–
Dividend on shares issued for share options exercised after declaration of 2002 interim dividend	(30)	–	(30)	–
At 31 Dec	3,672,008	3,458,929	557,032	288,418
Representing:				
Retained earnings at 31 Dec	3,223,268	3,198,763	108,292	28,252
Proposed and declared dividend	448,740	260,166	448,740	260,166
At 31 Dec	3,672,008	3,458,929	557,032	288,418

# Consolidated Financial Statements

## 29. RETAINED EARNINGS (continued)

- (a) Profit attributable to shareholders includes a profit of \$612,708,000 (2001: \$460,919,000) which has been dealt with in the accounts of HKEx, the holding company of the Group.
- (b) The Group's profit after taxation includes the investment income net of expenses of the Clearing House Funds, Compensation Fund Reserve Account and CDMD Fund for an aggregate amount of \$14,480,000 (2001: \$39,713,000).
- (c) The reserve arising on consolidation of \$4,116,436,000, representing the difference between the cost of acquiring the subsidiaries at the time of the merger and their respective issued share capital, was offset against merger reserve of \$2,997,115,000 (note 28) and retained earnings of \$1,119,321,000.

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## 30. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

### (a) Reconciliation of profit before taxation to net cash outflow from operating activities

	2002 \$'000	2001 \$'000
Profit before taxation	649,574	822,446
Adjustments for:		
Net interest income	(260,815)	(381,950)
Dividends received from non-trading securities	(2,482)	(2,516)
Gain on trading securities and exchange differences on investments	(19,192)	(29,725)
Depreciation and amortisation	163,139	152,669
Changes in provisions	–	(4,185)
Share of profits less losses of associated companies	(6,141)	–
Loss on disposal of fixed assets	3,149	1
Operating profit before working capital changes	527,232	556,740
Net increase in trading securities	(290,645)	(3,152,802)
Settlement of amount transferred from retained earnings to Clearing House Funds and Compensation Fund Reserve Account	(35,795)	(50,078)
(Increase)/decrease in accounts receivable, prepayments and deposits	(765,155)	315,248
Increase/(decrease) in other current liabilities	281,112	(218,534)
Net cash outflow from operations	(283,251)	(2,549,426)
Interest received from banks and trading securities	211,500	247,957
Interest paid	(6,176)	(69,788)
Hong Kong Profits Tax paid	(57,877)	(114,473)
Refund of Hong Kong Profits Tax	9,319	42
Net cash outflow from operating activities	(126,485)	(2,485,688)

# Consolidated Financial Statements

## 30. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (continued)

### (b) Analysis of cash and cash equivalents

	2002 \$'000	2001 \$'000
Time deposits with original maturity within three months	629,776	918,620
Cash at bank and in hand	50,180	433,344
Cash and cash equivalents at the end of the year	<u>679,956</u>	<u>1,351,964</u>

(c) The net assets of the Clearing House Funds, Compensation Fund Reserve Account, CDMD Fund and margin funds are held in segregated accounts for specific purposes. Movements in individual items of the net assets of the funds during the year therefore do not constitute any cash or cash equivalent transactions to the Group except for the investment income net of expenses of these funds which has been accounted for as the Group's assets and profit.

(d) Following the adoption of SSAP 15 (revised), Cash Flow Statements, certain comparatives previously reported have been restated to conform to the new policy.

## 31. COMMITMENTS

### (a) Commitments in respect of capital expenditures:

	Group		HKEx	
	2002 \$'000	2001 \$'000	2002 \$'000	2001 \$'000
Contracted but not provided for	36,454	50,194	2,994	944
Authorised but not contracted for	57,170	267,199	13,222	83,873
	<u>93,624</u>	<u>317,393</u>	<u>16,216</u>	<u>84,817</u>

The commitments in respect of capital expenditures were mainly for the development and purchases of computer systems.

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## 31. COMMITMENTS (continued)

(b) Commitments for the total future minimum lease payments under operating leases in respect of:

	Group		HKEx	
	2002 \$'000	2001 \$'000	2002 \$'000	2001 \$'000
Land and buildings, payable				
– within one year	73,697	59,128	74	–
– in the second to fifth years	114,493	181,540	–	–
	<u>188,190</u>	<u>240,668</u>	<u>74</u>	<u>–</u>
Computer systems and equipment, payable				
– within one year	55,694	49,664	28,455	–
– in the second to fifth years	46,899	41,279	16,510	–
– after five years	3,357	10,072	–	–
	<u>105,950</u>	<u>101,015</u>	<u>44,965</u>	<u>–</u>
	<u>294,140</u>	<u>341,683</u>	<u>45,039</u>	<u>–</u>

As at 31 December 2002, in respect of computer systems and equipment, the majority of the leases would mature within three years and the Group did not have any purchase options.

## 32. FINANCIAL RISK MANAGEMENT

When seeking to optimise returns on its funds available for investment, the Group may invest in non-HKD securities from time to time. Forward foreign exchange contracts are used to hedge the currency exposures of the Group's non-HKD investments to mitigate risks arising from fluctuations in exchange rates. As at 31 December 2002, the total nominal value of outstanding forward foreign exchange contracts amounted to HK\$197 million (2001: HK\$120 million). All contracts will mature within 3 months.

# Consolidated Financial Statements

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## 33. CONTINGENT LIABILITIES

### (a) Group

- (i) The Compensation Fund is a fund set up under the SO for the purpose of compensating any person dealing with a Stock Exchange Participant (other than another Stock Exchange Participant) for any pecuniary losses suffered as a result of a default of the Stock Exchange Participant. According to section 109(3) of the SO, the maximum compensation amount is \$8 million for each Stock Exchange Participant's default. Under section 113(5A) of the SO, the Stock Exchange may, upon satisfying certain conditions, with the approval of the SFC, allow an additional payment to the successful claimants before apportionment. Under section 107(1) of the SO, the Stock Exchange has contingent liabilities to the Compensation Fund as it shall replenish the Compensation Fund upon the SFC's request to do so. The amounts to be replenished should be equal to the amount paid in connection with the satisfaction of the claims, including any legal and other expenses paid or incurred in relation to the claims but capped at \$8 million per default. As at 31 December 2002, there were outstanding claims received in respect of 14 defaulted Stock Exchange Participants (2001: 15).

Under the new compensation arrangements to be implemented on 1 April 2003 under the Securities and Futures Ordinance (SFO), a new Investor Compensation Fund would replace the existing Compensation Fund, the Commodity Exchange Compensation Fund and the Dealers' Deposit Schemes for non-exchange participant dealers. The new arrangements would not require Exchange Participants to make deposits to the Investor Compensation Fund. Existing deposits would be returned to the Stock Exchange and the Futures Exchange in accordance with the provisions of the SFO. The arrangements would remove the requirement for the Stock Exchange to replenish the Investor Compensation Fund.

# Consolidated Financial Statements

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## 33. CONTINGENT LIABILITIES (continued)

### (a) Group (continued)

- (ii) The Stock Exchange has undertaken to indemnify the Collector of Stamp Revenue against any loss of revenue resulting from any underpayment or default or delay in payment of stamp duty by its Participants, up to \$200,000 in respect of default of any one Participant. In the unlikely event that all of its 471 trading Participants as at 31 December 2002 (2001: 492) default, the maximum contingent liability of the Stock Exchange under the indemnity will amount to \$94 million (2001: \$98 million).
- (iii) Pursuant to Section 21 of the Exchanges and Clearing Houses (Merger) Ordinance, HKEx gave an undertaking on 6 March 2000 in favour of HKSCC to contribute an amount not exceeding \$50 million in the event of HKSCC being wound up while it is a wholly-owned subsidiary of HKEx or within one year after HKSCC ceases to be a wholly-owned subsidiary of HKEx, for payment of the debts and liabilities of HKSCC contracted before HKSCC ceases to be a wholly-owned subsidiary of HKEx, and for the costs, charges and expenses of winding up.

