



Hong Kong Exchanges and Clearing Limited
香港交易及結算所有限公司

2003

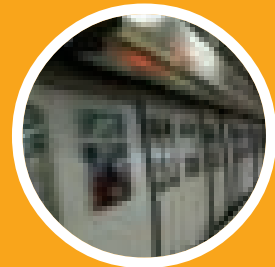
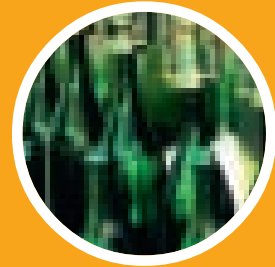
**ANNUAL
REPORT**

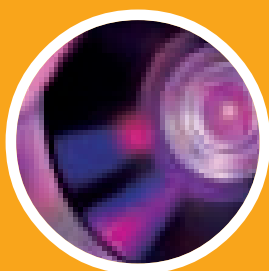


Hong Kong Exchanges and Clearing Limited is committed to:

- 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 userfriendly 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)

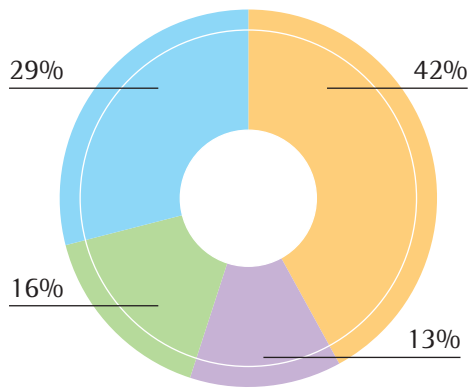
	2003	2002	Change
KEY MARKET STATISTICS			
Average daily turnover value on the Stock Exchange	\$10.4 billion	\$6.7 billion	55%
Average daily number of derivatives contracts traded on the Futures Exchange	41,889	30,038	39%
Average daily number of stock options contracts traded on the Stock Exchange	17,122	15,203	13%
	\$'000	As restated \$'000	
RESULTS			
Income	2,019,825	1,808,090	12%
Operating expenses	1,222,141	1,164,657	5%
Operating profit	797,684	643,433	24%
Share of profits less losses of associated companies	7,664	6,141	25%
Profit before taxation	805,348	649,574	24%
Taxation	(113,583)	(61,069)	86%
Profit attributable to shareholders	691,765	588,505	18%
Shareholders' funds	5,603,263	5,490,364 [#]	2%
Total assets*	19,802,264	14,035,471	41%
Earnings per share	\$0.66	\$0.56	18%
Interim dividend per share	\$0.18	\$0.08	125%
Final dividend declared per share	\$0.42	\$0.43	-2%
	\$0.60	\$0.51	18%
Dividend payout ratio	91%	91%	
SPECIAL DIVIDEND DECLARED PER SHARE	\$1.68	—	

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

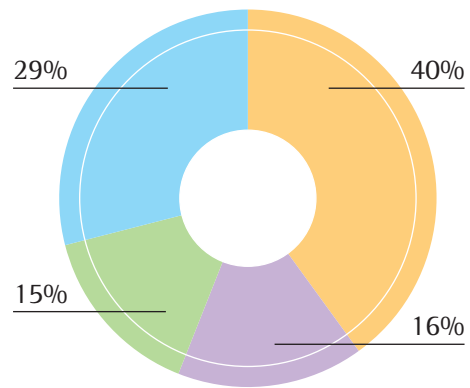
Audited and restated (down by \$6 million) as at 31 December 2002 due to the implementation of the new Hong Kong Statements of Standard Accounting Practice 12: Income Taxes

Financial Highlights

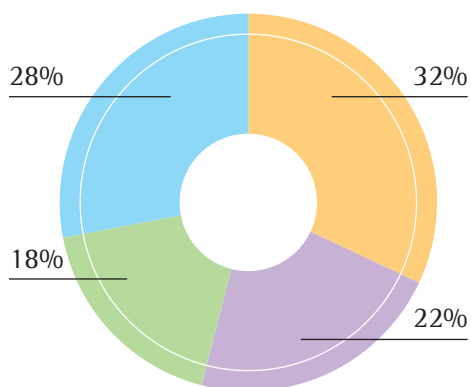
BY BUSINESS SEGMENT*



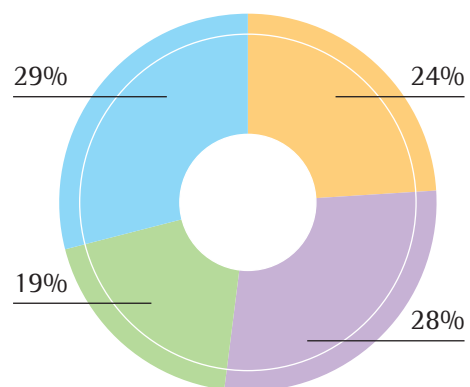
2003 Income



2002 Income



2003 Segment results



2002 Segment results

● Cash Market ● Derivatives Market ● Clearing Business ● Information Services

* Please refer to note 2 to the accounts on pages 105 to 108 for details. The business segments above exclude the Others Segment.



Five-Year Statistics

FIVE-YEAR STATISTICS

(Financial figures are expressed in Hong Kong dollars)

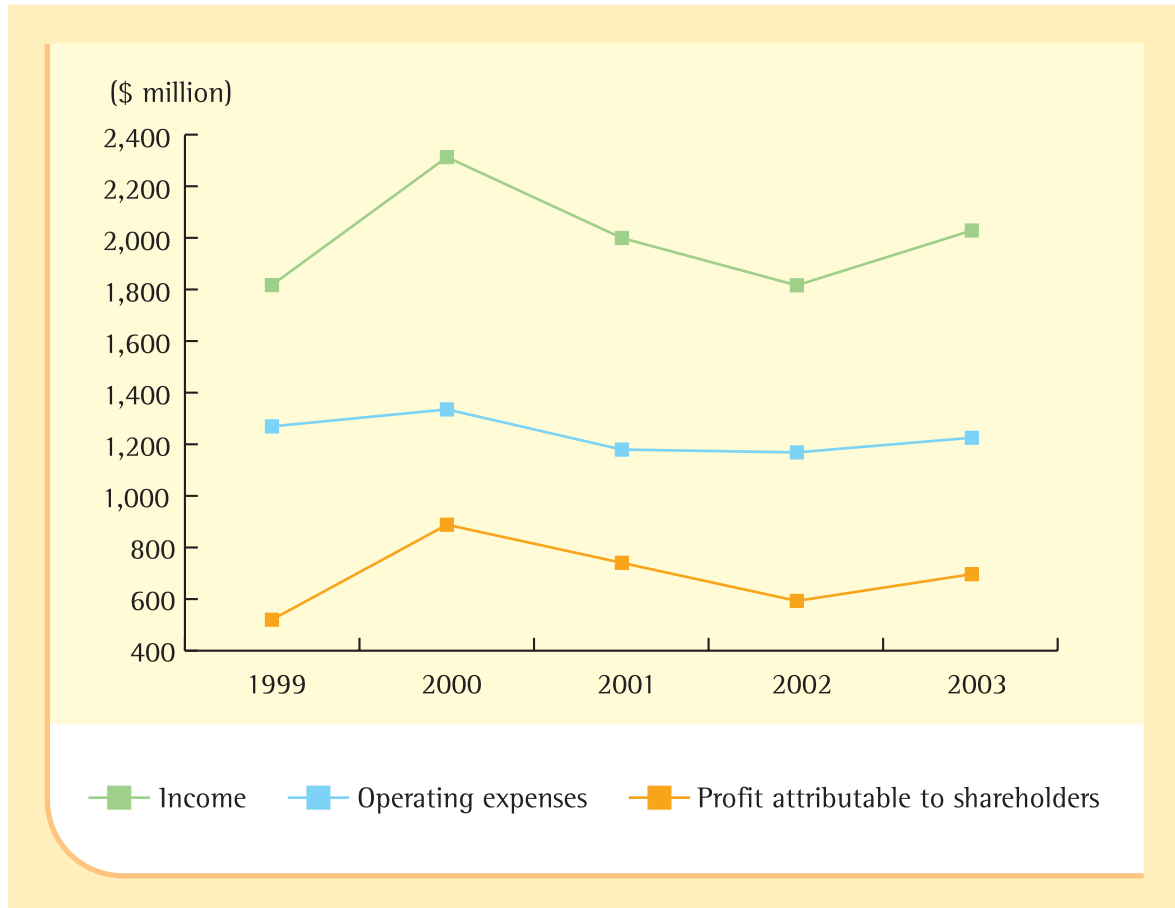
	2003 \$ million	As restated 2002 \$ million	As restated 2001 \$ million	As restated 2000 \$ million	As restated 1999 \$ million
Results*					
Income [#]	<u>2,027</u>	<u>1,814</u>	<u>1,998</u>	<u>2,312</u>	<u>1,815</u>
Profit attributable to shareholders	<u>692</u>	<u>588</u>	<u>736</u>	<u>884</u>	<u>515</u>
Assets and liabilities					
Non-current assets	<u>2,291</u>	<u>1,889</u>	<u>1,823</u>	<u>2,226</u>	<u>2,163</u>
Current assets	<u>17,511</u>	<u>12,146</u>	<u>11,926</u>	<u>11,948</u>	<u>12,293</u>
Current liabilities	<u>(13,048)</u>	<u>(7,939)</u>	<u>(7,888)</u>	<u>(8,672)</u>	<u>(9,756)</u>
Net current assets	<u>4,463</u>	<u>4,207</u>	<u>4,038</u>	<u>3,276</u>	<u>2,537</u>
Total assets less current liabilities	<u>6,754</u>	<u>6,096</u>	<u>5,861</u>	<u>5,502</u>	<u>4,700</u>
Non-current liabilities	<u>(1,151)</u>	<u>(606)</u>	<u>(628)</u>	<u>(628)</u>	<u>(618)</u>
Shareholders' funds	<u>5,603</u>	<u>5,490</u>	<u>5,233</u>	<u>4,874</u>	<u>4,082</u>

* Following the adoption of certain new Statements of Standard Accounting Practice issued by the Hong Kong Society of Accountants in 2001 and 2003, certain comparatives previously reported have been restated to conform to the new policies.

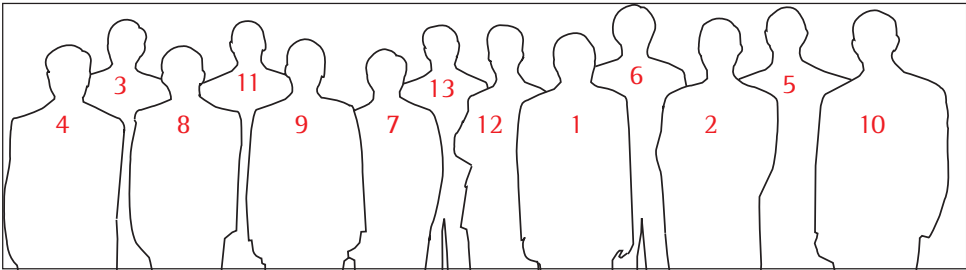
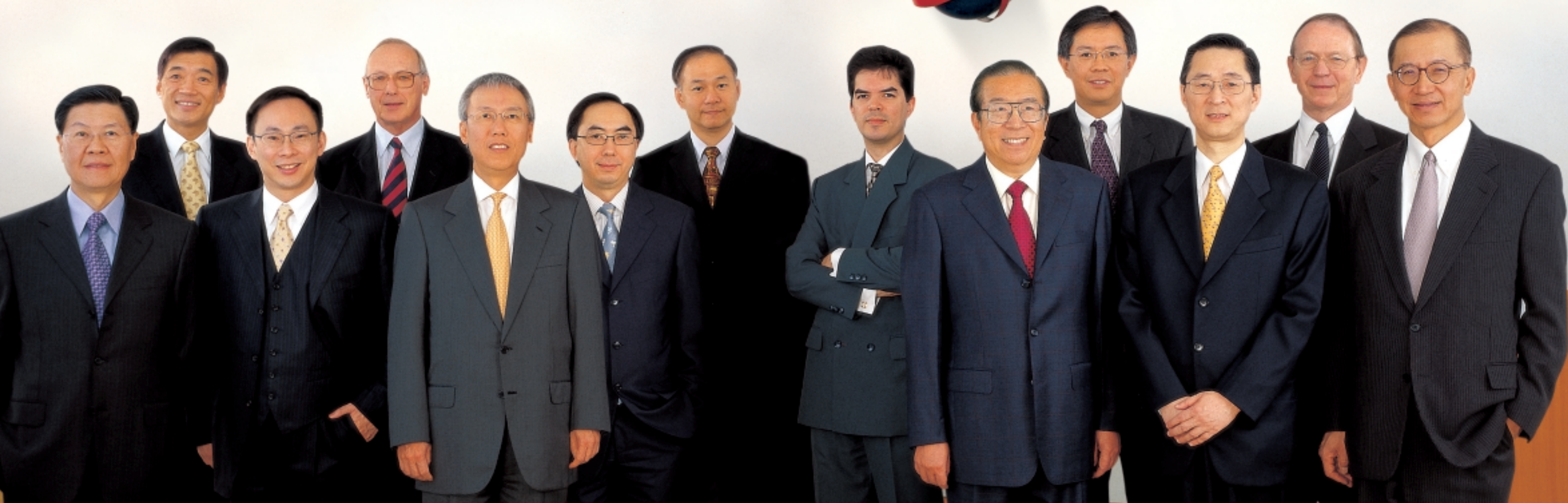
Income includes share of profits less losses of associated companies

Five-Year Statistics

FIVE-YEAR RESULTS



Corporate Information



BOARD OF DIRECTORS

Non-executive Chairman

- 1 LEE Yeh Kwong, Charles* GBS, JP

Executive Director, Chief Executive

- 2 CHOW Man Yiu, Paul JP
(joined on 1 May 2003)
KWONG Ki Chi GBS, JP
(retired on 15 April 2003)

Non-executive Directors

- 3 FAN Hung Ling, Henry* SBS JP
(appointment effective on 15 November 2003)
4 FONG Hup*
(appointment effective on 16 April 2003)
5 FRESHWATER, Timothy George*
6 KWOK Chi Piu, Bill

- 7 LEE Jor Hung, Dannis BBS
8 LEE Kwan Ho, Vincent Marshall
9 LEONG Ka Chai* JP
LIU Jinbao*
(resigned on 28 May 2003)
10 LO Ka Shui* GBS, JP
SETO Gin Chung, John
(retired on 15 April 2003)
11 STRICKLAND, John Estmond GBS, JP
(retired on 15 April 2003 as a Public Interest
Director and appointed by the Board
on 16 April 2003)
WARD, Rodney Gordon*
(retired on 15 April 2003)
12 WEBB, David Michael
(elected on 15 April 2003)
13 WONG Sai Hung, Oscar
(elected on 15 April 2003)
YUE Wai Keung
(retired on 15 April 2003)