### (b) HKEx

- (i) Apart from the matter mentioned in (a)(iii) above, HKEx has given a guarantee to secure banking facilities granted to HKSCC since 13 December 2000. These facilities, on a committed basis of an aggregate amount of \$1.1 billion, were granted to HKSCC by five banks to provide stand-by liquidity to meet the obligations of HKSCC in CCASS in circumstances where CCASS Participants default on their payment obligations. As at 31 December 2002 and 31 December 2001, none of these banking facilities was utilised.
- (ii) HKEx has given a guarantee to secure banking facilities of SGD12 million to HKEx (Singapore) Limited for financing its investments since 16 April 2001. As at 31 December 2002, SGD11 million (equivalent to HK\$49 million) of the facility was drawn down (2001: SGD11 million, equivalent to HK\$46 million). The loan will mature within one year and has a fixed rate of interest.



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## 34. MATERIAL RELATED PARTY TRANSACTIONS

Certain Directors of HKEx are Directors and/or shareholders of (i) Stock Exchange Participants and Futures Exchange Participants (Exchange Participants) and Clearing Participants; (ii) companies listed on the Stock Exchange; and (iii) buy-in brokers. Securities and derivatives contracts traded by, and fees levied on these Exchange Participants and Clearing Participants, fees levied on these listed companies and fees paid to these buy-in brokers are all undertaken in the ordinary course of business of the Group on the standard terms and conditions applicable to all other Exchange Participants and Clearing Participants, listed companies and buy-in brokers.

## 35. OFF BALANCE SHEET RISKS

In the normal course of business, the clearing houses of the Group, HKSCC, SEOCH and HKCC, act as the counterparties to eligible trades concluded on the Stock Exchange and the Futures Exchange through the novation of the obligations of the buyers and sellers. HKSCC is also responsible for the good title to the securities deposited and accepted in the CCASS depository. As a result, the Group has considerable market risk and credit risk since the Participants' ability to honour their obligations in respect of their trades and securities deposited may be adversely impacted by economic conditions affecting the cash and derivatives markets. If the Participants default on their obligations on settlement or there are defects in the title of securities deposited and accepted in the CCASS depository, the Group could be exposed to potential risks not otherwise accounted for in these accounts.

The Group mitigates its exposure to risks described above by requiring the Participants to meet the Group's established financial requirements and criteria for admission as Participants, monitoring compliance with risk management measures such as position limits established by the Group and requiring Clearing Participants to contribute to the Clearing House Funds set up by HKSCC, SEOCH and HKCC. HKSCC also retains recourse against those Participants whose securities are deposited and accepted in the CCASS depository. Moreover, insurance has been taken out by the Group to cover the risks.

## 36. BANKING FACILITIES WITH ASSETS PLEDGED

As at 31 December 2001, the Group had a \$10 million overdraft facility with a bank in Hong Kong, which was secured by a pledge of the Group's time deposits of an equivalent amount at that bank. This overdraft facility was not utilised and was terminated during the year. The Group did not have any assets pledged as at 31 December 2002.

# Notice of Annual General Meeting

NOTICE IS HEREBY GIVEN THAT the Annual General Meeting of the shareholders of Hong Kong Exchanges and Clearing Limited (HKEx) will be held at the Trading Hall of The Stock Exchange of Hong Kong Limited (Stock Exchange) at 1st Floor, One and Two Exchange Square, Central, Hong Kong on Tuesday, 15 April 2003 at 4:30 p.m. for the following purposes:

1. To receive and consider the Audited Accounts for the year ended 31 December 2002 together with the Reports of the Directors and Auditors thereon.
2. To declare a Final Dividend.
3. To elect Directors.
4. To re-appoint Auditors and to authorise the Directors to fix their remuneration.
5. To consider as special business and, if thought fit, pass with or without modification the following resolutions as Ordinary Resolutions and a Special Resolution respectively:

## **Ordinary Resolutions**

(I) "THAT:

- (a) subject to paragraph (c) below and pursuant to section 57B of the Companies Ordinance, the exercise by the Directors of HKEx during the Relevant Period (as hereinafter defined) of all the powers of HKEx to allot, issue and deal with additional shares of HK\$1.00 each in the capital of HKEx and to make or grant offers, agreements and options (including bonds, warrants and debentures convertible into shares of HKEx) which would or might require the exercise of such power be and is hereby generally and unconditionally approved;
- (b) the approval in paragraph (a) above shall authorise the Directors of HKEx during the Relevant Period to make or grant offers, agreements and options (including bonds, warrants and debentures convertible into shares of HKEx) which would or might require the exercise of such power after the end of the Relevant Period;
- (c) the aggregate nominal amount of share capital allotted or agreed conditionally or unconditionally to be allotted (whether pursuant to an option or otherwise) and issued by the Directors of HKEx pursuant to the approval in paragraph (a) above, otherwise than pursuant to:
  - (i) a Rights Issue (as hereinafter defined),

# Notice of Annual General Meeting

- (ii) an issue of shares as scrip dividends pursuant to the articles of association of HKEx from time to time,
- (iii) an issue of shares under any option scheme or similar arrangement for the time being adopted and approved by the shareholders of HKEx for the grant or issue to employees of HKEx and/or any of its subsidiaries of shares or rights to acquire shares of HKEx,
- (iv) an issue of shares in HKEx upon the exercise of the subscription rights attaching to any warrants which may be issued by HKEx provided that the issue of such warrants (and the consequent obligation to issue such shares) has been approved by the shareholders of HKEx, either by specific resolution or as part of a general approval, or
- (v) any adjustment, after the date of grant or issue of any options, rights to subscribe or other securities referred to in (iii) or (iv) above, in the price at which shares in HKEx shall be subscribed, and/or in the number of shares in HKEx which shall be subscribed, on exercise of relevant rights under such options, warrants or other securities, such adjustment being made in accordance with, or as contemplated by, the terms of such options, rights to subscribe or other securities,

shall not exceed 20 per cent of the aggregate nominal amount of the issued share capital of HKEx at the date of passing this Resolution, and the said approval shall be limited accordingly; and

- (d) for the purpose of this Resolution,

“Relevant Period” means the period from the passing of this Resolution until whichever is the earlier of:

- (i) the conclusion of the next annual general meeting of HKEx;
- (ii) the expiration of the period within which the next annual general meeting of HKEx is required by law to be held; or
- (iii) the passing of an ordinary resolution by shareholders of HKEx in general meeting revoking or varying the authority given to the Directors of HKEx by this Resolution.

“Rights Issue” means an offer of shares in HKEx, or an offer of warrants, options or other securities giving rights to subscribe for shares, open for a period fixed by the Directors of HKEx to the holders of shares of HKEx on the register of members of

# Notice of Annual General Meeting

HKEx on a fixed record date in proportion to their then holdings of such shares as at that date (subject to such exclusions or other arrangements as the Directors of HKEx may deem necessary or expedient in relation to fractional entitlements or having regard to any restrictions or obligations, or the expense and delay in determining the extent of any restrictions or obligations, under the laws of, or the requirements of any recognised regulatory body or any stock exchange in, any territory outside Hong Kong which are applicable to HKEx).”

(II) “THAT:

- (a) subject to paragraph (b) below, the exercise by the Directors of HKEx during the Relevant Period (as hereinafter defined) of all powers of HKEx to repurchase shares of HKEx on the Stock Exchange or on any other stock exchange on which the shares of HKEx may be listed and which is recognised by the Securities and Futures Commission and the Stock Exchange for this purpose, subject to and in accordance with all applicable laws and/or the requirements of the Rules Governing the Listing of Securities on the Stock Exchange or of any other stock exchange as amended from time to time, be and is hereby generally and unconditionally approved;
- (b) the aggregate nominal amount of shares which HKEx is authorised to repurchase pursuant to the approval in paragraph (a) above shall not exceed 10 per cent of the aggregate nominal amount of the issued share capital of HKEx at the date of passing this Resolution, and the said approval shall be limited accordingly; and
- (c) for the purposes of this Resolution:

“Relevant Period” means the period from the passing of this Resolution until whichever is the earlier of:

- (i) the conclusion of the next annual general meeting of HKEx;
- (ii) the expiration of the period within which the next annual general meeting of HKEx is required by law to be held; or
- (iii) the passing of an ordinary resolution by shareholders of HKEx in general meeting revoking or varying the authority given to the Directors of HKEx by this Resolution.”

- (III) “THAT conditional upon the passing of Resolutions 5(I) and 5(II) set out in the notice convening this meeting, the general mandate granted to the Directors of HKEx and for the time being in force to exercise the powers of HKEx to allot, issue and deal with additional shares pursuant to Resolution 5(I) set out in the notice convening this meeting be and is hereby extended by the addition thereto of an amount representing

# Notice of Annual General Meeting

the aggregate nominal amount of shares in the capital of HKEx repurchased by HKEx under the authority granted pursuant to Resolution 5(II) set out in the notice convening this meeting, provided that such amount of shares so repurchased shall not exceed 10 per cent of the aggregate nominal amount of the issued share capital of HKEx at the date of the said Resolution.”

- (IV) “THAT a remuneration of HK\$100,000 be paid to each of the non-executive Directors of HKEx at the conclusion of the next annual general meeting of HKEx for the period from the conclusion of this meeting to the conclusion of the next annual general meeting of HKEx, provided that such remuneration will be paid in proportion to the period of service in the case of a Director who has not served the entire period.”

## **Special Resolution**

- (V) “THAT subject to the written approval of the Securities and Futures Commission pursuant to section 67 of the Securities and Futures Ordinance:

- (a) Clause 3(d) of the Memorandum of Association of HKEx be deleted in its entirety and replaced by the following:

“(d)in this clause:

- (i) “assets” includes property, rights and interests of every description, whether present or future, actual or contingent and wherever situate and, in the case of the Company, its uncalled capital;
- (ii) “charge” includes any mortgage, pledge, lien or other form of security;
- (iii) “dispose of”, in relation to an asset, includes selling or transferring it or surrendering or extinguishing it, and also creating or granting it or any interest or right out of or in respect of it;
- (iv) “liabilities” includes debts and obligations of every description, whether present or future, actual or contingent;
- (v) “person” includes any partnership or other body of persons, whether corporate or unincorporate, and any country, territory, public authority and international organisation; and
- (vi) “subsidiary” has the meaning ascribed to it in the Companies Ordinance (Chapter 32 of the Laws of Hong Kong).”

# Notice of Annual General Meeting

(b) Article 2 of the Articles of Association of HKEx be amended by:

(i) deleting the definitions of “clearing house” and “Commission” in Article 2(1) and replacing with the following:

“clearing house      a recognised clearing house within the meaning of Schedule 1 of the SFO or a clearing house recognised by the laws of the jurisdiction in which the shares of the Company are listed or quoted with the permission of the Company on a stock exchange in such jurisdiction;

Commission      the Securities and Futures Commission established under the Securities and Futures Commission Ordinance (now repealed) which continues in existence in its original name under the SFO;”

(ii) adding a new definition to Article 2(1):

“SFO      the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong);”

(iii) deleting the definition of “Merger Ordinance” from Article 2(1).

(c) Article 55 of the Articles of Association of HKEx be deleted in its entirety and replaced by the following:

“(1) Pursuant to section 61 of the SFO, a person, either alone or with any associated person or persons, is not permitted to be entitled to exercise, or control the exercise of, 5 per cent. or more of the voting power at any general meeting of the Company except in certain limited circumstances.

(2) For the purposes of this Article:

(a) “associated person” shall have the meaning ascribed to it in section 18 of the SFO;

(b) “minority controller” shall have the meaning ascribed to it in section 61(20) of the SFO in relation to a recognised exchange controller;

(c) “Permitted Person” means any person or class of persons who is permitted to be a minority controller of the Company pursuant to the SFO;

(d) “recognised exchange controller” shall have the meaning ascribed to it in Schedule 1 of the SFO;

# Notice of Annual General Meeting

- (e) “Relevant Share Capital” means securities of the Company which carry (or may, according to their terms, in certain circumstances carry) the right to vote on any resolution at any general meeting of the Company (whether or not the right is exercisable in relation to all resolutions at all general meetings);
  - (f) “Restricted Person” means any person who is a minority controller of the Company and is not a Permitted Person; and
  - (g) “Restricted Shares” means the securities to which section 1(9) of Part 6 of Schedule 3 to the SFO applies (with references to “the corporation concerned” in that section being interpreted as references to the Company).
- (3) No person shall become a minority controller of the Company except in accordance with the provisions of the SFO and other applicable law.
- (4) (a) Every person shall forthwith provide written notice to the Company if:
- (i) he/it becomes a minority controller of the Company or a company of which the Company is a subsidiary; or
  - (ii) he/it has been served with a notice (a “Commission Notice”) from the Commission pursuant to section 61(9)(b) of the SFO or section 1(2) of Part 6 of Schedule 3 to the SFO.
- (b) A notice given in relation to paragraph (a)(i) above shall include details of that person’s and his/its associated persons’ interests in the Relevant Share Capital and either the basis on which that person is permitted to be a minority controller under the SFO (a “Permitted Person Notice”) or a statement that the person is not permitted to be such a minority controller (a “Restricted Person Notice”). The Directors may forward any notices to the Commission for further investigation and enforcement.
- (c) A notice given in relation to paragraph (a)(ii) above (also, a “Restricted Person Notice”) shall include a copy of the relevant Commission Notice.
- (d) The Directors may by notice in writing (a “Disclosure Notice”) require any member, or any other person appearing to be interested or appearing to have been interested in the securities of the Company, to disclose to the Company in writing such information (supported if the Directors so require by a statutory declaration and/or by independent evidence) as the Directors shall require relating to the ownership of or interests in the securities in question as lies within the knowledge of such member or other person, including (without prejudice to the generality of the foregoing):

# Notice of Annual General Meeting

- (i) any information which the Company would be entitled to seek pursuant to section 329 of the SFO;
  - (ii) any information which the Directors shall deem necessary or desirable in order to determine whether any securities or rights to subscribe for, or convert into, securities of the Company are Restricted Shares; and
  - (iii) any information which the Directors shall deem necessary or desirable in order to determine whether any person is or is deemed to be a Restricted Person or otherwise in relation to the application or potential application of this Article.
- (e) A Disclosure Notice pursuant to paragraph (4)(d) of this Article may be given by the Directors at any time. One or more Disclosure Notices may be given in respect of the same securities in the Company to a member and/or any other person appearing to be, or to have been, interested in those securities.
- (f) The Directors may forward any response in respect of a Disclosure Notice to the Commission for further investigation and enforcement. Furthermore, where the holder of any securities or rights to subscribe for, or convert into, securities in the Company, or any person appearing to be interested in such securities or rights, fails to comply within 14 days with a Disclosure Notice, the Directors may notify the Commission of such non-compliance together with such other information as the Directors deem necessary or desirable in this connection.
- (5) If the Directors shall become aware (as a result of having received a Restricted Person Notice or a Commission Notice pursuant to Section 1(10) of Part 6 of Schedule 3 to the SFO or otherwise) that any person has become a Restricted Person, the Directors may serve a written notice on all persons (other than persons referred to in paragraph (9) of this Article) who appear to the Directors to have interests in (and, if different, are the registered holders of) the Restricted Shares. Such notice shall set out the restrictions referred to in paragraph (6) of this Article.
- (6) A holder of a Restricted Share on whom a notice has been served under paragraph (5) above shall not in respect of those securities be entitled, until such time as the relevant person notifies the Company in writing (together with such confirmation from the Commission or other evidence as may be required by the Directors) that such person has ceased to be a Restricted Person, to attend or vote at any general meeting of the Company or meeting of the holders of Relevant Share Capital or of any class thereof, and the rights to attend (whether in person or by proxy), to speak and to demand and vote on a



# Notice of Annual General Meeting

poll which but for the provisions of this paragraph would have attached to the Restricted Share shall vest in the chairman of such meeting. The manner in which the chairman exercises or refrains from exercising any such rights shall be entirely at his discretion. The chairman of any such meeting as aforesaid shall be informed by the Directors of any securities becoming or being deemed to be a Restricted Share or ceasing to be a Restricted Share.