* Public Interest Directors

Corporate Information

AUDIT COMMITTEE

STRICKLAND, John Estmond (Chairman)
FONG Hup (Deputy Chairman)
FAN Hung Ling, Henry
LEE Kwan Ho, Vincent Marshall
WEBB, David Michael

EXECUTIVE COMMITTEE

LEE Yeh Kwong, Charles (Chairman)
CHOW Man Yiu, Paul
CONROY, Patrick Kevin
LEE Jor Hung, Dannis
LEONG Ka Chai

INVESTMENT ADVISORY COMMITTEE

FRESHWATER, Timothy George (Chairman)
WONG Sai Hung, Oscar (Deputy Chairman)
SUN, David
WEBB, David Michael

NOMINATION COMMITTEE

LEE Yeh Kwong, Charles (Chairman)
LO Ka Shui
WONG Sai Hung, Oscar

REMUNERATION COMMITTEE

LO Ka Shui (Chairman)
LEE Jor Hung, Dannis
LEE Kwan Ho, Vincent Marshall

RISK MANAGEMENT COMMITTEE

(a committee established under Section 65 of the Securities and Futures Ordinance)

LEE Yeh Kwong, Charles (Chairman)
FAN Hung Ling, Henry
DICKENS, Mark**
KWOK Chi Piu, Bill
LAM Kin**
LAU James H. Jr**
LEONG Ka Chai**
OR Ching Fai, Raymond**

** Appointed by the Financial Secretary under Section 65 of the Securities and Futures Ordinance

COMPANY SECRETARY

MAU Kam Shing, Joseph

AUTHORISED REPRESENTATIVES

CHOW Man Yiu, Paul
MAU Kam Shing, Joseph

AUDITORS

PricewaterhouseCoopers

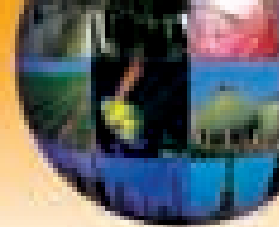
LEGAL ADVISORS

Allen & Overy

REGISTERED OFFICE

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

Shareholder Information



WEBSITE

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

E-MAIL ADDRESS

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

FINANCIAL CALENDAR

Information on 2003 Results Announcement

Announcement of first quarter results	14 May 2003
Announcement of interim results	13 August 2003
Payment date for interim dividend	15 September 2003
Announcement of third quarter results	12 November 2003
Announcement of final results	26 February 2004
Ex-dividend date for final and special dividends	24 March 2004
Book closing dates for final and special dividends	26-31 March 2004
Record date for final and special dividends	31 March 2004
Annual General Meeting for 2004	31 March 2004
Payment date for final and special dividends	on or about 14 April 2004

Shareholder Information

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

Price and Turnover History

2003	Price per Share		Turnover (in millions)	
	High (HK\$)	Low (HK\$)	Shares	HK\$
January	10.50	9.15	62.2	620.5
February	9.50	8.60	85.6	770.0
March	9.60	8.30	117.4	1,060.7
April	9.25	7.60	98.4	840.6
May	10.45	8.95	107.8	1,036.4
June	11.80	10.30	111.4	1,235.8
July	12.95	10.90	131.7	1,596.1
August	14.30	12.70	138.1	1,881.1
September	17.00	14.05	162.4	2,520.5
October	17.30	16.15	117.8	1,967.8
November	17.30	14.50	144.2	2,234.2
December	17.15	15.85	91.8	1,511.5

Shareholder Information

Analysis of Shareholdings

(Shareholdings according to the Register of Members as at 31 December 2003)

Size of holding	Number of shareholders	% of shareholders	Number of shares (‘000)	% of total issued capital
1 - 1,000	16	1.2%	6	0.0%
1,001 - 5,000	587	47.5%	1,581	0.2%
5,001 - 10,000	284	23.0%	2,366	0.2%
10,001 - 100,000	202	16.3%	6,644	0.6%
100,001 and above	148	12.0%	1,038,402	99.0%
Total	<u>1,237</u>	<u>100.0%</u>	<u>1,048,999</u>	<u>100.0%</u>

The following is a further analysis of share ownership as at 31 December 2003:

Category	Number of shares (‘000)	% of total issued capital
Individual ¹	99,209	9.4%
<i>Local</i>	97,827	9.3%
<i>Overseas</i>	1,382	0.1%
Corporate ²	16,559	1.6%
Institutions ³	563,642	53.7%
<i>Local</i>	39,893	3.8%
<i>Overseas</i>	523,749	49.9%
Exchange Participants ⁴	238,969	22.8%
Other nominees/banks ⁵	130,620	12.5%
Total	<u>1,048,999</u>	<u>100.0%</u>

The ownership analysis is according to a survey conducted as at 31 December 2003

¹ Shares owned by individuals other than those who are Exchange Participants

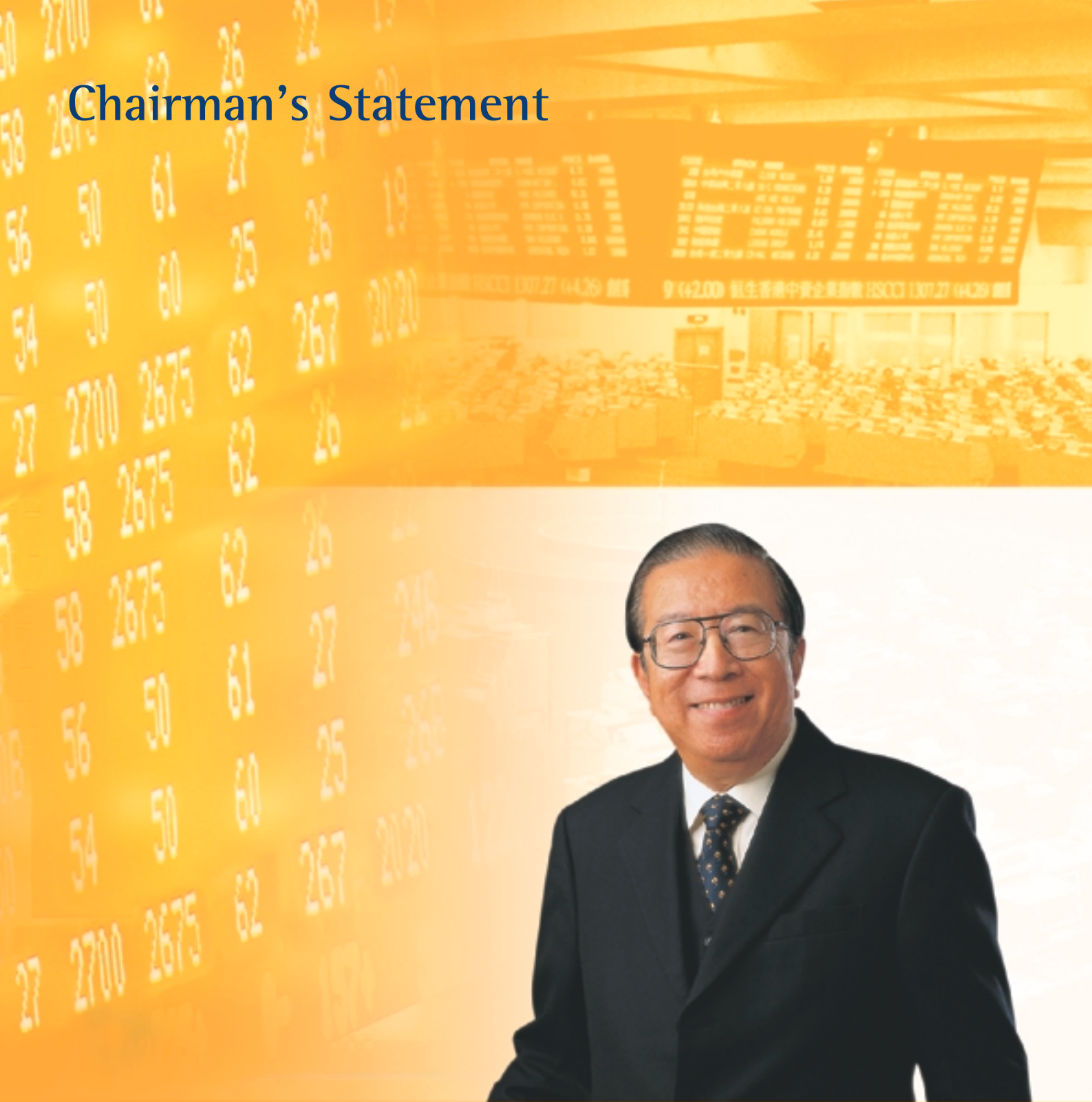
² Shares owned by companies other than those who are Exchange Participants and nominees/banks

³ Institutional investors identified by the six major custodians and HKSCC Nominees Limited

⁴ Exchange Participants include Stock Exchange Participants and Futures Exchange Participants

⁵ Other nominees/banks excluding HKSCC Nominees Limited and the six major custodians

Chairman's Statement



LEE Yeh Kwong, Charles
Chairman

Chairman's Statement

(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 year 1 January to 31 December 2003. It should be read in conjunction with the Review of Operations by the Chief Executive, which reports on the Group's operations and development.

Financial Results

The period under review was a year marked by different economic circumstances. The first half of the year was adversely affected by poor domestic economic conditions, emanating from the onset of SARS (Severe Acute Respiratory Syndrome), rising unemployment, continuing weakness in the property market and slow growth overseas. The second half saw the end of SARS in Hong Kong, enthusiasm about the signing of the Mainland and Hong Kong Closer Economic Partnership Arrangement, or CEPA, and the first signs of returning confidence and economic health – although there is still some way to go before full recovery.

HKEx recorded a profit before taxation of \$805 million during the year, an increase of 24 per cent over 2002. Profit attributable to shareholders was \$692 million, 18 per cent higher than in the previous year. The rise in profit is principally due to strong activity in the securities and derivatives markets in the second half of the year,

resulting in increased revenue from trading fees, trading tariff and clearing and settlement fees. However, the low level of interest rates continued to affect our interest income.

The Board of Directors has recommended payment of a final dividend of \$0.42 per share, which, together with the interim dividend of \$0.18 per share, will bring the total dividend distribution for the year to \$0.60 per share.

The Board has carried out a review of the Group's policy regarding its cash funds, which are made up largely of liquid funds required in connection with our clearing businesses but also include substantial retained earnings. The review has taken into account the changed economic environment, the Group's strategy and our medium-term capital and risk management requirements. Following this review, the Board has recommended, in addition to the dividend referred to above, a special dividend of \$1.68 per share.

Chairman's Statement

Operating expenses increased by 5 per cent to \$1,222 million, largely due to one-off expenses of \$52 million incurred in the second quarter that are not expected to recur. The Group continued to maintain rigorous control of costs in order to minimise operating expenses. Shareholders' funds amounted to \$5,603 million at the end of the year, compared with \$5,490 million a year earlier.

Quarterly Reporting

HKEx introduced quarterly reporting during 2003 to promote high standards of corporate governance and provide shareholders with timely information about the Group's performance. The quarterly, interim and final financial reports were reviewed by the Audit Committee before they were presented to the Board. The voluntary publication of our results on a quarterly basis demonstrates our commitment to transparency and good corporate governance.

Strategic Plan

Since the merger of the exchanges and clearing houses, HKEx has established an integrated corporate structure, strengthened the market infrastructure and streamlined management and operations. One of the most important tasks in 2003 was to formulate a strategic plan for 2004-2006, to guide the path of the Group's future development.

Our mission is to operate a world-class market for capital formation and the trading of securities and derivatives products. We are committed to fulfilling our obligations to ensure a fair and orderly market, to ensure that risks of the markets are managed prudently and to safeguard the interests of the public, in particular the interests of the investing public. Our strategic focus is to further strengthen the status of Hong Kong as an international financial centre and China's leading capital market, where Mainland issuers can gain access to international investors through listings on our market.

Development during the period 2004 to 2006 will incorporate three aspects: Consolidation; Building a higher quality market; and Expanding relationship with the Mainland.

Consolidation

The efficiency and cost effectiveness of the Group's internal operations will be raised by cost rationalisation, constant review of project portfolios and strengthening of project management. Development of a business culture that emphasises quality service will continue to be promoted. Through consolidation, the Group seeks to become a more efficient organisation with a dedicated workforce focussed on stakeholders and performance.

Building a Higher Quality Market

It is vital for HKEx and the markets it operates to maintain international quality standards and practices in today's competitive global environment. This will require further strengthening of market regulation and risk management. Issuer supervision will be augmented at all levels, encompassing structure, policy and day-to-day operations, to further affirm our commitment to raise market quality.

We have also submitted our views on "Proposals to Enhance the Regulation of Listing", a consultation paper published by the Government in October 2003, and we will continue to work closely with the Government to identify and establish the most suitable model for the enhancement of the regulation of listing in Hong Kong.

Expanding Relationship with the Mainland

The further development of Mainland China-related business is a major component in the strategy of HKEx. Our goal is to further expand our relationship with the Mainland, building upon the solid foundation we have laid. For over a decade, through sustained and persistent efforts, we have successfully promoted and attracted the listing of

Mainland state enterprises in Hong Kong through H shares, as well as the listing of red-chip companies and private enterprises. Our close partnership with Mainland businesses will continue to grow through the opening of the Beijing office in November 2003.

Last year marked the 10th anniversary of the listing of the first Mainland state enterprise in Hong Kong, and the beginning of a new era of large-scale capital formation by Mainland companies in the Hong Kong market. Development of this activity and the impact on the growth of our markets have been phenomenal. The China dimension of our business has become the most dynamic driving force in our operations.

In 2003, a total of 73 companies were listed, including 38 Mainland enterprises, which comprise H-share issuers, red-chip companies and private enterprises. The total funds raised by the newly listed Mainland enterprises amounted to \$52 billion, representing 88 per cent of the total funds raised by initial public offering (IPO) in 2003. At the end of 2003, a total of 258 Mainland enterprises were listed in Hong Kong, with a market capitalisation of \$1,695.1 billion, representing 31 per cent of our total market

Chairman's Statement

capitalisation. Trading of Mainland-related shares in our equity market accounted for 46 per cent of our total turnover of \$2,304.8 billion last year. The size of our market has quadrupled in the space of about 10 years from a market capitalisation of \$1,332.2 billion at the end of 1992 to \$5,547.8 billion last year. Average daily turnover increased from \$2.8 billion in 1992 to \$10.4 billion in 2003. Since the first H-share listing, funds totalling \$780 billion have been raised by Mainland enterprises, including \$458 billion or 58 per cent by way of further issues after listing.

The Group's efforts to develop our market into the premier international capital formation centre for Mainland enterprises have helped strengthen Hong Kong's role as an international financial centre. Issuers and investors are attracted by the quality of our regulation and accounting standards, the absence of foreign exchange controls, reliable and cost effective banking and securities services, the rule of law and the free flow of information. We will seek to ensure that our markets remain attractive to investors and issuers from Hong Kong, the Mainland and overseas in the face of today's intense competition in the world's financial markets.