- (7) The Directors may assume without enquiry that a person is a Permitted Person or is not a Restricted Person.
- (8) The Directors may take such action and do such things which they believe to be necessary or desirable in order to ensure that the Company (a) does not assist in or permit the contravention of any restrictions imposed on any person and/or securities by the Commission pursuant to any Commission Notice (including without limitation refusing to register any transfer of any securities), and (b) does not commit an offence under section 2 of Part 6 of Schedule 3 to the SFO or any other applicable law.
- (9) The Directors shall not be obliged to serve any notice required under this Article to be served upon any person if either his identity or his address is not known to them. The absence of service of such notice in such circumstances as aforesaid, and any accidental error in or failure to give any notice to any person upon whom notice is required to be served under this Article, shall not prevent the implementation of or invalidate any procedure under this Article.
- (10) If any Director believes that a person is a Restricted Person he shall inform the other Directors of that fact.
- (11) The provisions of these Articles regarding the giving of notice to members shall apply to the giving to a member of any notice required by this Article. Any notice required by this Article to be given to a person who is not a member, or who is a member whose registered address is not within Hong Kong and who has not given to the Company an address within Hong Kong at which notices may be given to him, shall be deemed validly given if it is sent by mail (or airmail if the address is outside Hong Kong) in a prepaid envelope addressed to that person at the address (or if more than one, at one of the addresses), if any, at which the Directors believe him to be resident or carrying on business or to his last known address as shown on the register of members. The notice shall in such a case be deemed to have been given on the day following that on which the envelope containing the same is posted, unless it was sent by airmail, in which case it shall be deemed to have been given on the fifth day following that on which it was posted. Proof that the envelope was properly addressed and put into post as prepaid mail or prepaid airmail (as the case may be) shall be conclusive evidence that the notice was given.

# Notice of Annual General Meeting

(12) Any resolution or determination of, or decision or exercise of any discretion or power by, the Directors or any Director or the chairman of any meeting under or pursuant to the provisions of this Article shall be final and conclusive; and any act or thing done, by or on behalf of, or on the authority of, the Directors or any Director pursuant to the foregoing provisions of this Article shall be conclusive and binding on all persons concerned and shall not be open to challenge, whether as to its validity or otherwise on any ground whatsoever. The Directors shall not be required to give any reasons for any decision, determination or declaration taken or made in accordance with this Article.

(13) This Article shall apply notwithstanding any provision in these Articles to the contrary.”

(d) Article 90(3) of the Articles of Association of HKEx be deleted in its entirety and replaced by the following:

“(3) Subject to the provisions of section 77 of the SFO, the Financial Secretary may at any time:

(a) appoint any person as a Director representing the public interest; and

(b) remove from office any person so appointed (whether or not his term has been completed);

provided that the number of Directors from time to time appointed by the Financial Secretary shall not exceed eight.”

(e) Article 106 of the Articles of Association of HKEx be deleted in its entirety and replaced by the following:

“The Directors may from time to time appoint committees (including, but without limitation, a Risk Management Committee in compliance with section 65 of the SFO) consisting of such member or members of their body and/or such other person(s) as they think fit, and may delegate any of their powers to any such committee, and from time to time revoke any such delegation and discharge any such committee wholly or in part. Any committee so formed shall, in the exercise of the powers so delegated, conform to any regulations that may from time to time be imposed upon it by the Directors. Without limiting the generality of this Article 106, any committee so formed may be authorised by the Directors to sub-delegate all or any of the powers, authorities or discretions for the time being vested in it.”

# Notice of Annual General Meeting

- (f) Article 111(2) and (3) of the Articles of Association of HKEx be deleted in its entirety and replaced by the following:

“(2) Any appointment of a person to the office of Chairman by the Directors shall be subject to (and effective only upon) the written approval of such appointment by the Chief Executive of Hong Kong. The Chairman shall be a non-executive Director and shall be appointed for an initial term coinciding with his term as a non-executive Director and may be re-appointed in accordance with the provisions of this Article for a further period or periods up to a maximum of the longer of six consecutive years or six consecutive annual general meetings (including the initial term as aforesaid but disregarding any annual general meeting held in the year 2000). For greater certainty, a person who has served as Chairman for the maximum consecutive period as aforesaid shall not be eligible for reappointment until the later of one year after he ceases to be Chairman or the next annual general meeting after he ceases to hold such office. A person may only be removed from his office as Chairman by:

- (a) a resolution of the Directors passed by two-thirds in number of the Directors from time to time; or
- (b) written notice from the Chief Executive of Hong Kong removing him from his office in accordance with section 69 of the SFO.

- (3) Any appointment of a person to the office of Chief Executive or Chief Operating Officer by the Directors shall be subject to (and effective only upon):

- (a) the Chairman providing his prior written recommendation to the appointment of the relevant person to the relevant office; and
- (b) the written approval of the Commission.

A person may only be removed from his office as Chief Executive or Chief Operating Officer by:

- (i) a resolution of the Directors passed by a simple majority in number of the Directors from time to time if such removal has been recommended by the Chairman; or
- (ii) written notice from the Commission removing him from his office in accordance with section 70 of the SFO.

# Notice of Annual General Meeting

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A person removed from office by the Commission pursuant to subparagraph 3(ii) above shall be entitled to appeal his removal to the Chief Executive in Council (having the same meaning as used in section 73 of the SFO) in accordance with the provisions of section 73 of the SFO.””

By Order of the Board  
HONG KONG EXCHANGES AND CLEARING LIMITED  
Joseph Mau  
Company Secretary

Hong Kong, 12 March 2003

Notes:

- (1) A shareholder entitled to attend and vote at the above meeting (or at any adjournment thereof) is entitled to appoint one or more proxies to attend and vote in his stead. The proxy need not be a shareholder of HKEx.
- (2) Where there are joint registered holders of any shares, any one of such persons may vote at the above meeting (or at any adjournment thereof), either personally or by proxy, in respect of such share as if he were solely entitled thereto; but if more than one of such joint holders be present at the above meeting personally or by proxy, that one of the said persons so present whose name stands first on the register of members of HKEx in respect of such share shall alone be entitled to vote in respect thereof.
- (3) In order to be valid, the enclosed form of proxy, together with the power of attorney or other authority (if any) under which it is signed or a certified copy of that power of attorney or authority (such certification to be made by either a notary public or a solicitor qualified to practise in Hong Kong), must be deposited at HKEx's registrar, Hong Kong Registrars Limited, at Rooms 1901-5, 19/F, Hopewell Centre, 183 Queen's Road East, Hong Kong, not less than 48 hours before the time fixed for holding the above meeting or adjourned meeting (as the case may be).
- (4) The register of members of HKEx will be closed from Thursday, 10 April 2003 to Tuesday, 15 April 2003, both days inclusive, during which period no transfer of shares will be effected. In order to qualify for the proposed final dividend, all transfers, accompanied by the relevant share certificates, must be lodged for registration with HKEx's registrar, Hong Kong Registrars Limited at the above address not later than 4:00 p.m. on Wednesday, 9 April 2003.
- (5) Concerning Resolutions 5(I) and 5(II), the Directors wish to state that there are no immediate plans to issue any new shares or to repurchase any shares of HKEx. The general mandates are being sought from shareholders in compliance with the Companies Ordinance and the Rules Governing the Listing of Securities on the Stock Exchange.
- (6) There will be six elected Director vacancies to be filled at the forthcoming annual general meeting. A circular containing further information concerning the election of Directors and Resolutions 5(I) to 5(V) will be sent to shareholders together with HKEx's 2002 Annual Report.

# Market Statistics

## Market Performance (as at year-end)

	MAIN BOARD			GEM		
	2002	2001	change (%)	2002	2001	change (%)
IPO fund raised (\$bil)	45	22	108	7	4	70
Market capitalisation (\$bil)	3,559	3,885	-8	52	61	-15
Number of listed companies	812	756	7	166	111	50
Number of listed securities	1,416	1,075	32	170	114	49
Total turnover for year (\$bil)	1,599	1,950	-18	44	39	12
Average daily turnover (\$mil)	6,474	8,025	-19	178	162	10

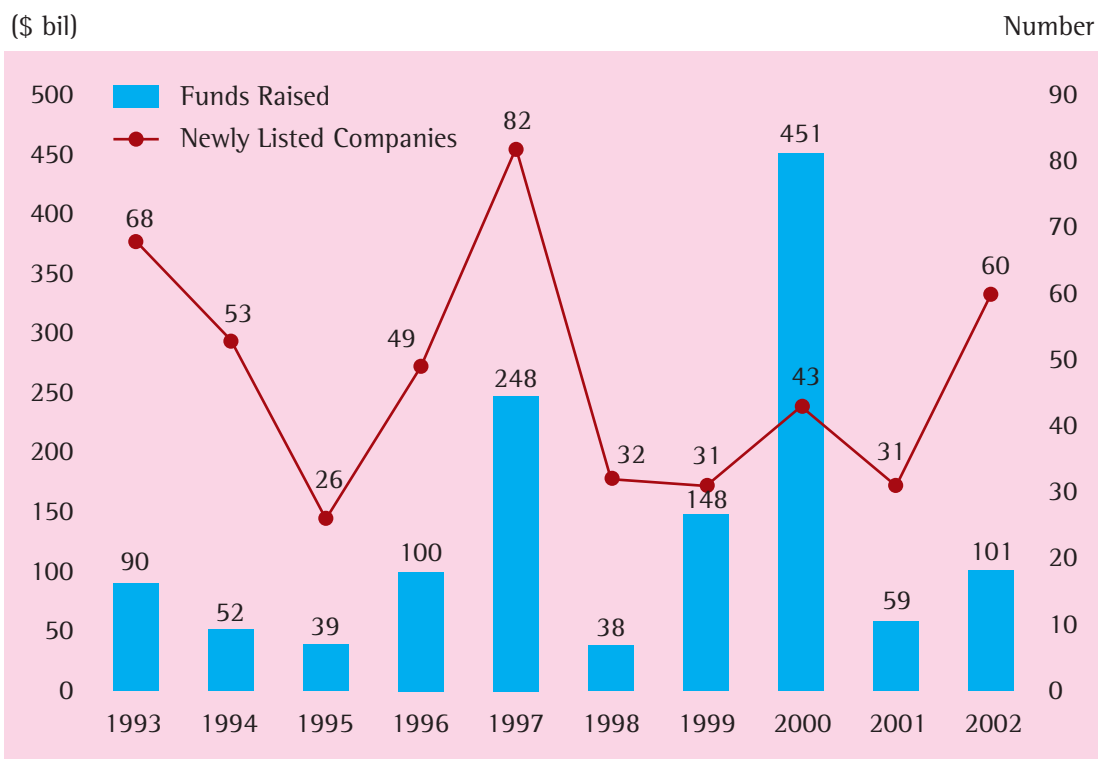
## Closing Indices (as at year-end)

	2002	2001	change (%)
AOI	4113.06	4885.63	-16
HSI	9321.29	11397.21	-18
HSCI	1130.24	1346.16	-16
HSCEI	1990.44	1757.75	13
HSCCI	1011.13	1340.45	-25
GEI	110.40	199.42	-45

# Market Statistics

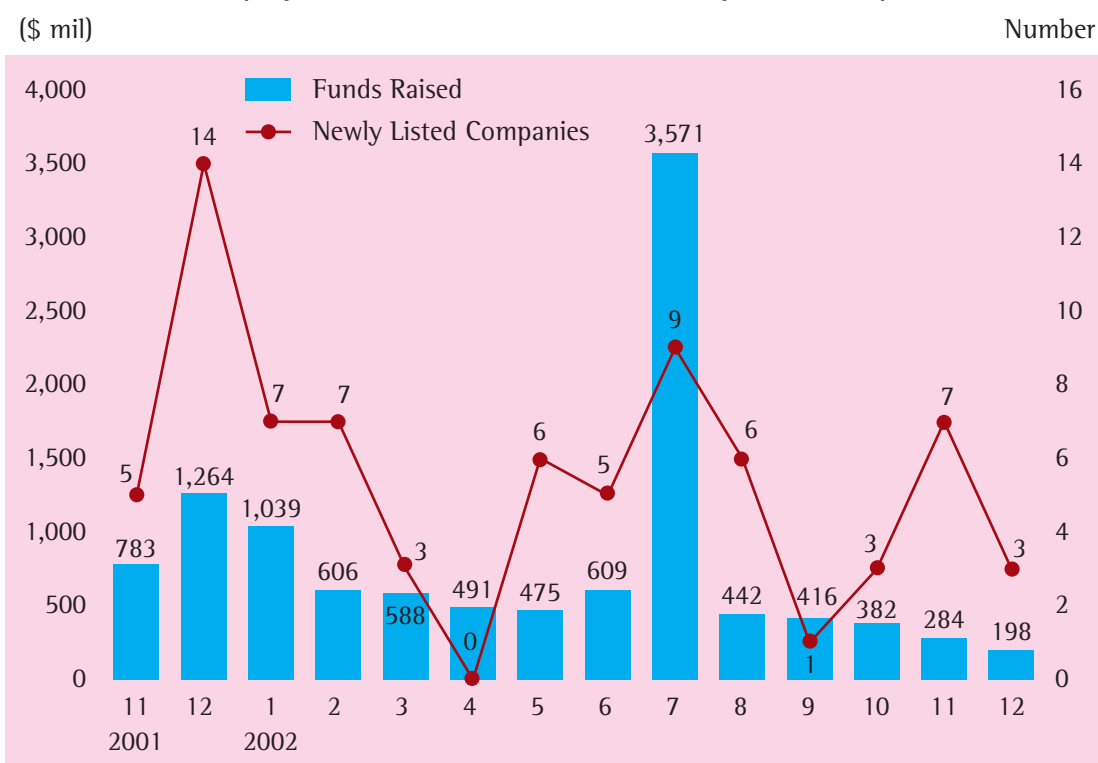
## MAIN BOARD

Total Equity Funds Raised and Number of Newly Listed Companies



## GEM

Total Equity Funds Raised and Number of Newly Listed Companies



# Market Statistics

## MAIN BOARD

### New Listings

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Newly Listed Companies	68	53	26	49	82	32	31	43	31	60
New Warrants										
– Equity Warrants	66	64	39	80	101	31	51	46	31	27
– Derivative Warrants	27	49	55	201	351	157	162	279	181	644
Total	93	113	94	281	452	188	213	325	212	671
Equity Linked Instrument*	–	–	–	–	–	–	–	–	–	25
New Debt Securities	47	71	58	84	61	21	87	20	21	18
New Unit Trusts	9	4	1	1	0	0	1	0	1	1

\* Commenced trading on 5 August 2002

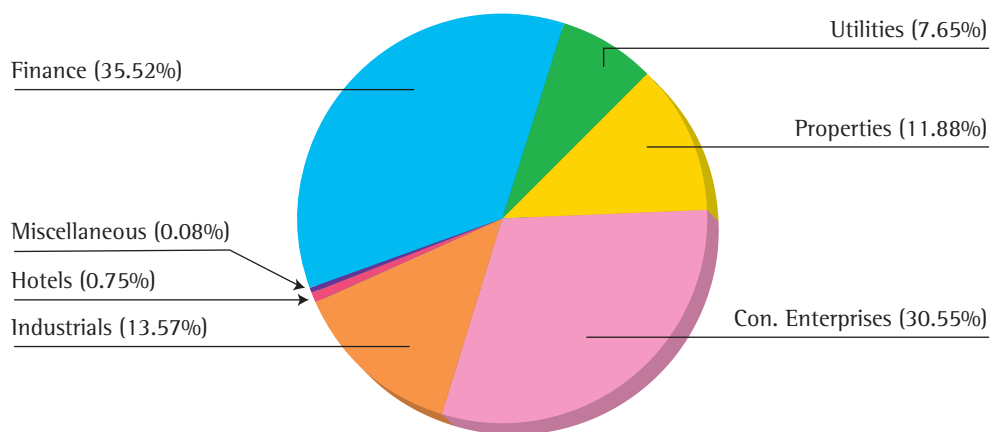
## MAIN BOARD

### Number of Listed Companies

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Finance	57	60	58	58	56	55	51	60	59	71
Utilities	11	11	11	13	14	14	14	12	11	13
Properties	85	85	87	96	105	109	108	106	97	98
Con. Enterprises	143	167	174	182	203	210	218	227	240	257
Industrials	159	183	190	212	256	269	288	308	327	354
Hotels	14	14	14	14	14	13	13	14	14	14
Miscellaneous	8	9	8	8	10	10	9	9	8	5
Total	477	529	542	583	658	680	701	736	756	812