Staff Changes

Successful implementation of our strategic plan and HKEx's future development require us to maintain a highly professional management team. We were pleased that Paul Chow joined the Group to succeed Kwong Ki-chi as the chief executive in May last year. Mr Chow is a former chief executive of The Stock Exchange of Hong Kong Limited who was involved in the establishment of the framework for the initial listing of H shares and the development of the Exchange's Automatic Order Matching and Execution System.

Patrick Conroy, a former director for financial sector development and global partnerships at the International Bank for Reconstruction and Development (the World Bank) and a former senior director of the supervision of markets division of the Securities and Futures Commission, also joined the Group as chief operating officer last year. Other senior management changes in 2003 included the appointment of Stewart Shing as the head of the Clearing Business Unit. Mr Shing, who has more than 30 years of securities operations and business management experience, was the chief executive of Hong Kong Securities Clearing Company Limited from 1996 to 2000.

Outlook

The external environment is likely to be influenced by low interest rate levels, Mainland China's rapid economic growth, and movements in the currency markets. In this climate, investment funds will likely continue to be drawn to equities. The inflow of international funds will continue to bring about a favourable environment for the listing of major enterprises, in particular those from the Mainland. I am optimistic that these factors augur well for the prospects of our markets.

I acknowledge with deep gratitude the work and support of my fellow directors, and the executives and staff of HKEx, which have been crucial to our success. I am confident that their endeavours will continue to help the Group achieve greater accomplishments in the years ahead.

LEE Yeh Kwong, Charles
Chairman

26 February 2004



Review of Operations



CHOW Man Yiu, Paul
Director and Chief Executive

Review of Operations

(Financial figures are expressed in Hong Kong dollars)

Financial Review

Hong Kong's economy improved in the second half of the year after slowing in the second quarter due to the outbreak of SARS (Severe Acute Respiratory Syndrome) and other factors. Better economic conditions led to improved investor sentiment and a significant increase in market activity along with stronger revenue for the Group as reflected in the financial results reported by the chairman.

Operational Review

We continued working to raise the quality of our markets. We reorganised our operations to make them more efficient, and we completed a thorough review of ongoing projects to ensure we focus on our most important initiatives.

Listing Matters

The Listing, Regulation and Risk Management Unit was reorganised in June. The Exchange Business Unit is now responsible for Participant admission and surveillance. Risk Management is conducted by the Finance, Treasury, Administration and Risk Management Unit, and Listing is dedicated to listing matters and sponsor regulation. After the changes, Listing was reorganised into three functional teams to increase effectiveness and efficiency. They comprise Compliance and Monitoring, Enforcement and IPO (initial public offering) Transactions. Apart from the three core functional teams, there are various sub-teams which are primarily responsible for providing advice and support in accounting and legal matters, policy coordination, quality assurance and other areas.

Listing accepted a total of 101 applications for listing on The Stock Exchange of Hong Kong Limited (Stock Exchange) in 2003. Fifty-two of the applications, or 51 per cent, were for listings on the Main Board while 49 of the applications, or 49 per cent, were for listings on the Growth Enterprise Market (GEM). Of the 223 listing applications considered in 2003, comprising listing applications accepted during the year and 122 active listing applications submitted in 2002 in respect of which the vetting was carried over into 2003, 73 had been approved and subsequently 46 issuers had listed on the Main Board and 27 listed on the GEM as at 31 December. Of the rest, eight applications had been granted approval in principle but had not yet listed, 12 applications had been granted approval in principle but the approvals had since lapsed as the companies had not yet been listed by the respective expiry dates of the approval, seven applications were rejected, seven had been withdrawn, 65 applications had lapsed prior to approval in principle to list being granted and 51 applications remained active and were being processed.

During the year Listing vetted 8,938 listed company announcements and 1,773 circulars. They conducted enquiries in 8,305 cases in the light of share price and trading volume movements and as a result 3,801 clarifications announcements were published by listed issuers.

During the same period, Listing handled 170 complaints about the conduct of issuers or their directors. Arising from these complaints, 24 cases required remedial action to be taken

Review of Operations

by listed issuers (usually the publication of further information) and another 21 cases were either referred to the Listing Enforcement team for further investigation in contemplation of disciplinary action or were referred to the Securities and Futures Commission (SFC).

Investigations were completed on 178 cases involving possible breaches of the Listing Rules of the Main Board and GEM involving listed issuers and/or their directors. This led to four public censures, eight public statements of criticism, and three private reprimands by the Disciplinary Committee for breaches of the Listing Rules relating to failure to disclose price sensitive information; failure to obtain shareholder approval prior to entering into connected party transactions; late financial reporting; failure to maintain a public float; failure to comply with the dealing restrictions for share repurchases; and failure to meet the standards of conduct required of directors. A further 113 cases relating to minor breaches were dealt with by the issue of warning letters and 21 cases relating to conduct inconsistent with Listing Rules requirements were dealt with by issuing caution letters.

In August 2003, a listed company sought judicial review of procedural directions issued by the chairman of the Listing (Disciplinary) Committee in disciplinary proceedings against the listed company. The judicial review hearing was held in February 2004 and judgement reserved. The Stock Exchange opposed the listed company's application for judicial review and has sought to recover its costs in responding to the application.

On the advice of its legal advisers, the Stock Exchange considers that there are good grounds to believe that the listed company's application will not be successful. The maximum liability in respect of legal costs to be payable to the listed company in the event its application against the Stock Exchange is successful is not expected to be material.

The dual filing regime has been working smoothly since its implementation on 1 April last year under the Securities and Futures (Stock Market Listing) Rules of the Securities and Futures Ordinance (SFO).

We jointly published a consultation paper with the SFC in May on the regulation of sponsors and independent financial advisers. The paper included proposed measures to tighten the regulation of IPO intermediaries. The submissions were published in November and we are working with the SFC on the way forward.

Listing completed drafting the rule amendments stemming from our Corporate Governance consultation and the consultation on initial listing criteria and continuing obligations. The rule amendments were published at the end of January this year together the draft Corporate Governance Code and Corporate Governance Report. We have given market participants an opportunity to comment on the Code and the timetable for its implementation. Listing is working on proposals arising from our market consultation on continuing listing criteria and related issues. We plan to announce the way forward later this year.

On 14 January this year, we submitted our views on the Government's consultation paper on "Proposals to Enhance the Regulation of Listing". We support a modified version of the model that retains the present division of functions between the SFC and HKEx, except that the SFC would be the ultimate enforcement agency for new statutory obligations. In order to sharpen the teeth of the regulatory regime for deterring and dealing with corporate misconduct, Hong Kong's statutory framework should be updated through primary legislation. Our proposed modifications would improve the present system by clarifying roles and accountability and making the system more efficient. The present system for regulating listed companies is generally accepted to have served Hong Kong well. There has been no experience which shows that fundamental change in the structure is necessary. The institutionalised checks and balances in the present three-tier system are of great value, especially in the Hong Kong context; they would be practically impossible to replace; to dismantle them would be likely to damage Hong Kong as a capital formation centre.

Ongoing projects relating to listing matters include revamping the listing committees' roles in decision-making and related issues, and improving disciplinary processes. In addition, Listing will take proposals to the Listing Committee arising from our market consultation on continuing listing criteria and related issues, and we will announce the way forward later this year.

Securities Market

Total funds raised amounted to \$214 billion. A total of 73 companies were listed in 2003, comprising 46 on the Main Board (of which six were the transfer of listings from GEM), and 27 on GEM. Thirty-eight of the 73 new listings, or more than half, were categorised as Mainland enterprises, which comprise H-share, red-chip and private companies. Total funds raised in IPOs amounted to \$59 billion, \$57 billion on the Main Board and \$2 billion on GEM. Mainland enterprises represented 88 per cent of all IPO funds raised. Post-issue fund raising totalled an additional \$155 billion, made up of \$152 billion on the Main Board and \$3 billion on GEM.

Total market turnover was \$2,584 billion, the third highest on record, compared with \$1,643 billion in 2002. Turnover attributable to Mainland enterprises was 46 per cent of the total equity turnover. Warrant turnover on the Main Board increased by 132 per cent compared with that in 2002 and represented more than 10 per cent of total Main Board turnover. In October, derivative warrants set a monthly turnover record of \$47.8 billion.

There were 688 warrants listed on the Stock Exchange during the year and one Exchange Traded Fund (ETF). The ETF, the third ETF listed on the Exchange, is designed to track the performance of the Hang Seng China Enterprises Index, which comprises H shares.

Review of Operations

Under our programme that allows Stock Exchange Participants to increase the order throughput rate, or throttle rate, of their Open Gateways to the Stock Exchange's trading system, AMS/3 (Third Generation Automatic Order Matching and Execution System), 39 Participants subscribed to increase their throttle rates by a total of 120 units.

Derivatives Market

Futures and Options turnover rose 31.9 per cent from 2002 to 14,546,213 contracts, a record high. Hang Seng Index (HSI) Futures' trading volume of 6,800,360 contracts led the market, followed by stock options, with 4,220,638 contracts traded. Mini-HSI Futures and HSI Options were also among the top products in terms of trading volume. HSI Options volume rose 97.9 per cent from the previous year, while HSI Futures volume rose 41.6 per cent. Both contracts set one-day volume records along with Mini-HSI Futures, Dow Jones Industrial Average Futures and Three-year Exchange Fund Note Futures. In addition, HSI Options and Mini-HSI Futures set open interest records.

In October, we upgraded the software used for our derivatives trading system, the Hong Kong Futures Automated Trading System (HKATS), as part of our continuing efforts to further strengthen our market infrastructure. The new software improved the performance and stability of HKATS, and made it more efficient. The upgrade was also a core part of the DCASS (Derivatives Clearing and Settlement System) project and a prerequisite for the introduction of DCASS.

We introduced H-shares Index Futures on 8 December to meet market demand created by the rapid growth of the H-shares market, and to offer an effective trading and hedging instrument for investors interested in Mainland China enterprises listed in Hong Kong. Trading volume rose from 1,419 contracts on the first day to 4,824 on 30 December, the last trading day for the December contract, while open interest rose from 572 contracts to 7,711. Average daily trading volume between 8 and 31 December was 3,196 contracts.

We are planning to introduce H-shares Index Options this year.

Clearing and Settlement

Average daily settlement efficiency of continuous net settlement stock positions stood at 99.69 per cent on settlement day, rising to 99.97 per cent on the following day.

We completed the rollout of CCASS/3, the upgraded Central Clearing and Settlement System (CCASS), on 26 May with the introduction of the Participant Gateway. CCASS/3 is capable of supporting multiple markets with different settlement cycles as well as extended operating hours. It can also facilitate straight-through processing.

On 23 October, we published our Consultation Paper on a Proposed Operational Model for a Scripless Securities Market. The proposed operational model is mainly based on the scripless market model set out in a consultation paper issued in

February 2002 by the SFC. Under that model, the complete register of members comprises an Issuer Register and a CCASS Register to be maintained respectively by issuers or their appointed share registrars and Hong Kong Securities Clearing Company Limited, a wholly-owned subsidiary of HKEx. We are reviewing the 26 responses HKEx received on the consultation paper. We are also continuing our discussions on the issue with the SFC and market participants.

We have identified several potential enhancements to the Investor Participant (IP) Accounts in CCASS which we plan to implement later this year. Separately, we are working on an enhanced IP model suitable for the local environment and we will consult the market on the proposed model.

We plan to introduce DCASS in the early second quarter of this year. DCASS will replace the two systems currently in use to clear and settle futures and options contracts trading in our markets, enabling us to consolidate the clearing and settlement of all our derivatives market products on a single platform. PRiME (Portfolio Risk Margining System of HKEx), which is based on SPAN (Standard Portfolio Analysis of Risk), will be introduced with DCASS to serve as the clearing house margining methodology for all futures and options contracts, replacing the methods currently in use. PRiME will enable the derivatives clearing houses to assess and manage their exposure to their Participants more accurately. Several briefings were held in October and November to explain the features of DCASS and PRiME to Participants from our clearing houses for futures and options.

During the year Tai Wah Securities Limited and Yicko Futures Limited failed to meet their obligations to the clearing houses. The Tai Wah Securities default totalled approximately \$2.4 million and the Yicko Futures default totalled approximately \$4.9 million. The incidents should have no financial impact on the clearing houses.

Information Services

At the end of the year, there were 63 real-time information vendors for the securities market, a decrease of seven from the end of 2002, and 34 for the derivatives market, a decrease of one. The total real-time data services provided by these vendors rose to 353 from 331, while the total delayed data services rose to 98 from 94. Our income from the sale of information declined as a result of consolidation in the brokerage industry and a reduction in the demand for stock market information.

Sixteen information vendors participated in our extended China Promotion programme that allows investors on the Mainland to follow the HKEx markets by subscribing for HKEx market data.

In late April, we introduced *HKEx Data Products*, an Internet-based service which provides easy access to our historical market data products through online subscription, payment and delivery. The service is available through the HKEx website.

There was a sharp increase in Disclosure of Interests information processed for posting on the HKEx and GEM websites after a new disclosure regime became effective on 1 April.

Review of Operations

According to Part XV of the SFO on Disclosure of Interests, the Stock Exchange is to publish the information it receives in a manner approved by the SFC. The SFC also prescribes the ways of filing disclosure notices with the Stock Exchange. We published 2,753 disclosure notices in the first three months of the year and approximately 27,000 in the final nine months of the year. About 10 per cent of the notices were filed through the Internet after an online submission channel was introduced together with the new regime.

IT/Systems

Our key market systems all achieved very good system uptime. Uptime for securities trading and derivatives clearing was 100 per cent. Uptime for derivatives trading was 99.99 per cent and uptime for securities clearing was 99.92 per cent. For securities trading, we have maintained a 100 per cent uptime record since the launch of AMS/3 in October 2000. For derivatives trading, we achieved 100 per cent uptime for 12 consecutive months on 29 January this year. In securities clearing, there was a major revamp in December 2002 when the new CCASS/3 architecture was rolled out. Uptime for the final three quarters of last year was 100 per cent. Our objective remains 100 per cent availability for all key systems.

We are studying the possible consolidation of the networks of our trading and clearing systems, the market data feed and other systems to reduce our costs and the costs of our Participants without sacrificing service quality. We are also considering the consolidation of our data centres.

Total IT capital expenditures decreased by \$99 million or 77 per cent from \$129 million in 2002 to \$30 million in 2003, mainly attributable to the drop in spending following the introduction of CCASS/3 in May 2002, and lower expenditure on DCASS and HKATS in 2003 as the projects were completed/close to completion.

Total information technology and computer maintenance expenses fell by \$16 million or 6 per cent from \$263 million in 2002 to \$247 million in 2003, mainly attributable to lower hardware and software rental but partly offset by expenditures relating to the maintenance of CCASS/3.

Depreciation charge relating to IT systems increased by \$18 million or 14 per cent to \$149 million (2002: \$131 million), mainly on account of the commencement of depreciation of CCASS/3 in May 2002.

Treasury

The Treasury Division supervises the investment of funds amounting to about \$10.6 billion on average, comprising mainly three sources of funds, viz Corporate Funds (accumulated operating profits), Clearing House Funds and margin funds received (excluding contributions receivable from Participants of the Clearing House Funds and securities deposited by Participants as alternatives to cash deposits of the margin funds). The average amount of funds available for investment increased by 17 per cent or \$1.5 billion to \$10.6 billion (2002: \$9.1 billion), mainly due to a rise in margin funds received from Clearing Participants as a result of increased trading in futures and options contracts.

Review of Operations

Investment income represents approximately 15 per cent (2002: 16 per cent) of HKEx's total income.

An Investment Advisory Committee, comprised of non-Executive Directors and an external member from the financial community, advises the Board on portfolio management and monitors the risk and performance of our investments. The Treasury Division is dedicated to the day-to-day management and investment of the funds. Three external fund managers have also been appointed to manage part of the Corporate Funds since July 2001.

Investment and fund management is governed by investment policies and risk management parameters approved by the Board. Investment restrictions and guidelines form an integral part of risk control. Fund-specific restrictions and guidelines are set according to the investment objectives of each fund. In addition, specific limits are set for each fund to control risk (e.g., permissible asset type, asset allocation,

liquidity, credit, counterparty concentration, maturity, foreign exchange, interest rate and market risks).

The investment objective of the Corporate Funds is the provision of liquidity for funding ongoing operations and long-term capital preservation. Accordingly, the funds can be invested in cash, money market instruments, bonds, collective investment schemes and equities. Only external fund managers are permitted, subject to compliance with guidelines on conflict of interest and to limits forming part of the investment policies, to invest in equities, which include convertible bonds. For Clearing House Funds and margin funds, the investment objective of which is to satisfy liquidity requirements and safeguard financial assets of the funds, their portfolios only consist of cash, money market instruments and bonds. As at 31 December 2003, of the total portfolio of \$13.58 billion, 39 per cent of the funds were invested in investment grade bonds, 59 per cent in cash or bank deposits and 2 per cent in global equities.

	Fund size \$ billion	Bonds	Cash or bank deposits	Global equities
Corporate Funds	5.04	58%	36%	6%
Margin funds	7.07	31%	69%	0%
Clearing House Funds	1.47	9%	91%	0%
Total	13.58	39%	59%	2%

Review of Operations

Investments of the three funds are kept sufficiently liquid to meet operating needs of the Group and possible liquidity requirements of the Clearing House Funds and margin funds. Excluding equities held under the Corporate Funds (\$0.28 billion), which do not have a maturity date, the maturity profile of the remaining \$13.30 billion of investments as at 31 December 2003 was as follows:

	Fund size \$ billion	Overnight	>Overnight to 1 month	>1 month to 1 year	>1 year to 3 years	>3 years
Corporate Funds	4.76	22%	10%	18%	34%	16%
Margin funds	7.07	56%	7%	12%	25%	0%
Clearing House Funds	1.47	82%	0%	0%	18%	0%
Total	13.30	47%	8%	13%	27%	5%

Risk management techniques, such as Value-at-Risk (VaR) and portfolio stress testing, are used to identify, measure, monitor, and control market risks. VaR measures the expected maximum loss over a given time interval (a holding period of 10 trading days is used by HKEx) at a given confidence level (95 per cent confidence interval is adopted by HKEx) based on historical data (one year is used by HKEx). In 2003, the overall risk, as measured by this VaR methodology, was as follows:

	Average VaR \$ million	Maximum VaR \$ million	Minimum VaR \$ million
Corporate Funds	15.39	18.35	13.11
Margin funds	8.54	11.54	5.70
Clearing House Funds	1.48	1.69	1.13

Review of Operations

Credit exposure was well diversified. As at 31 December 2003, all bonds held were of investment-grade and had a weighted average credit rating of Aa2 and a weighted average maturity of 1.9 years. Deposits were placed only with the note-issuing banks in Hong Kong and licensed banks and restricted licence banks with a minimum credit rating of A3 by Moody's or equivalent, which are approved by the Board from time to time.

Total investment income of the Group for the year amounted to \$311 million, which is 9 per cent or \$26 million higher than the \$285 million reported for 2002. Of the total, \$13 million related to income from the Group's investment in Singapore Exchange Limited (dividend of \$14 million, including a special dividend of \$12 million received during the year, less interest expense of \$1 million for funding the investment; 2002: dividend of \$2 million less interest expense of \$1 million) and \$5 million (2002: \$6 million) was accommodation income (i.e., retention interest charged on securities deposited by Participants as alternatives to cash deposits of the margin funds).

Investment income for the year for the funds supervised by the Treasury Division was \$293 million, 5 per cent or \$15 million higher than the \$278 million in 2002. The increase was due to higher net realised gain at \$35 million (2002: loss of \$14 million), net unrealised mark-to-market gain at \$43 million

(2002: \$33 million) on the investment portfolio, and dividends at \$4 million (2002: \$3 million) received on Corporate Fund investments, but partly offset by lower net interest income at \$211 million (2002: \$256 million) due to lower interest rates. As the valuation of the investments in bonds and equities reflects movements in their market prices, unrealised gains or losses may fluctuate or reverse unless the investments are sold.

The average 6-month Hong Kong Exchange Fund Bill rate dropped from 1.70 per cent in 2002 to 0.84 per cent in 2003, and the average 90-day US Treasury Bill rate declined from 1.62 per cent to 1.02 per cent.

For the year ended 31 December 2003, the Group achieved a positive return on investments of 2.76 per cent (2002: 3.10 per cent). The Corporate Funds returned 4.25 per cent (2002: 3.92 per cent), the margin funds 1.55 per cent (2002: 2.10 per cent), and the Clearing House Funds 1.56 per cent (2002: 2.60 per cent). Therefore the overall portfolio recorded a spread of 192 basis points above the 6-month Hong Kong Exchange Fund Bill yield (2002: 140 basis points), with the Corporate Funds registering a spread of 341 basis points (2002: 222 basis points), the margin funds 71 basis points (2002: 40 basis points), and the Clearing House Funds 72 basis points (2002: 90 basis points) above the 6-month Hong Kong Exchange Fund Bill yield.

Review of Operations

Risk Management

We participated in a successful market-wide rehearsal for the financial services sector at the end of January this year to test market contingency plans and inter-organisation communication in the event of high impact events, in particular those with cross-market implications, which could undermine the financial stability of Hong Kong. The rehearsal involved several other financial regulators and was led by the Financial Services and Treasury Bureau. Further updates and improvements on our market contingency plans will be made as and when necessary.

Business and Market Development

Beijing Representative Office

We opened our Beijing Representative Office on 17 November under the Mainland and Hong Kong Closer Economic Partnership Arrangement, or CEPA. On the same day, a conference was held in Beijing to mark the 10th anniversary of the listing of Mainland enterprises in Hong Kong in recognition of their significant contribution to our markets. The Beijing office will support our efforts to strengthen Hong Kong's position as the international capital formation centre for China.

We are looking into stationing staff in other Mainland cities including Shanghai and Guangzhou.

China Development & Listing Promotion

Apart from regular marketing visits to the Mainland, we organised listing conferences in Harbin, Guangzhou, Fuzhou and Hangzhou. The conferences attracted some 1,530 representatives from approximately 850 Mainland enterprises, and wide support from market practitioners from both Hong Kong and the Mainland. In addition, we conducted four training programmes for listed issuers and potential listing applicants on the Mainland with a view to promoting listing and increasing awareness of corporate governance issues. Through our marketing efforts during the year, we were able to identify many Mainland enterprises with an interest in listing on our markets.

Cooperation with Mainland Counterparts

We signed an agreement on 11 April with the Shanghai Futures Exchange (SHFE) to jointly explore the possibility of developing an Asian energy derivatives market. Our Hong Kong Futures Exchange Limited (Futures Exchange) and the SHFE have formed a working group to coordinate the exploratory efforts.

We also established a working group with the Shenzhen Stock Exchange (SZSE) to explore further cooperation between HKEx and the SZSE.

International Activities

HKEx co-organised the 13th Annual Asia-Pacific Futures Research Symposium, which was held in Shanghai on 27 and 28 February, in conjunction with the Chicago Board of Trade Educational Research Foundation, the SHFE, Hong Kong Baptist University and the Journal of Futures Markets. The Group sent a representative to the Organisation of Economic Cooperation and Development's November Asian Roundtable on Corporate Governance in Tokyo for the formal presentation of the White Paper on Corporate Governance in Asia. The head of our Clearing Business Unit chaired the June CCP 12 Meeting organised by 12 clearing organisations from Asia, Europe and the Americas, and we participated in the Seventh Conference of Central Securities Depositories, also in June. Both clearing events were in Europe.

Exchange Participants

At the end of the year, there were 499 Stock Exchange Participants and 129 Futures Exchange Participants. In addition, there were 33 holders of Stock Exchange Trading Rights and 65 holders of Futures Exchange Trading Rights which were not Exchange Participants.

Since 6 March 2002, HKEx has been able to issue new Stock Exchange Trading Rights for no less than \$3 million each and Futures Exchange Trading Rights for no less than \$1.5 million each, but no new trading rights were issued last year. Commencing from 6 March this year, new trading rights can be issued without any price restrictions.

We streamlined our regulatory requirements for Exchange Participants with measures that took effect on 1 April and 25 August. The changes included the abolition of some fees and the standardisation of several other fees.

Websites

There was increasing use of our websites. There were 14,846,887 visits to the HKEx website and the linked GEM website, compared with 9,200,520 in 2002. Page views increased to 170,381,920 from 97,938,829 in 2002.

We further strengthened the websites. In addition to more content, we introduced upgraded versions of the Disclosure of Interests (DI) sections of the HKEx and GEM websites on 1 April to cater for the new DI regime which took effect the same day. They included a new electronic submission channel. HKEx operates electronic filing systems for the submission of completed DI forms and publishes disclosure information on its websites in accordance with the requirements of the SFC. We also added a new section to the HKEx website for the posting of responses to our consultation papers. Anonymity is granted to respondents upon request.

This year, we will introduce a revamped version of the HKEx website. Our aim is to provide better information services in a cost-effective manner. The current structure, design and functionality of the website will be improved based on users' comments. In addition to a new look and a more user-

Review of Operations

friendly navigation structure, there will be functional upgrades, including the introduction of an update alert service for selected web content with high utilisation rates and irregular updates. There will also be tools for the dynamic conversion of web content from traditional to simplified Chinese characters and a more advanced search function.

Investor Education & Community Support

We raised more than \$13.1 million for the Community Chest through balloting of special stock codes for new listed companies on the Main Board and GEM. In addition, the staff contributed to the Community Chest by participating in Dress Casual Day.

We continued to provide a wide range of public education programmes. HKEx organised 21 investor seminars and participated in events arranged by local and international professional bodies. We joined Hong Kong's Information Infrastructure Expo, we were one of the five supporting organisations for the Professional Diploma in Corporate Governance and Directorship programme that ran from early June to the end of August, and we sponsored the 3rd Hong Kong Investment Competition organised by the Hong Kong Institute of Investors. As in years past, we arranged briefings on our operations for teachers from Hong Kong's secondary schools, business students, journalists, and other important visitors. We also continued to support public access to market information by donating hard and/or soft copy versions of issuer

annual reports, circulars and HKEx publications to public and university libraries.

Recent Development

The Government has raised the possibility of HKEx contributing to the funding of an independent investigation board for the accounting profession. The Board will discuss the details when they are available.

Office Consolidation

We completed further consolidation of our offices at the beginning of this year to reduce our leased space. As a result, we were able to surrender portions of leased premises at two locations to the landlords. The space surrendered comprised nearly 13,000 square feet.

Staff

Our human resources policies are aimed at aligning individual, unit and Group objectives. Incentives have been established and good performance is rewarded. The Board approved performance rewards for 2003 and most employees received a bonus.

People are one of our most important assets so we are committed to further developing the collective skills of our staff. During the year, we arranged 49 in-house training courses and seminars and 77 external sessions. These included programmes on products, customer service, presentation skills, language, information technology and market development. We also continued to sponsor staff members who are pursuing academic and professional qualifications to further develop their careers.

Internal communication has been strengthened through the introduction of monthly executive forums on operations and quarterly presentations on our business strategy, our performance and other issues. In addition, there is a new Intranet web page, “My Community”, where we post Staff Social Club news and other in-house information for our staff.

The Staff Social Club organised a variety of activities during the year. They included the annual staff dinner party, visits to Hong Kong’s outlying islands and Spring Fun Day. Club-sponsored teams competed against other organisations in basketball and soccer tournaments, and the club arranged for HKEx to participate in Boundabout 2003, where teams played games to raise funds for Outward Bound Hong Kong’s outreach programme for young people with financial or social difficulties.

Our achievements last year would not have been possible without the hard work and dedication of our staff. I thank them for their contributions, and I am confident that their efforts will ensure more success in the years ahead.

The Board of Directors continued to provide excellent leadership in 2003. I thank the members for their guidance and support.

CHOW Man Yiu, Paul
Director and Chief Executive

26 February 2004



Senior Management

Patrick Conroy
Chief Operating Officer



Lawrence Fok
Deputy Chief Operating Officer



Karen Lee
Chief Financial Officer



Richard Williams
Head - Listing



Stewart Shing
Head - Clearing



Mary Kao
Head - Legal and Secretarial Services



Senior Management



Stephen Law
Head - IT/Systems



Roger Lee
Head - E-Business and
Information Services



Matthew Harrison
Head - Research and Planning



Coven Hui
Head - Internal Audit



Henry Law
Head - Corporate Communications



Joseph Mau
Company Secretary



Brenda Yen
Head - Human Resources



Management Discussion and Analysis

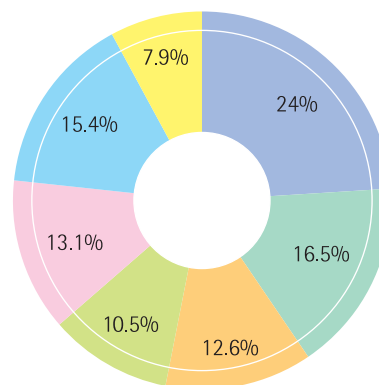
(Financial figures are expressed in Hong Kong dollars)

OVERALL PERFORMANCE

The Group recorded a profit attributable to shareholders of \$692 million for the year (2003 first quarter: \$89 million; 2003 second quarter: \$125 million; 2003 third quarter: \$190 million; 2003 fourth quarter: \$288 million), compared with \$588 million for 2002 (2002 first quarter: \$118 million; 2002 second quarter: \$171 million; 2002 third quarter: \$138 million; 2002 fourth quarter: \$161 million). The 18 per cent or \$103 million increase in profit was mainly attributable to the increase in cash and derivatives market activities in the latter half of the year, which has caused an increase in revenue from trading fees and trading tariff, and clearing and settlement fees.