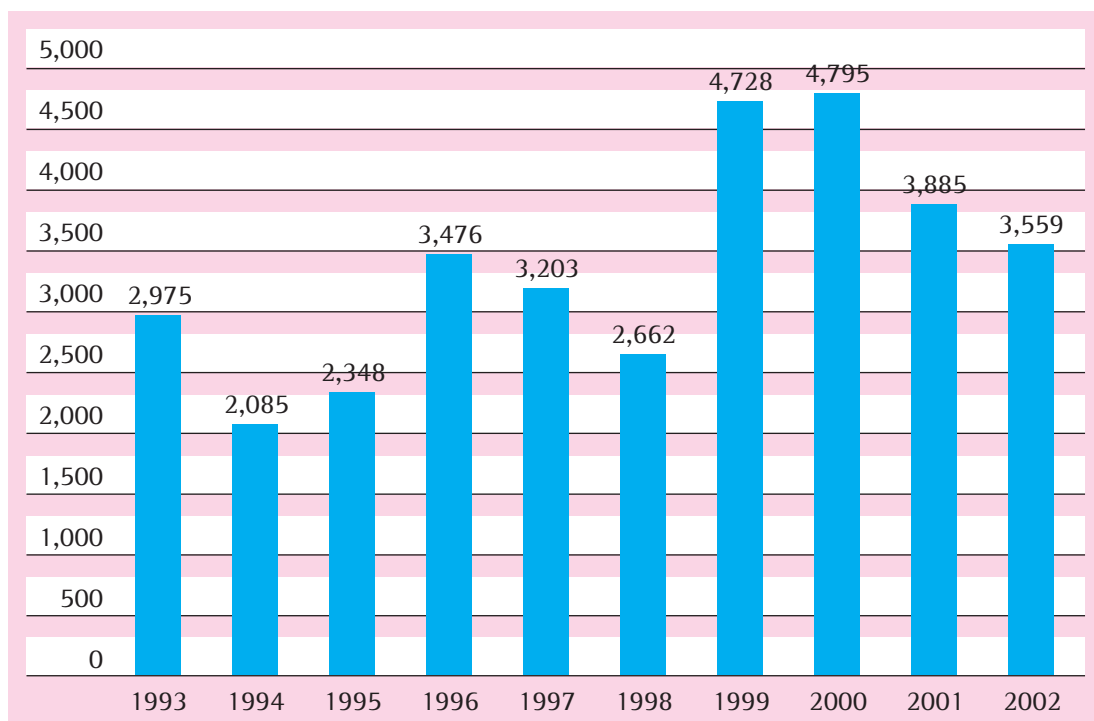
# Market Statistics

MAIN BOARD  
Composition of Market Capitalisation as at 2002 year-end



MAIN BOARD  
Market Capitalisation (as at year-end)

(\$ bil)

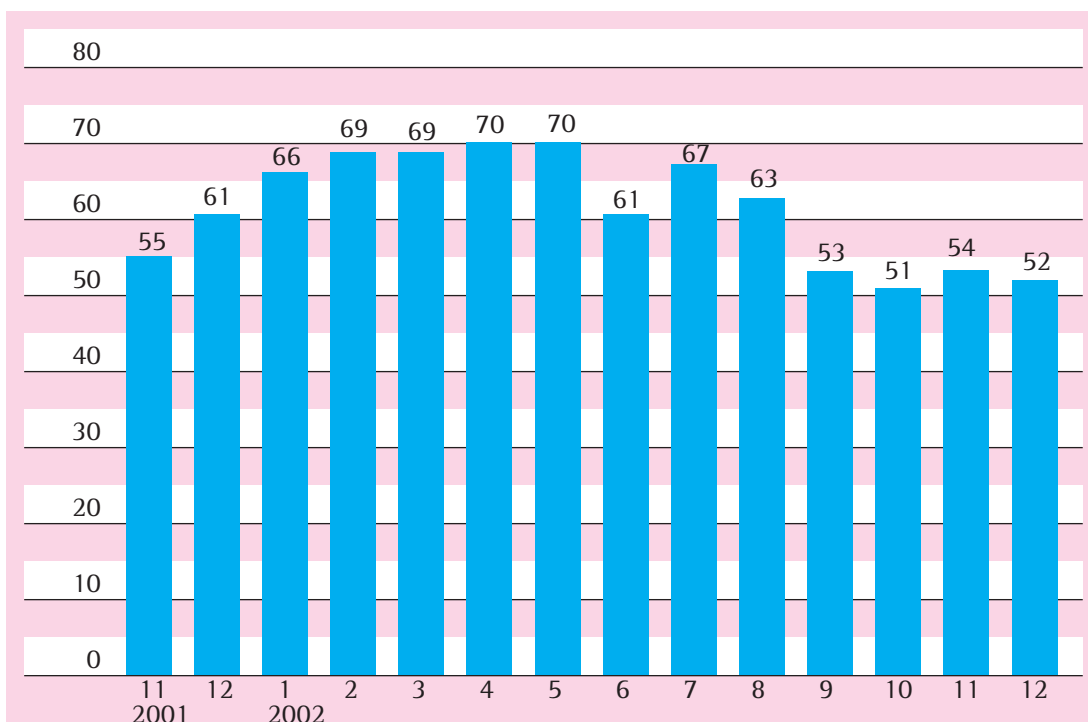




# Market Statistics

GEM  
Market Capitalisation (as at month-end)

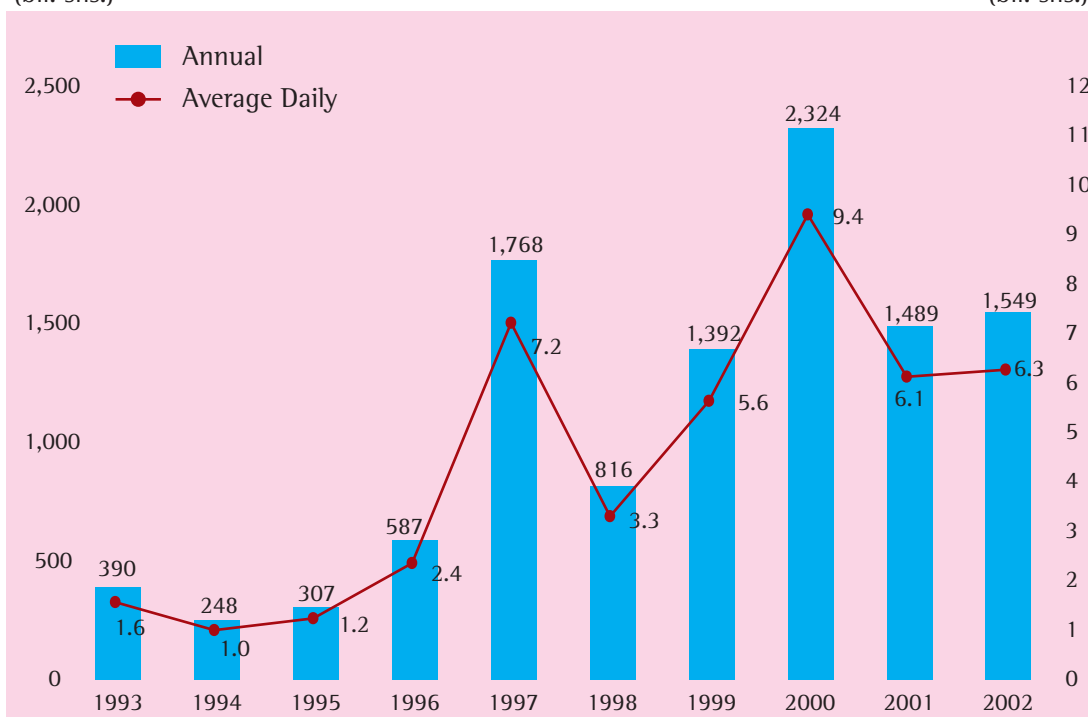
(\$ bil)