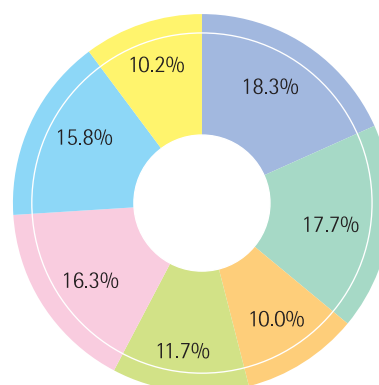
Total operating expenses increased by \$57 million or 5 per cent to \$1,222 million (2002: \$1,165 million), primarily attributable to one-off costs incurred in 2003 second quarter that are not expected to recur in the coming few years. The one-off costs included a write-down of strategic investments (\$33 million), retirement of redundant IT systems (\$10 million), and severance costs (\$9 million) following the review of the Group's business strategy and operations in May 2003. After taking into account tax deduction available, the one-off costs reduced the Group's profit by \$51 million in 2003. Moreover, there was a one-off increase in deferred tax charge of \$6 million in 2003 following the implementation of the new Hong Kong Statement of Standard Accounting Practice (SSAP) 12: Income Taxes, which became effective on 1 January 2003.

Analysis of 2003 Income



- Trading fees and trading tariff
- Stock Exchange listing fees
- Clearing and settlement fees
- Depository, custody and nominee services fees
- Income from sale of information
- Investment income
- Other income

Analysis of 2002 Income



- Trading fees and trading tariff
- Stock Exchange listing fees
- Clearing and settlement fees
- Depository, custody and nominee services fees
- Income from sale of information
- Investment income
- Other income

Management Discussion and Analysis

Had the above-mentioned one-off costs (\$51 million after tax) and deferred tax charge (\$6 million) not been incurred, after-tax profit attributable to shareholders for the year would have been \$749 million, which would be \$161 million or 27 per cent higher than that in 2002.

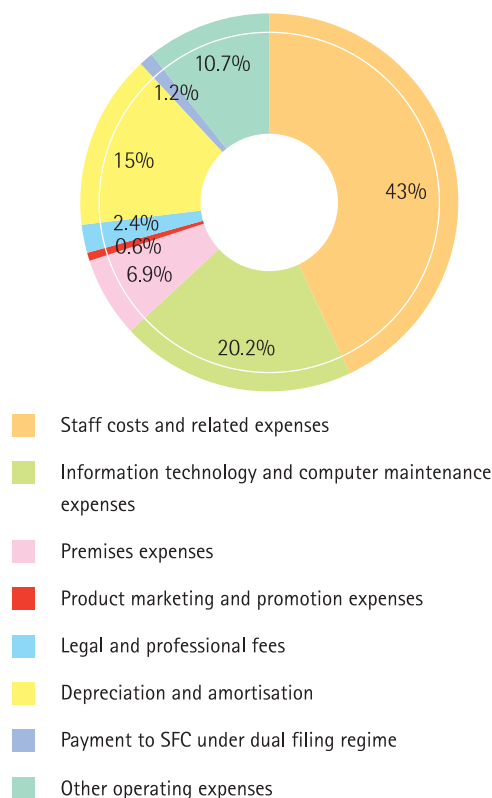
Income

Total income (including share of profits less losses of associated companies) for the year increased by \$213 million or 12 per cent to \$2,027 million (2002: \$1,814 million).

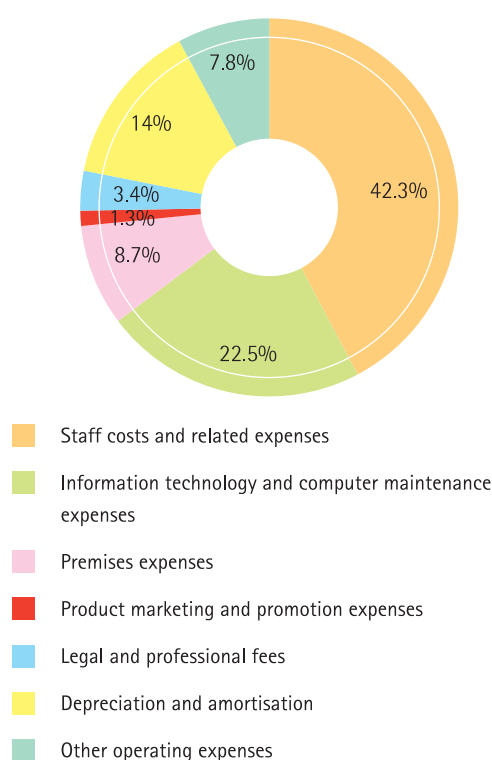
Bolstered by improved investor sentiment, the cash market rebounded distinctly in the second half of the year, after the setback caused by the Severe Acute Respiratory Syndrome in the second quarter. Average daily turnover on The Stock Exchange of Hong Kong Limited (Stock Exchange) for the year increased by 55 per cent to \$10.4 billion, compared with \$6.7 billion in 2002. Average daily number of stock options contracts traded on the Stock Exchange increased by 13 per cent in 2003 compared with that in 2002. Average daily number of derivatives contracts traded on Hong Kong Futures Exchange Limited (Futures Exchange) increased by 39 per cent, mainly on account of an increase in the trading of Hang Seng Index (HSI) Futures contracts. Consequently, income from trading fees and trading tariff rose by \$153 million or 46 per cent to \$485 million (2002: \$332 million).

Listing fee income rose by \$14 million or 4 per cent to \$334 million (2002: \$320 million), largely because of an increase in initial listing fees, and a rise in annual listing

Analysis of 2003 Expenses



Analysis of 2002 Expenses



Management Discussion and Analysis

fees due to a higher number of listed securities. The increase in initial listing fees was primarily as a result of higher number of initial public offerings (IPOs) processed. Although the number of new listings fell compared with 2002, the reduction in initial listing fees from new listings was more than offset by initial listing fees forfeited due to increased numbers of lapsed and withdrawn IPO applications and approved IPOs not listed within six months of application. A total of 46 (2002: 60) new companies joined the Main Board and 27 (2002: 57) the Growth Enterprise Market (GEM) during the year. As at 31 December 2003, 3 Main Board and 5 GEM (31 December 2002: 13 Main Board and 7 GEM) IPO applications had obtained approval in principle from the Listing Committee for listing, and 19 Main Board and 32 GEM applications were under processing (31 December 2002: 35 Main Board and 72 GEM). As at 31 December 2003, there were 852 companies listed on the Main Board and 185 on GEM (31 December 2002: 812 and 166 respectively).

In line with the increase in cash market activities, clearing and settlement fee income increased by \$74 million or 41 per cent to \$255 million (2002: \$181 million).

Depository, custody and nominee services fee income only increased by \$1 million or 0.1 per cent to \$212 million (2002: \$211 million) as higher fees from electronic IPOs and dividend/interest collection were offset by lower stock custody fees, which was partly due to stock consolidation undertaken by issuers in 2003.

Income from sale of information declined by \$30 million or 10 per cent to \$264 million (2002: \$294 million), due to the consolidation of broking firms and lower demand for stock information. However, demand for information started to pick up in the second half of 2003 as the market became more buoyant.

Investment income comprises income from investments supervised by the Treasury Division, investment in Singapore Exchange Limited and accommodation income on securities deposited by Participants as alternatives to cash deposits of the margin funds. Total investment income for the Group increased by 9 per cent or \$26 million to \$311 million (2002: \$285 million).

For investments supervised by the Treasury Division, income for the year amounted to \$293 million, 5 per cent or \$15 million higher than the \$278 million reported for last year. The increase was due to higher net realised gain at \$35 million (2002: loss of \$14 million), net unrealised mark-to-market gain at \$43 million (2002: \$33 million) on the investment portfolio, and dividends at \$4 million (2002: \$3 million), but partly offset by lower net interest income at \$211 million (2002: \$256 million) due to lower interest rates. As the valuation of the investments in bonds and equities reflects movements in their market prices, unrealised gains or losses may fluctuate or reverse unless the investments are sold.

During the two years under review, the average 6-month Hong Kong Exchange Fund Bill rate dropped from 1.70 per cent in 2002

Management Discussion and Analysis

to 0.84 per cent in 2003, and the average 90-day US Treasury Bill rate declined from 1.62 per cent to 1.02 per cent.

For the year ended 31 December 2003, the Group achieved a positive return on investments of 2.76 per cent (2002: 3.10 per cent). The Corporate Funds returned 4.25 per cent (2002: 3.92 per cent), the margin funds 1.55 per cent (2002: 2.10 per cent), and the Clearing House Funds 1.56 per cent (2002: 2.60 per cent). Therefore, the overall portfolio recorded a spread of 192 basis points above the 6-month Hong Kong Exchange Fund Bill yield (2002: 140 basis points) with the Corporate Funds registering a spread of 341 basis points (2002: 222 basis points), the margin funds 71 basis points (2002: 40 basis points), and the Clearing House Funds 72 basis points (2002: 90 basis points) above the 6-month Hong Kong Exchange Fund Bill yield.

The average amount of funds available for investment increased by \$1.5 billion or 17 per cent to \$10.6 billion (2002: \$9.1 billion), mainly due to a rise in margin funds received from Clearing Participants as a result of increased trading in futures and options contracts. As at 31 December 2003, 59 per cent (2002: 44 per cent) of the funds were invested in cash or bank deposits, 39 per cent (2002: 55 per cent) in investment-grade bonds with an average credit rating of Aa2, and 2 per cent (2002: 1 per cent) in global equities. For more details of the investment portfolios supervised by the Treasury Division, please refer to the section on Treasury in Review of Operations.

Income from investment in Singapore Exchange Limited increased by 924 per cent or \$12 million to \$13 million (dividend of \$14 million less interest expense of \$1 million for funding the investment) in 2003 from \$1 million (dividend of \$2 million less interest expense of \$1 million) in 2002, mainly attributable to a special dividend of \$12 million received during the year. Accommodation income (i.e., retention interest charged on securities deposited by Participants as alternatives to cash deposits of the margin funds) dropped by 8 per cent or \$1 million to \$5 million (2002: \$6 million).

Other income decreased by \$26 million or 14 per cent to \$159 million (2002: \$185 million), mainly due to a \$7 million reduction in brokerage on direct IPO applications from \$19 million in 2002 to \$12 million in 2003, and a \$17 million decrease in share registration services fees following the disposal in May 2002 of the Group's share registration operations, Hong Kong Registrars Limited, in return for an 18 per cent shareholding in an associated company, Computershare Hong Kong Investor Services Limited (CHIS). The Group's share of CHIS's profit is included under Share of Profits Less Losses of Associated Companies in the Consolidated Profit and Loss Account.

Operating Expenses

Total operating expenses increased by \$57 million or 5 per cent to \$1,222 million (2002: \$1,165 million), primarily as a result of \$52 million of one-off costs incurred in 2003 second quarter that are not expected to recur in the near future.

Management Discussion and Analysis

Staff costs and related expenses increased by \$33 million or 7 per cent to \$526 million (2002: \$493 million), largely due to higher severance costs of \$12 million (of which \$9 million was one-off costs incurred following the reorganisation and streamlining of the Group's operations in May 2003), and the payment of performance bonus of \$15 million (2002: \$Nil) due to improved performance of the Group.

Information technology and computer maintenance expenses fell by \$16 million or 6 per cent from \$263 million in 2002 to \$247 million in 2003, mainly attributable to lower hardware and software rental but partly offset by expenditures relating to the maintenance of the upgraded Central Clearing and Settlement System (CCASS/3) rolled out in May 2002.

Premises expenses fell by \$17 million or 17 per cent to \$84 million (2002: \$101 million) as lower rental was negotiated upon the renewal of certain leases.

Legal and professional fees decreased by \$11 million or 27 per cent to \$29 million (2002: \$40 million), primarily as a result of professional fees incurred for several one-off consulting projects in 2002.

Depreciation and amortisation costs increased by \$20 million or 12 per cent to \$183 million (2002: \$163 million), mainly due to the additional depreciation charge arising from the roll-out of CCASS/3 in May 2002.

Payment to the Securities and Futures Commission (SFC) under the dual filing regime started from 1 April 2003 and amounted to \$15 million (2002: \$Nil).

Other operating expenses rose by \$40 million or 44 per cent to \$131 million (2002: \$91 million), mainly attributable to one-off items not expected to recur in the near future, which included the write-down of a 100 per cent (\$32.3 million) of the Group's investment in BondsInAsia Limited and \$0.4 million of investment in ADP Wilco Processing Services Limited, and the retirement of redundant IT systems (\$10 million) following the review of the Group's business strategy and operations in May 2003.

The Group's taxation charge rose by \$53 million or 86 per cent to \$114 million (2002: \$61 million), mainly on account of an increase in net profit and Hong Kong Profits Tax rate from 16 per cent to 17.5 per cent announced in the March 2003 Hong Kong Budget (\$34 million), the tax charge on non-deductible expenses including part of the one-off costs mentioned above (\$6 million) and an increase of \$7 million due to prior year taxation (prior year underprovision of \$1 million booked as a charge in 2003 compared with prior year overprovision of \$6 million reversed as a credit in 2002). In addition, there was a one-off increase in deferred tax charge of \$6 million as, under the new SSAP 12: Income Taxes, effective from 1 January 2003, outstanding deferred tax liabilities brought forward from 2002

Management Discussion and Analysis

(calculated at the 16 per cent tax rate in 2002) have to be recomputed in 2003 by using the higher rate of 17.5 per cent.

Liquidity, Financial Resources, Gearing and Capital Commitments

Working capital increased by \$256 million or 6 per cent to \$4,463 million as at 31 December 2003 (2002: \$4,207 million), mainly due to current year profit retained. Bank balances and time deposits of corporate funds increased by \$793 million or 80 per cent to \$1,778 million (2002: \$985 million).

Although the Group has consistently been in a very liquid position, banking facilities have nevertheless been put in place for contingency purposes. As at 31 December 2003, the Group's total available credit facilities amounted to \$2,764 million (2002: \$2,763 million), of which \$1,500 million were repurchase facilities to augment the liquidity of the margin funds and \$1,100 million were for meeting the Group's Continuous Net Settlement money obligations of Hong Kong Securities Clearing Company Limited (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 2003, the only facility drawn down was a fixed rate bank loan of SGD11 million (equivalent to HK\$50 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 Exchange Limited (2002: SGD11 million, equivalent to HK\$49 million).

As at 31 December 2003, 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 (2002: less than 1 per cent).

The Group's capital expenditure commitments, largely in respect of its ongoing investments in facilities and technology, amounted to \$91 million as at 31 December 2003 (2002: \$94 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 2003, 98 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

The Group did not have any charges on assets as at 31 December 2003 and 31 December 2002.

Significant Investments Held and Material Acquisitions and Disposals of Subsidiaries

The Group has been holding 1 per cent of the issued ordinary share capital of Singapore

Management Discussion and Analysis

Exchange Limited since November 2000 (cost: \$49.1 million; and market value: \$77.2 million), 14.47 per cent of the issued ordinary share capital of BondsInAsia Limited since April 2002 (cost: \$32.3 million; and book value: \$Nil), and 24 per cent of Computershare Hong Kong Investor Services Limited (cost: \$26.5 million; and book value: \$32.6 million) and 30 per cent of ADP Wilco Processing Services Limited since May 2002 (cost: \$1.8 million; and book value: \$1.4 million).

During the year, the Group has written down 100 per cent (\$32.3 million) of the value of its investment in BondsInAsia Limited, and 21 per cent (\$0.4 million) of investment in ADP Wilco Processing Services Limited to the Group's share of the net assets of this associated company due to impairment.

There were no material acquisitions or disposals of investments and subsidiaries during the year.

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 2003, aggregate net open foreign currency positions amounted to HK\$1,663 million, of which HK\$204 million were non-USD exposures (2002: HK\$1,924 million, of which HK\$200

million were non-USD exposures). The Group's foreign currency liabilities, mainly in the form of margin deposits or collateral received, are hedged by investments in the same currencies.

Contingent Liabilities

The Compensation Fund is a fund set up under the repealed 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 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 2003, there were outstanding claims received in respect of 13 defaulted Stock Exchange Participants (2002: 14).

Pursuant to the Securities and Futures Ordinance (SFO), the Stock Exchange issued a notice on 3 April 2003 inviting for claims

Management Discussion and Analysis

against the Compensation Fund in relation to any default of a Stock Exchange Participant occurring before 1 April 2003. The claims period expired on 3 October 2003 and no claims had been received in response to that notice. Claims made after the claims period shall, unless the Stock Exchange otherwise determines, be barred. As at 31 December 2003, no such claims had been received.

Under the new compensation arrangements implemented under the SFO, a new Investor Compensation Fund has replaced 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. In accordance with the provisions of the SFO, deposits to the Commodity Exchange Compensation Fund had been returned to the Futures Exchange by the SFC in January 2004. The Futures Exchange had in turn reimbursed holders of Futures Exchange Trading Rights their contributions to the Commodity Exchange Compensation Fund. Existing deposits to the Unified Exchange Compensation Fund would be returned to the Stock Exchange in accordance with the provisions of the SFO. There is no 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 437 trading Participants as at 31 December 2003 (2002: 471) default, the maximum contingent liability of the Stock Exchange under the indemnity will amount to \$87 million (2002: \$94 million).

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 CCASS Participants default on their payment obligations. As at 31 December 2003 and 31 December 2002, 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 2003, SGD11million (equivalent to HK\$50 million) of the facility was drawn

Management Discussion and Analysis

down (2002: SGD11 million, equivalent to HK\$49 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 the Chief Executive and employees of the Group to subscribe for shares in HKEx in accordance with the terms and conditions of the Share Option Scheme 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 fell from 1,052 (including 88 temporary staff) prior to the merger to 803 (including 38 temporary staff) as at 31 December 2003. Total employees' cost increased by \$33 million or 7 per cent from \$493 million in 2002 to \$526 million in 2003, mainly due to higher severance costs of \$12 million (of which \$9 million were one-off costs incurred following the reorganisation and streamlining of the Group's operations in May 2003), and the payment of performance bonus due to improved performance of the Group.

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 activity on the Stock Exchange and Futures Exchange, and movements in interest rates. The recent increases in trading activities in the cash and derivatives markets suggest that investor confidence has rebounded significantly. The external environment is likely to be influenced by low interest rate levels, Mainland China's rapid economic growth, and movements in the currency markets. In this climate, investment funds will likely continue to be drawn to equities. The inflow of international funds will continue to bring about a favourable environment for the listing of major enterprises, in particular those from the Mainland. These factors suggest a more promising outlook for Hong Kong's financial market.

The Expert Group appointed by the Government to review the operation of the securities and futures market regulatory structure recommended on 21 March 2003 various market reform measures, including the transfer of the listing function on a bottom-line neutral basis from the Group to the SFC. In light of this, the Government issued a consultation paper to seek public views on enhancing listing regulations on 3 October 2003. HKEx submitted its views in January 2004. HKEx supports the proposal to expand the existing dual filing system as they would benefit the market and require

Management Discussion and Analysis

minimal changes. HKEx will further improve the listing regulatory structure based on the outcome of the Government's review, and continue to work closely with the Government and the SFC on measures to raise the quality of Hong Kong's financial markets.

HKEx will continue to exercise control over its costs vigilantly, and to develop new financial products and services to meet investor needs. It will seek to further raise the quality and efficiency of its markets to increase their competitiveness. Continued investments in market infrastructure will be made to ensure that it remains robust and reliable. HKEx will also encourage more fund-raising activities on the Stock Exchange and strengthen its position among the world's equity markets.

Mainland related activities have buoyed and exerted a dynamic impact on the size and trading volume of Hong Kong's equities market. The rapid economic development and continued market reform of China could lead to an increasing number of financially important and large-scale state and other

enterprises seeking listings in Hong Kong. The Closer Economic Partnership Arrangement (CEPA) between the Mainland and Hong Kong will provide opportunities for HKEx to further develop its Mainland business. The official establishment of HKEx's Beijing Representative Office in November 2003 will enable HKEx to better promote its services to mainland enterprises. We are looking into stationing staff in other Mainland cities including Shanghai and Guangzhou. HKEx will focus its marketing efforts in Mainland China, and expand its business network in the Mainland through promotional and educational activities. HKEx will continue to develop China-related products and enhance listing services to Mainland issuers in order to attract more major, high quality Mainland enterprises to list in Hong Kong. HKEx will further explore possible business co-operation with the Mainland exchanges.

HKEx will strive to maintain an open, secure, fair, orderly and transparent marketplace contributing to Hong Kong's status as an international financial centre and premier capital market for China.



Report of the Directors

(Financial figures are expressed in Hong Kong dollars)

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 2003.

PRINCIPAL ACTIVITIES

HKEx is the recognised exchange controller under the Securities and Futures Ordinance (SFO). 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 (Stock Exchange) and Hong Kong Futures Exchange Limited (Futures Exchange) are recognised exchange companies under the SFO to operate and maintain a stock market and futures market in Hong Kong respectively. HKSCC, SEOCH and HKCC are the recognised clearing houses for the purposes of the SFO.

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 2003 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 pages 85 and 86.

An interim dividend of \$0.18 per share, amounting to a total of about \$188 million, was paid to shareholders during the year.

The Board recommends the payment of a final dividend of \$0.42 per share to shareholders on the register of members on 31 March 2004, which together with the interim dividend payment amounts to a total of about \$629 million, and the retention of the remaining profit for the year.

The Board has carried out a review of the Group's policy regarding its cash funds, which are made up largely of liquid funds required in connection with our clearing businesses but also include substantial retained earnings. The review has taken into account the changed economic environment, the Group's strategy and our medium-term capital and risk management requirements. Following this review, the Board has recommended, in addition to the dividend referred to above, a special dividend of \$1.68 per share (2002: Nil) to shareholders on the register of members on 31 March 2004 amounting to about \$1,762 million.

The share register will be closed from Friday, 26 March 2004 to Wednesday, 31 March 2004, both dates inclusive, during which period, no transfer of shares will be registered. Dividend warrants will be despatched to shareholders on or about Wednesday, 14 April 2004. In order to qualify for the final and the special dividends, 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 Thursday, 25 March 2004.

RESERVES

The distributable reserves of HKEx as at 31 December 2003, calculated under section 79B of the Companies Ordinance, amounted to \$3,377 million (2002: \$3,554 million).

The movements in reserves of the Group and HKEx during the year are set out from notes 27 to 29 and 31 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 14 to the accounts.

SHARE CAPITAL

Details of the share capital during the year are set out in note 26 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.
- (ii) Based on the Pre-Listing options granted, the total number of shares available for issue is 13,715,626 which represents 1.31 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.

Report of the Directors

(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.

Details of share options outstanding as at 31 December 2003 under the Pre-Listing Scheme were as follows:

	Date of grant	Exercise price	No. of shares				Exercise period
			issuable as at 1 January 2003	issued during the year ended 31 December 2003	lapsed during the year ended 31 December 2003	issuable as at 31 December 2003	
Aggregate total for employees (note 1)	20 June 2000	\$7.52	23,253,020	5,418,000 (note 2)	3,663,394 (note 3)	14,171,626	6 March 2002 - 30 May 2010 (note 4)

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. 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 74,760,858 which represents 7.1 per cent of the existing issued share capital of HKEx at the date of this report.

Report of the Directors

- (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.
- (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 grant 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.

Report of the Directors

Details of the share options outstanding as at 31 December 2003 under the Post-Listing Scheme were as follows:

Date of grant	Exercise price	No. of shares issuable under the option granted	Option value	No. of shares issuable under the option granted as at 31 December 2003	Exercise period
Director (note 5)					
2 May 2003	\$9.05 (note 6)	3,000,000	\$8,010,000 (note 9a)	—	2 May 2005 - 1 May 2013 (note 10)
Employees (note 1)					
14 August 2003	\$13.60 (note 7)	1,000,000	4,560,000 (note 9b)	—	14 August 2005 - 13 August 2013 (note 11)
18 August 2003	\$13.65 (note 8)	1,800,000	8,226,000 (note 9c)	—	18 August 2005 - 17 August 2013 (note 12)

Notes:

1. Employees working under employment contracts that were regarded as “continuous contracts” for the purpose of the Employment Ordinance of Hong Kong.
2. The weighted average closing price immediately before the dates on which the options were exercised was \$11.53.
3. Options lapsed in accordance with the terms of the Pre-Listing Scheme due to resignation of employees.
4. Options granted are exercisable between 6 March 2002 and 30 May 2010, in tranches of 25 per cent each reaching 100 per cent as from 6 March 2005.
5. The option was granted to Mr Chow Man Yiu, Paul, a Director and the Chief Executive of HKEx.
6. The closing price immediately before the date on which the option was granted was \$9.10.
7. The closing price immediately before the date on which the option was granted was \$13.95.
8. The closing price immediately before the date on which the option was granted was \$13.35.

Report of the Directors

9. According to the Binomial Option Pricing Model, the value of the options granted during the period under review were as follows:

(a) 2 May 2003

The value of the option was estimated at \$8,010,000 with the following variables and assumptions:

- Risk Free Rate 4.3%, being the yield of 10-year Exchange Fund Note as at 30 April 2003.
- Expected Volatility 36%, being the annualised volatility of the closing price of the shares in HKEx from 3 May 2002 to 2 May 2003.
- Expiration date of the option 10 years from 2 May 2003.
- Expected Dividend 5.6%, being the 2003 prospective dividend yield of the shares as at 2 May 2003.
- Assumption No material difference between the expected volatility over the whole life of the options and the historical volatility of the shares in HKEx over the period from 3 May 2002 to 2 May 2003 is assumed.

(b) 14 August 2003

The value of the option was estimated at \$4,560,000 with the following variables and assumptions:

- Risk Free Rate 4.84%, being the yield of 10-year Exchange Fund Note as at 14 August 2003.
- Expected Volatility 36%, being the annualised volatility of the closing price of the shares in HKEx from 15 August 2002 to 14 August 2003.
- Expiration date of the option 10 years from 14 August 2003.
- Expected Dividend 4.49%, being the 2003 prospective dividend yield of the shares as at 14 August 2003.
- Assumption No material difference between the expected volatility over the whole life of the options and the historical volatility of the shares in HKEx over the period from 15 August 2002 to 14 August 2003 is assumed.

(c) 18 August 2003

The value of the option was estimated at \$8,226,000 with the following variables and assumptions:

- Risk Free Rate 4.76%, being the yield of 10-year Exchange Fund Note as at 18 August 2003.
- Expected Volatility 36%, being the annualised volatility of the closing price of the shares in HKEx from 19 August 2002 to 18 August 2003.
- Expiration date of the option 10 years from 18 August 2003.
- Expected Dividend 4.47%, being the 2003 prospective dividend yield of the shares as at 18 August 2003.
- Assumption No material difference between the expected volatility over the whole life of the options and the historical volatility of the shares in HKEx over the period from 19 August 2002 to 18 August 2003 is assumed.

The Binomial Option Pricing Model is developed to estimate the fair value of American style options. It is one of the commonly used models to estimate the fair value of an option which can be exercised before the expiry of the option period. The value of an option varies with different variables of certain subjective assumptions. Any change in variables so adopted may materially affect the estimation of the fair value of an option.

No option granted during the period under review has lapsed.

10. Option granted is exercisable between 2 May 2005 to 1 May 2013, in tranches of 25 per cent each reaching 100 per cent as from 2 May 2008.
11. Option granted is exercisable between 14 August 2005 to 13 August 2013, in tranches of 25 per cent each reaching 100 per cent as from 14 August 2008.
12. Option granted is exercisable between 18 August 2005 to 17 August 2013, in tranches of 25 per cent each reaching 100 per cent as from 18 August 2008.

Report of the Directors

SUBSIDIARIES

Particulars of HKEx's subsidiaries, as at 31 December 2003 are set out in note 25 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 9 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

CHOW Man Yiu, Paul (joined on 1 May 2003)

KWONG Ki Chi (retired on 15 April 2003)

Non-executive Directors

CHAN Cho Chak, John

(retired on 15 April 2003)

FAN Chor Ho, Paul (retired on 15 April 2003)

FAN Hung Ling, Henry

(appointment effective on 15 November 2003)

FONG Hup

(appointment effective on 16 April 2003)

FRESHWATER, Timothy George

KWOK Chi Piu, Bill

LEE Jor Hung, Dannis

LEE Kwan Ho, Vincent Marshall

LEONG Ka Chai

LIU Jinbao (resigned on 28 May 2003)

LO Ka Shui

SETO Gin Chung, John

(retired on 15 April 2003)

STRICKLAND, John Estmond

(retired on 15 April 2003 as a Public Interest

Director and appointed by the Board

on 16 April 2003)

WARD, Rodney Gordon

(retired on 15 April 2003)

WEBB, David Michael

(elected on 15 April 2003)

WONG Sai Hung, Oscar

(elected on 15 April 2003)

YUE Wai Keung (retired on 15 April 2003)

As at 31 December 2003, the Board consisted of thirteen Directors. Messrs Lee Yeh Kwong, Charles, Fan Hung Ling, Henry, Fong Hup, Timothy George Freshwater, Leong Ka Chai, and Lo Ka Shui were appointed by the Financial Secretary of the Hong Kong Special Administrative Region (HKSAR) in the interest of the investing public or in the public interest (Public Interest Directors). Mr Fan Hung Ling, Henry was appointed by the Financial Secretary of the HKSAR on 15 November 2003 to fill the vacancy left by the resignation of Dr Liu Jinbao. Messrs Kwok Chi Piu, Bill, Lee Jor Hung, Dannis, Lee Kwan Ho, Vincent Marshall, David Michael Webb and Wong Sai Hung, Oscar,

were elected by shareholders at the annual general meeting held on 15 April 2003 (2003 AGM). Since only five Directors were elected by shareholders to fill six available vacancies at the 2003 AGM, the Board of HKEx had on 16 April 2003, in accordance with Article 92, appointed Mr John Estmond Strickland, to fill the casual vacancy and his term of office shall expire at the conclusion of the forthcoming annual general meeting to be held on 31 March 2004 (AGM). 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.