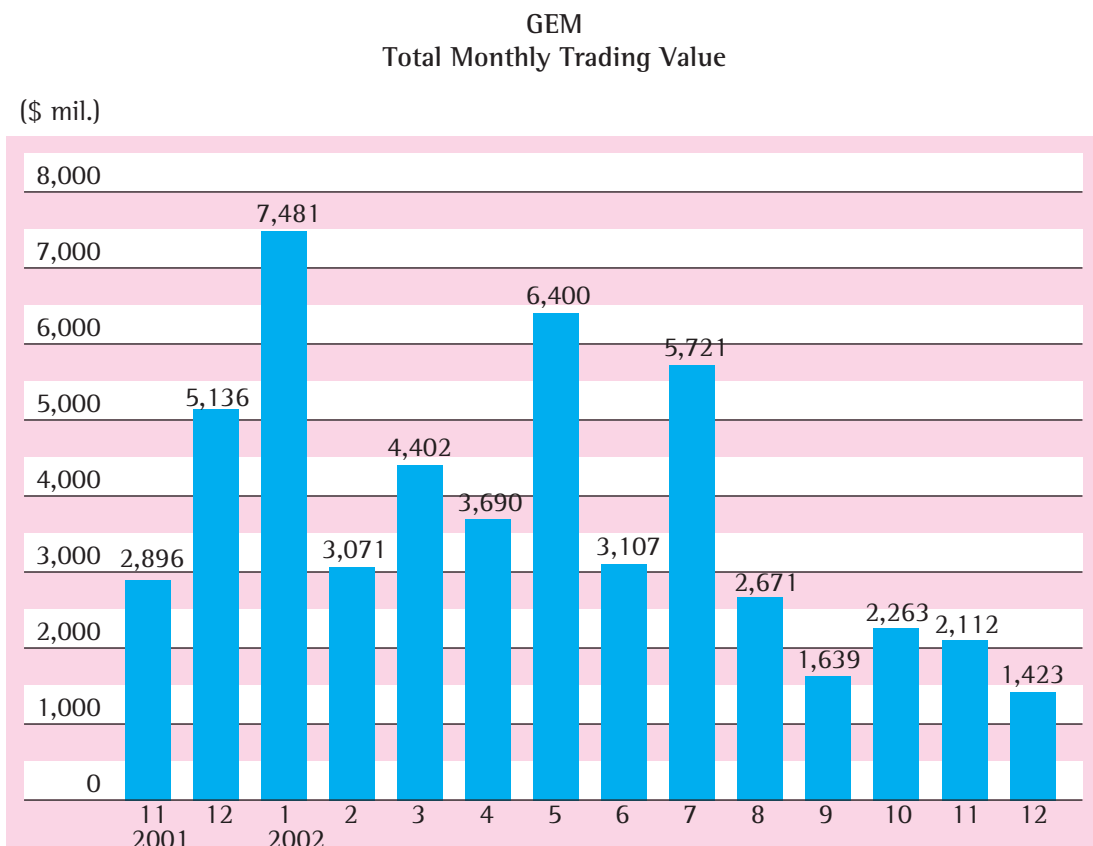
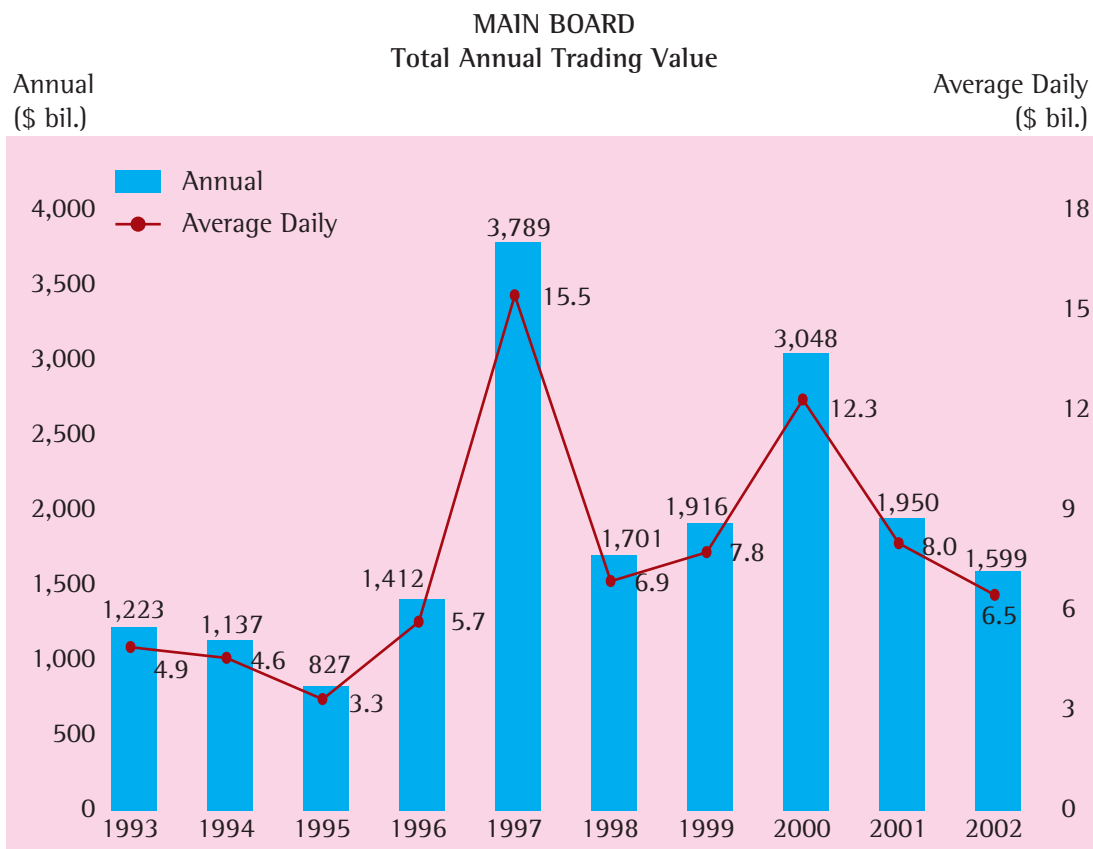
MAIN BOARD  
Total Annual Trading Volume

Annual  
(bil. shs.)

Average Daily  
(bil. shs.)