According to Article 93(1) and (2), at every annual general meeting after the 2003 AGM, one-third of the Directors who are subject to retirement by rotation or, if their number is not three or a multiple of three, then the number nearest to but not exceeding one-third of the Directors shall retire from office. The Public Interest Directors and the Chief Executive are not subject to retirement by rotation. Mr John Estmond Strickland, who was appointed under Article 92 to hold office until the AGM, is also not subject to retirement by rotation. Article 93(3) further provides that the Directors to retire by rotation on each occasion shall be those who have been longest in office since their last appointment or reappointment, but as between persons who became or were last reappointed Directors on the same day, those to retire shall (unless they otherwise agree among themselves) be determined by drawing lots. Article 93(5) provides

that a retiring Director is eligible for reappointment. Mr John Estmond Strickland, being a Director appointed by the Board after the 2003 AGM, will hold office only until the AGM in accordance with Article 92. In addition to Mr Strickland, one of the five Elected Directors elected by shareholders of HKEx on 15 April 2003, who are subject to retirement by rotation, shall retire at the AGM. The five Elected Directors are Messrs Kwok Chi Piu, Bill, Lee Jor Hung, Dannis, Lee Kwan Ho, Vincent Marshall, David Michael Webb and Wong Sai Hung, Oscar. Pursuant to Article 93(3), lots have been drawn and Mr Wong Sai Hung, Oscar shall retire at the conclusion of the AGM. Both Messrs John Estmond Strickland and Wong Sai Hung, Oscar are eligible for reappointment. Shareholders are invited to elect up to two Elected Directors at the AGM to fill the vacancies available due to retirement of the two said Directors. Details of the proposed candidates standing for election are set out in the circular sent together with this annual report.

The Securities and Futures Commission (SFC) had, on 4 August 2003 and 9 February 2004, 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 67, 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

Report of the Directors

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 was until 2003 a member of the Equal Opportunities Commission of Hong Kong, Chairman of the Council of the Open University of Hong Kong and a member of the Court of the Hong Kong Polytechnic University. He is currently a member of the Council of the Hong Kong University of Science and Technology, and the Vice-Patron of the Community Chest. He is 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

CHOW Man Yiu, Paul, JP, aged 57, was appointed the Chief Executive of HKEx on 1 May 2003. In this capacity, Mr Chow is also an ex-officio member of the board of HKEx and chairman and director of various subsidiaries of HKEx. Before he joined HKEx, Mr Chow was the chief executive, Asia Pacific ex-Japan Region, of HSBC Asset Management

(Hong Kong) Limited for 6 years from April 1997 to April 2003. From November 1991 to January 1997, Mr Chow was the chief executive of the Stock Exchange and before then, he was the chief executive of Hong Kong Securities Clearing Company Limited for 2 years. Mr Chow holds various Government committee and community appointments, inter alia, a member of the Information Infrastructure Advisory Committee of the Government of Hong Kong Special Administrative Region, the Advisory Committee of the Securities and Futures Commission, the Corporate Advisory Council of the Hong Kong Securities Institute, and the Standing Committee on Company Law Reform, and a director of Cyberport Management Limited, Investor Compensation Company Limited, and the Community Chest of Hong Kong. He has also been a director of World Federation of Exchanges since 1 May 2003. Mr Chow holds a Bachelor of Science degree in Mechanical Engineering, a Diploma in Management Studies and an MBA degree from the University of Hong Kong, and a Diploma in Finance (Distinction) from the Chinese University of Hong Kong. Mr Chow is a Fellow of the Hong Kong Computer Society and the Hong Kong Management Association. Mr Chow has over 33 years of business and management experience, and has worked in a number of industries, including information technology, securities, banking and fund management.

(c) Non-executive Directors

FAN Hung Ling, Henry, SBS, JP, aged 55, was appointed a Non-executive Director of HKEx on 15 November 2003. Mr Fan is the Managing Director of CITIC Pacific Limited,

Report of the Directors

a Deputy Chairman of Cathay Pacific Airways Limited, and a Director and Chairman of the executive committee of Hong Kong Dragon Airlines Limited. Mr Fan also serves on various public bodies. He is a Deputy Chairman of the Takeovers and Mergers Panel of the Securities and Futures Commission, a member of the Standing Committee on Judicial Salaries and Conditions of Service, a Director of the Hong Kong Science and Technology Parks Corporation and the Treasurer and Chairman of the Finance Committee of the University of Hong Kong. In addition, he is a member of the Zhejiang Province Committee of the Chinese People's Political Consultative Conference, the Hong Kong-United States Business Council and a Racing Steward of the Hong Kong Jockey Club. He graduated from the University of Hong Kong in 1969 with an honours degree in Economics and Business Management and holds a Bachelor of Laws degree from the University of Beijing. He was called to the Bar by Lincoln's Inn, England and subsequently admitted to the Bar in Hong Kong where he practised as a barrister. He is also an Attorney and Counselor at Law in the State of California, U.S.A.

FONG Hup, aged 59, has been a Non-executive Director of HKEx since 16 April 2003. Mr Fong is the Senior Advisor of Deloitte Touche Tohmatsu. Prior to that, he was a senior partner of Kwan Wong Tan & Fong and a senior assurance and advisory partner of Deloitte Touche Tohmatsu. Mr Fong is a fellow of both the Institute of Chartered Accountants in England & Wales and the Hong Kong Society of Accountants and holds a Bachelor degree in Business

Administration from Boston University. Mr Fong is currently a member of the Process Review Panel for the Securities and Futures Commission, a member of the Securities and Futures Appeals Tribunal, and a member of the Supervisory Committee of the Tracker Fund of Hong Kong. Mr Fong was formerly a member of the Council and a member of the Listing Committee of the Stock Exchange. He was also a former director of each of Hong Kong Securities Clearing Company Limited and The SEHK Options Clearing House Limited. Mr Fong has over 30 years of experience in the accounting profession as well as in the securities industry.

FRESHWATER, Timothy George, aged 59, 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 of the Hong Kong Securities and Futures Appeals Panel from 1999 to 2004. 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

Report of the Directors

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 35 years of experience in the securities industry.

KWOK Chi Piu, Bill, aged 51, has been a Non-executive Director of HKEx since 3 April 2000. Dr Kwok is the Managing Director of Wocom Holdings Limited, a director of Wing On International Holdings Limited, Wing On Company International Limited and the Investor Compensation Company Limited. He is a member of the Government's Advisory Committee on Human Resources Development in the Financial Services Sector, the Panel of the Securities and Futures Appeals Tribunal and the Professional Advisory Board of the Asian Institute of International Financial Law at the University of Hong Kong. He was a director of the Hong Kong Securities Institute from 1997 to 2003 and the Chairman from 1999 to 2001. He was also a director of the Futures Exchange from 1991 to 2000 and a Vice Chairman from 1997 to 2000. 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 over 20 years of experience in the securities and futures industry.

LEE Jor Hung, Dannis, BBS, aged 49, 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 director of the Hong Kong Securities Institute and a member of the Securities and Futures Appeals Panel. 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 over 20 years of experience in the securities industry.

LEE Kwan Ho, Vincent Marshall, aged 48, 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), a Vice Chairman of the Institute of Securities Dealers Limited and a Panel Member of the Securities and Futures Appeals Tribunal. 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

Report of the Directors

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.

LEONG Ka Chai, JP, aged 54, has been a Non-executive Director of HKEx since 3 April 2000. Mr Leong is a dealing director of Roctec Securities Company Limited and Roctec Futures Trading Company Limited, and an investment adviser of Roctec Investment Limited. He was a director of the Futures Exchange from 1989 to 2000 and the Chairman of the Futures Exchange from 1992 to 1995. Mr Leong has been appointed as a member of the Shanghai Stock Exchange Index Advisory Committee in 2003. Mr Leong was also a member of the Advisory Committee of the Securities and Futures Commission from 1989 to 2000, and a member of the Shareholders Group of the Securities and Futures Commission from 2001 to 2002. Mr Leong has involved in various community services. He was a member of the Professional Education Committee of the Hong Kong Securities Institute from 1989 to 2002. He was the Chairman of the Advisory Committee of City University's Department of Finance and

Economics from 1995 to 1999 and an Advisory Committee member of the Baptist's University's Department of Finance from 1996 to 1997. Mr Leong has been a member of the Finance Committee of the Queen Elizabeth Foundation for the Mentally Handicapped since 1999. He has been an honorary member of the Hong Kong Association of Financial Advisors since 1995. Mr Leong has over 20 years of experience in the securities and derivatives industry.

LO Ka Shui, GBS, JP, aged 57, 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 was the Chairman of the GEM Listing Committee from 1999 to 2003 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 a Vice President of The Real Estate Developers Association of Hong Kong, a trustee of the Hong Kong Centre for Economic Research, a member of the Council of Advisors on Innovation and Technology and a member of the Airport Authority. He was a past chairman of the Hospital Authority. 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

STRICKLAND, John Estmond, GBS, JP, aged 64, has been a Non-executive Director of HKEx since 3 April 2000. Mr Strickland graduated from Jesus College, Cambridge University with a degree in Physics. He spent most of his working career with HSBC in Hong Kong, being responsible for the HSBC Group's IT from 1971 to 1995. From 1996 to 1998 he was chairman of The Hongkong and Shanghai Banking Corporation Limited, which has responsibility for HSBC's operations in Asia Pacific. Presently he is chairman of Hong Kong Cyberport Management Co Ltd, a director of the Airport Authority Hong Kong and Esquel Holdings Inc. He is a member of the Council of The University of Hong Kong, President of the Outward Bound Trust, and a member of the boards of the Community Chest, the Boys and Girls Clubs Association, the Youth Hostel Association, the Salvation Army Advisory Board, the Antiquities Advisory Board, the Hong Kong Adventure Corps, the China Exploration and Research Society, the Asia Society and the ICAC Operations Review Committee. He has honorary doctorates awarded by City University of Hong Kong and The Hong Kong Polytechnic University. He has honorary fellowships awarded by The Hong Kong Computer Society, the Hong Kong Institute of Bankers, the Hong Kong Management Association and The University of Hong Kong.

WEBB, David Michael, aged 38, is the Editor of Webb-site.com, a non-profit publication he established in 1998 to promote better corporate and economic governance in Hong Kong. He has published wide-ranging articles on the regulatory framework of Hong Kong's

securities markets. He is a member of the Shareholders Sub-Committee of the Standing Committee on Company Law Reform, the SFC's Takeovers and Mergers Panel, the Takeover Appeals Committee and the SFC Shareholders Group. Mr Webb has over 17 years' experience of the securities markets, including five years as a corporate financier in London before moving in 1991 to Hong Kong. From 1993 to 1994, he was a director of BZW Asia Limited, and from 1994 to 1998, he was a director of Wheelock Capital Limited, both of which were registered investment advisers. In 2000, he was named by Business Week magazine as a "Star of Asia" in the "Opinion Shapers" category. In 2001 the World Economic Forum named him a "Global Leader for Tomorrow". In 2002 CFO Magazine named him one of the "Global 100" who shape finance. He gained an honours degree in Mathematics from Oxford University in 1986 and prior to that was a best-selling author of games and books for the first generation of home computers. He is a full member of the Hong Kong Securities Institute and was Chairman of Hong Kong Mensa from 1998-2000.

WONG Sai Hung, Oscar, aged 48, has been the Chief Executive Officer of BOCI-Prudential Asset Management Limited since 1 January 2001. Mr Wong was the Regional Managing Director of Prudential Portfolio Managers Asia from 1999 to 2000. From 1977 to October 1998, Mr Wong was working with LGT Asset Management Limited, a company which became a subsidiary of AMVESCAP, the parent of INVESCO in June 1998. During his first 10 years with LGT in Hong Kong, Mr Wong

was involved in managing equity portfolios with investments in the Japanese and other Asia Pacific markets. From 1987 to 1990, Mr Wong was seconded to run an investment management joint venture in Taipei and assisted in starting of other similar investment management joint ventures of LGT in Thailand, Indonesia and the Mainland China. From 1994 to 1997, Mr Wong was responsible for LGT's mutual fund marketing operations in Canada, a business which he helped to establish in 1994. Mr Wong was the Deputy Managing Director of LGT from 1990 to 1994 and became the head of its Asian operations in January 1998. From June to October 1998, Mr Wong was the Deputy Chief Executive of INVESCO Asia Limited. Mr Wong studied business at Hong Kong Polytechnic University and was one of its first Marketing graduates in 1977. Mr Wong has over 26 years of experience in the fund management industry.

Senior Management

CONROY, Patrick Kevin, aged 51, is the Chief Operating Officer of HKEx and Chief Executive of the Futures Exchange. He is also a director of various subsidiaries of HKEx. He joined HKEx on 18 August 2003. As the company's Chief Operating Officer, he oversees all business units of HKEx and serves as Chairman of the IT Working Group. Prior to joining HKEx he was the Director of the Financial Sector Development and Global Partnership Departments of the International Bank for Reconstruction and Development (the World Bank). Before joining the World Bank, Mr Conroy was an advisor for special projects at the Australian Stock Exchange (ASX), where his responsibilities included

assistance in the development and implementation of strategic policies such as the open interface project and ASX's demutualisation. Mr Conroy is also a former senior director of the supervision of markets division at the SFC and held other executive positions in market supervision, research and policy during his tenure with the SFC from May 1991 to January 1997. Prior to joining the SFC, Mr Conroy was the chief legal officer, corporate business ventures of the Chicago Stock Exchange, where he had worked since January 1982. Mr Conroy holds a Bachelor of Arts degree in English Literature from DePaul University in the US and a Juris Doctor degree from The John Marshall School of Law in the US.

FOK Kwong Man, Lawrence, aged 54, 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 22 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

Report of the Directors

Administration degree from Columbia University, and a Master of Arts (Economics) degree and a Master of Science (Statistics) degree from Stanford University.

KAO May Loy, Mary, aged 54, is the Head of Legal and Secretarial Services Unit of HKEx. Ms Kao joined the Stock Exchange in July 1990. She holds a LL.B. degree from the University of Hong Kong, a B.C.L. degree from the University of Oxford, England, a diploma in Chinese Law, University of East Asia, Macau. She is a barrister of the Supreme Court of England & Wales and of Hong Kong as well as a barrister and solicitor of the Australian Capital Territory. She has about 30 years' legal experience in the financial services industry, including insurance, securities, banking and derivatives. She also has significant experience in corporate regulatory matters.

LEE Kit Ying, Karen, aged 55, is the Chief Financial Officer of HKEx. Ms Lee has about 18 years experience in the securities and derivatives industry holding various senior executive positions, including about 10 years in the Compliance, Operation and Administration Divisions of the Futures Exchange, 5 years in the Traded Options Division of the Stock Exchange and 3 years in the Listing, Regulation and Risk Management Unit of HKEx. Ms Lee is a fellow member of the Institute of Chartered Accountants in England & Wales and an associate member of the Hong Kong Society of Accountants. She holds a Bachelor of Arts (Hons) in Accountancy degree from City of London Polytechnic in UK and a Master of Science in Financial Engineering degree from City University in Hong Kong.