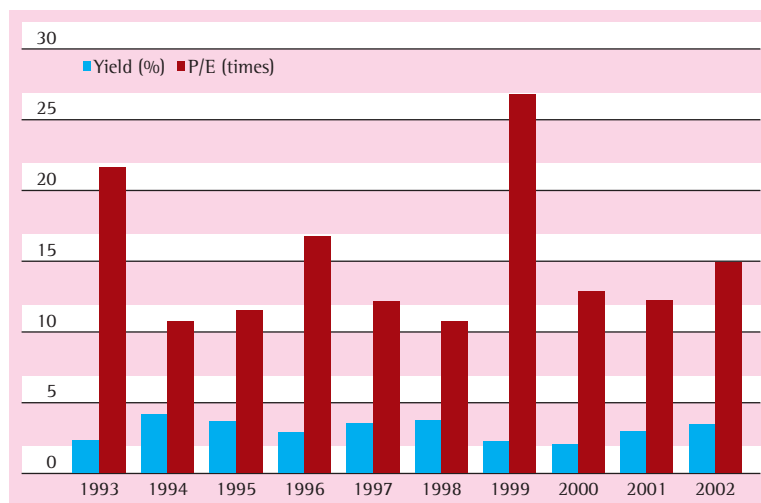


# Market Statistics

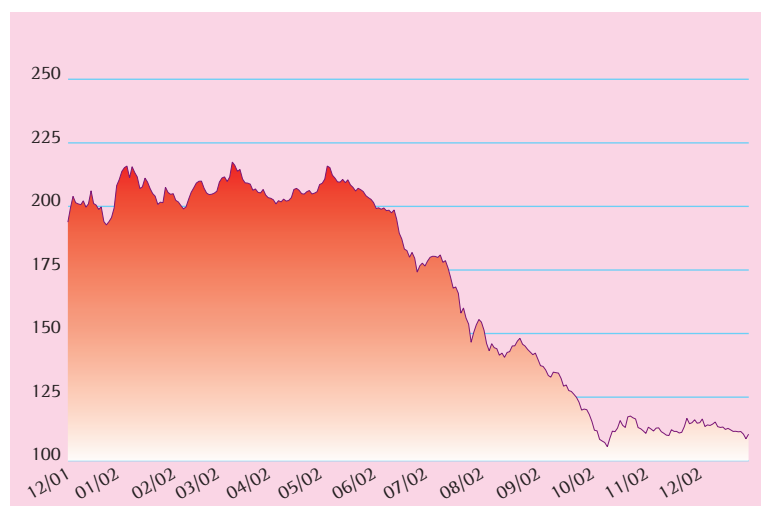


# Market Statistics

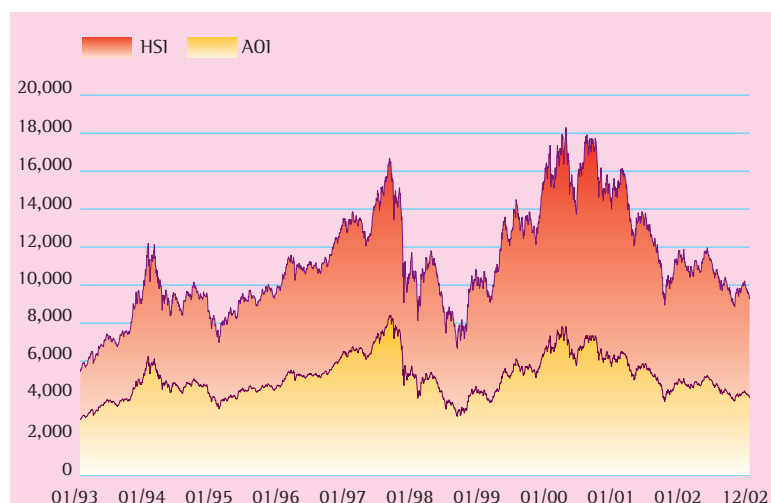
MAIN BOARD  
Average Yield and P/E Ratio (year-end figures)



Growth Enterprise Index  
12/2001 – 12/2002



Hang Seng Index and All Ordinaries Index  
January 1993 to December 2002



# Market Statistics

## DERIVATIVES MARKET STATISTICS (as at year-end)

	2002		2001	
	Volume (Contracts)	Period-end Open Interest	Volume (Contracts)	Period-end Open Interest
Hang Seng Index Futures	4,802,422	48,469	4,400,071	33,138
Mini-Hang Seng Index Futures <sup>(1)</sup>	1,107,964	2,473	769,886	1,232
MSCI China Free Index Futures <sup>(2)</sup>	1,869	8	3,141	179
Hang Seng 100 Futures <sup>(3)</sup>	–	–	78	–
Hang Seng Properties				
Sub-Index Futures <sup>(3)</sup>	–	–	–	–
Red-Chip Futures <sup>(4)</sup>	–	–	533	–
Stock Futures	21,006	405	6,945	455
International Stock Futures <sup>(5)</sup>	50	–	811	–
Rolling Forex	3,053	–	4,226	303
One-month HIBOR Futures	970	20	14,315	750
Three-month HIBOR Futures	280,257	13,806	629,491	58,830
Three-Year Exchange Fund				
Note Futures <sup>(6)</sup>	3,673	–	1,175	375
Hang Seng Index Options	1,070,431	66,813	716,114	29,741
Hang Seng 100 Options <sup>(3)</sup>	–	–	111	–
Hang Seng Properties				
Sub-Index Options <sup>(3)</sup>	–	–	–	–
Red-Chip Options <sup>(3)</sup>	–	–	–	–
International Stock Options <sup>(5)</sup>	55	–	1,641	210
Stock Options	3,724,705	370,891	4,001,014	231,657
	(Average Daily)		(Average Daily)	
	15,203		16,567	

(1) Commenced trading on 9 October 2000

(2) Commenced trading on 7 May 2001

(3) Suspended with effect from 31 July 2001

(4) Suspended with effect from 31 August 2001

(5) Commenced trading on 4 October 2001

(6) Commenced trading on 19 November 2001

# Market Statistics

## PARTICIPANTSHIP AND TRADING RIGHT HOLDERS STATUS (as at year-end)

	Stock Exchange 2002	Futures Exchange 2002	Clearing 2002
<b>Participants <sup>(1)</sup></b>	<b>509</b>	<b>133</b>	<b>479</b>
Trading	471	133	470
Non-trading	38	0	9
<b>Trading Right Holders <sup>(1)</sup></b>	<b>34</b>	<b>62</b>	<b>N/A</b>
Corporate	2	53	N/A
Individual	32	9	N/A
<b>Average no. of trading rights held by Participants and Trading Rights Holders <sup>(2)</sup></b>	<b>1.71</b>	<b>1.25</b>	<b>N/A</b>

(1) Participants and Trading Right Holders were Members of the two exchanges before the merger was completed on 6 March 2000.

(2) Average no. of trading rights held by Participants and Trading Right Holders = Total no. of trading rights held/Total no. of Participants and Trading Rights Holders.

# Market Statistics

## CCASS STATISTICS

	2002	2001
<b>Average Daily Exchange Trades</b>		
Handled by CCASS		
– Number of Trades	83,144	99,272
– Value of Trades	\$6.7 billion	\$8.2 billion
– Share quantity involved	6.5 billion	6.3 billion
<b>Average Daily Settlement Instructions (SIs)</b>		
Settled by CCASS		
– Number of SIs	15,889	21,259
– Value of SIs	\$18.6 billion	\$23.2 billion
– Share quantity involved	7.4 billion	8.5 billion
<b>Average Daily Investor Settlement Instructions (ISIs)</b>		
Settled by CCASS		
– Number of ISIs	360	302
– Value of ISIs	\$267.6 million	\$341.3 million
– Share quantity involved	87.6 million	70.6 million
<b>Average Daily Settlement Efficiency of CNS</b>		
Stock Positions on Due Day (T+2)	99.65%	99.59%
<b>Average Daily Settlement Efficiency of CNS</b>		
Stock Positions on the Day following the Due Day (T+3)	99.96%	99.96%
<b>Average Daily Buy-ins Executed on T+3</b>		
– Number of brokers involved	5	7
– Number of buy-ins	6	8
– Value of buy-ins	\$1.8 million	\$3.4 million
<b>Shares Deposited in the CCASS Depository</b>		
– Number of shares	953.0 billion	897.3 billion
– Percentage of total issued share capital of admitted securities	54.58%	55.84%
– Value of shares	\$1,116.7 billion	\$1,220.3 billion
– Percentage of the total market capitalisation of admitted securities	29.62%	28.61%

# Market Highlights

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(As at 2002 year-end)

(Financial figures are expressed in Hong Kong dollars)

<b>Funds raised</b>	<b>\$110 billion</b>
Main Board	\$101 billion
GEM	\$9 billion
<b>Funds raised by IPOs</b>	<b>\$52 billion</b>
Main Board	\$45 billion
GEM	\$7 billion
<b>Funds raised in secondary markets</b>	<b>\$58 billion</b>
<b>Funds raised in H share and red chips markets</b>	<b>\$70.8 billion</b>
<b>No. of IPOs</b>	
Main Board	60 <sup>#</sup>
GEM	57

<sup>#</sup> Of which two were transfer of listing from GEM

# Financial Highlights

(Financial figures are expressed in Hong Kong dollars)

	2002	2001	Change
<b>KEY MARKET STATISTICS</b>			
Average daily turnover value on the Stock Exchange	\$6.7 billion	\$8.2 billion	(18%)
Average daily number of derivatives contracts traded on the Futures Exchange	30,038	27,192	10%
Average daily number of stock options contracts traded on the Stock Exchange	15,203	16,567	(8%)
	\$ million	\$ million	
<b>RESULTS</b>			
Income	1,808	1,998	(10%)
Operating expenses	1,164	1,176	(1%)
	644	822	
Share of profits less losses of associated companies	6	–	–
Profit before taxation	650	822	(21%)
Taxation	(57)	(82)	(31%)
Profit attributable to shareholders	593	740	(20%)
Shareholders' funds	5,496	5,235	5%
Total assets *	14,035	13,745	2%
Earnings per share	\$0.57	\$0.71	(20%)
Interim dividend per share	\$0.08	\$0.08	0%
Final dividend declared per share	\$0.43	\$0.25	72%
	\$0.51	\$0.33	55%
Dividend payout ratio	90%	46%	

\* The Group's total assets include the margin funds received from Participants on futures and options contracts.





香港交易及結算所有限公司

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