SHING Shin Cheung, Stewart, aged 56, is the Head of the Clearing Business Unit of HKEx and Chief Executive of HKSCC. He joined HKEx on 15 December 2003. Mr Shing has more than 30 years of securities operations and business management experience. He has worked in several major international and local financial institutions where he has been responsible for planning and development, securities operations, system development and auditing. Before he joined HKEx, Mr Shing was the executive director and chief executive of South China Brokerage Company Limited from February 2001 to November 2003. Mr Shing became chief executive of HKSCC in October 1996. He subsequently became the first head of HKEx's clearing business unit and served in both positions until October 2000. Mr Shing joined HKSCC in April 1991 as director of planning and development, responsible for the development of CCASS, the Central Clearing and Settlement System, and was appointed deputy chief executive in November 1991. Mr Shing, who started his career in 1970 working in audit, is a fellow member of the Hong Kong Society of Accountants and has served as a member of working groups for various regulatory bodies and stockbroking associations in Hong Kong. From September 2002 to November 2003, Mr Shing represented South China Brokerage Company Limited in his role as the chairman of The Hong Kong Association of Online Brokers. He was also a founding member of the Asia-Pacific Central Securities Depository Group and was admitted to the Board of the International Securities Services Association in 1999. Mr Shing holds a Master of Business Administration degree from the University of New South Wales, Australia.

WILLIAMS, Richard George, aged 41, is the Head of Listing of HKEx. He became HKEx's Head of Listing and secretary to the Main Board and Growth Enterprise Market listing committees in June 2003, following the restructuring of Listing, Regulation and Risk Management (LRRM). He joined HKEx as Senior Vice President in October 2002 and headed LRRM's Listing Division before taking up his current post. A chartered accountant with extensive capital markets experience, Mr Williams was head of Listing Policy and Compliance at the Financial Services Authority in the UK between 2000 and 2002. He has also served as head of Listing Policy at the London Stock Exchange (LSE). His most recent UK role involved participation in the policy development work of the Committee of European Securities Regulators under the European Financial Services Action Plan. Before moving to the LSE, Mr Williams was with PricewaterhouseCoopers.

Company Secretary

MAU Kam Shing, Joseph, aged 45, is the Company Secretary of HKEx and its group of companies. Mr Mau is a Fellow Member of The Hong Kong Institute of Company Secretaries, The Institute of Chartered Secretaries and Administrators, 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' AND CHIEF EXECUTIVE'S INTERESTS AND SHORT POSITIONS

The Directors' and Chief Executive's interests and short positions are set out in the Corporate Governance report on pages 66 and 67.

DISCLOSABLE INTERESTS AND SHORT POSITIONS OF SHAREHOLDERS UNDER THE SFO

As at 31 December 2003, J.P. Morgan Chase & Co and its associates were holding 52,667,254 shares of HKEx, representing approximately 5.02 per cent of the issued share capital of HKEx as recorded in the register required to be kept by HKEx under Section 336 of the SFO, of which 989,724 shares were held by J.P. Morgan Chase & Co and its associates as beneficial owner, 322,000 shares as investment manager, and 51,355,530 shares as an approved lending agent pursuant to the Securities and Futures (Disclosure of Interests – Securities Borrowing and Lending) Rules.

Apart from the aforesaid, no other party has an interest or a short position in the issued share capital of HKEx, as recorded in the register required to be kept by HKEx under Section 336 of the SFO.

MINORITY CONTROLLER

Under the SFO, 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 recognized exchange controller, except with the approval in writing of the SFC after consultation with the Financial Secretary of the HKSAR.

The SFC has so far granted approval to five entities to be Minority Controllers of HKEx, on the basis that the shares are held by them in custody for their clients.

As at 31 December 2003, the Minority Controllers were in aggregate holding 57.6 per cent of the issued share capital of HKEx (31 December 2002: 48.2 per cent).

Report of the Directors

TOP TEN SHAREHOLDERS

The respective holdings by the top ten shareholders that appeared on the Register of Members of HKEx as at 31 December 2003 were:

Name	Number of shares	% of holding
HKSCC Nominees Ltd	896,151,000	85.43
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	0.38
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 2003 is set out in Corporate Information Section on page 11.

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 2003. 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 2003.

PURCHASE, SALE OR REDEMPTION OF HKEx'S LISTED SECURITIES

During the year ended 31 December 2003, HKEx had not redeemed and neither HKEx nor any of its subsidiaries had purchased or sold any of HKEx's listed securities.

PROVIDENT FUND SCHEMES

Particulars of the provident fund schemes of the Group are set out in note 11 to the accounts.

AUDITORS

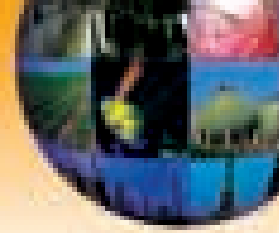
The accounts have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for reappointment at the 2004 AGM.

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

26 February 2004

Corporate Governance

(Financial figures are expressed in Hong Kong dollars)



Corporate Governance Statement

HKEx is the recognised Exchange Controller, and has the duty under the Securities and Futures Ordinance (SFO) to ensure an orderly, informed and fair market or arrangements for the trading, clearing, and settlement of securities or futures contracts on or through the Stock Exchange or the Futures Exchange which are wholly-owned subsidiaries of HKEx (The SFO, effective from 1 April 2003, repealed ten ordinances governing financial products, the securities and futures market, and protection of investors, inter alia the Exchanges and Clearing Houses (Merger) Ordinance which governed the operation of HKEx).

Due to the unique business nature, the political importance of HKEx to Hong Kong as an international finance centre, and being a listed company on the Main Board of the Stock Exchange, the Board is committed to achieving high standards of corporate governance practices. The Board believes that high standards and appropriately rigorous corporate governance practices are essential for HKEx to enhance its accountability and transparency, and achieve a balance of the interests of the public and the interests of its stakeholders, inter alia, shareholders, Exchange Participants, customers, employees, creditors, and the Government.

As the recognised Exchange Controller, HKEx accepts that it has a leadership role in setting and articulating corporate governance standards in Hong Kong. A consultation paper on proposed amendments to the Listing Rules in relation to corporate governance issues was issued in January

2002, and the amendments to the Listing Rules and the draft Code on Corporate Governance Practices were released at the end of January 2004. Although the general level of corporate governance practice in Hong Kong is at the forefront of the global economies, continuous refinement of corporate governance practices is critical to Hong Kong as a key member in the international finance market.

HKEx has fully complied with the Code of Best Practice, as set out in Appendix 14 of the Listing Rules throughout the year of 2003.

Achievements

HKEx is the first listed company in Hong Kong to have an assessment of its corporate governance standard by an independent third party since 2000. Standard & Poor's (S&P) had, after the third annual evaluation, reaffirmed the same score of 8.3 out of a possible score of 10 to HKEx for 2003, which it had assigned to HKEx in 2001 and 2002. Although S&P's scoring standards have further been tightened in accordance with the evolving standards of corporate governance in international markets, the consistent high score demonstrates HKEx's continued efforts in building upon its already strong corporate governance practices.

In 2003, HKEx was awarded the Diamond Award in the Non-Hang Seng Index Stock Category in the Best Corporate Governance Award organised by the Hong Kong Society of Accountants; ranked the leader in corporate governance of the "Diversified Financials" sector at the Asiamoney Corporate Governance Poll 2003; and

Corporate Governance

recommended for an Honourable Mention of the Best Annual Reports Awards organised by The Hong Kong Management Association for the second consecutive year.

Conflict Management

In discharging its obligations as the recognised Exchange Controller, HKEx has to act in the interests of the public, having particular regard to the interests of the investing public, and ensure that where the interests of the public conflict with any other interests, the former shall prevail.

A Memorandum of Understanding (MOU) had thus been entered into between HKEx, the Stock Exchange, and the Securities and Futures Commission (SFC) in regard to the listing of HKEx's shares on the Stock Exchange. A specific chapter, Chapter 38, was added to the Listing Rules for governing HKEx, as a listed company. The MOU provides that the SFC is the regulator of HKEx, and shall take all actions and make all decisions in relation to HKEx as a listed company that would normally be taken by the Stock Exchange in the case of other listed companies, including but not limited to the suspension or removal from, listing on the Stock Exchange, and the application for waivers in complying with the Listing Rules.

In addition, HKEx is required, under the MOU, to use its best endeavours to ensure that whenever a conflict or potential conflict of interest exists, the subject matter would be referred to a Conflict Committee comprising the Chief Executive, the Chief Operating Officer, and the Chief Executive of the Stock Exchange for consideration. If the Conflict Committee determines that

a conflict or potential conflict of interest does or may arise, the case would be referred to the SFC's representatives who would consider if the regulatory function could be discharged without its intervention. Any disagreement between the Conflict Committee and the SFC's representatives will be referred to the SFC for resolution.

As noted by S&P in its annual corporate governance evaluation, there is no evidence, to date, that the results of the Group have been adversely affected through placing the public interests ahead of shareholders' interests where the public interests and the financial interests of shareholders might diverge.

Organisational Structure

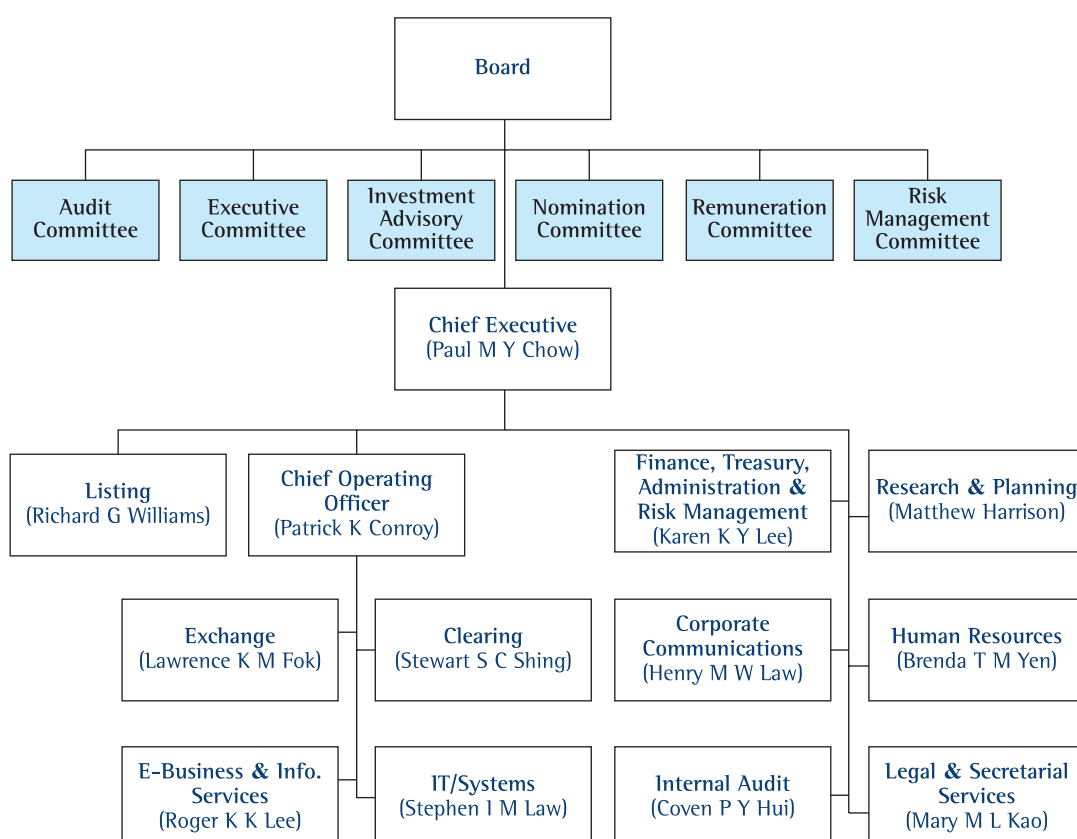
HKEx's organisational structure is clearly defined by establishing business units and functional units for which individual unit heads are responsible. Unit heads who in respect of their business / functional unit responsibilities, report either to the Chief Executive or the Chief Operating Officer, and have authority for management of their respective units.

A Management Committee comprising the Chief Executive, the Chief Operating Officer and all unit heads, meets on a monthly basis to review and make recommendations to the Executive Committee and to the Board on strategic plan, annual operating plan, annual budget, enterprise balanced scorecard, significant business proposals, and general management and internal development issues, inter alia, culture change, unit coordination, and staff training.

The Chief Executive and the Chief Operating Officer are appointed by the Board subject to approval by the SFC. The Board is able to remove the Chief Executive or the Chief Operating Officer, and the SFC may also

remove them on grounds of public interests, the interests of the investing public or the proper regulation of markets in securities and futures contracts after consultation with the Chairman and the Financial Secretary of the HKSAR (Financial Secretary).

The organisational structure as at 31 December 2003 is as follows:



Corporate Governance

The Board

Composition and appointment

Pursuant to the SFO, the number of Directors to be appointed by the Financial Secretary (Public Interest Directors) immediately after the annual general meeting held in 2003 shall not be more than the number of Directors elected by shareholders (Elected Directors). As at 31 December 2003, the Board comprised twelve Non-executive Directors, plus the Chief Executive who is an *ex-officio* member of the Board. Among the twelve Non-executive Directors, six of them are Public Interest Directors, and the rest are Elected Directors. Given the nature of HKEx's statutory objectives, and the complexity and breadth of the financial markets in which it operates, the wide range of business, financial, fund management, and securities trading experience of the Non-executive Directors provides an appropriate balance of public interests and stakeholders' interests. The list of Directors and their respective biographies are set out on pages 50 to 57 respectively.

Independence

After the reconstitution of the Board in April 2003, the SFC had re-affirmed that the twelve Non-executive Directors are all independent directors, including Mr Henry H L Fan who was appointed in November 2003 to fill the casual vacancy arisen after the resignation of Dr Liu Jinbao. The Chairman is an independent Non-executive Director, and his appointment was recommended by the Board, and approved by the Chief Executive of the HKSAR. The roles of the Chairman and the Chief Executive are distinct and

separate with a clear division of responsibilities.

Functions

The Board oversees HKEx's strategic development, and determines the objectives, strategies and policies of the Group. The Board also monitors and controls operating and financial performance and sets appropriate policies to manage risks in pursuit of the Group's strategic objectives. The Board has delegated the implementation of strategies, and day-to-day operation of HKEx to the Chief Executive. The Board has separate and independent access to the senior management for making enquiries on management information.

The Board meets regularly, normally once a month, and additional meetings would be arranged, if and when required. The Company Secretary is responsible for providing detailed papers to be circulated normally four days in advance of Board meetings with the aim of ensuring that Directors are able to make informed decisions on matters put before them. 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. Orientations are also organised for providing induction to new Directors.

The Board is supported by six committees and three advisory panels, each of them 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 Board and the committees may retain outside advisors at HKEx's expense, as they deem necessary. Individual Directors may also retain outside advisors, at HKEx's expense, to provide advice on any matter. The list of members of the various committees are set out in the "Corporate Information" section on page 8.

Guidelines on Conduct

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. The Board has, at all time fully complied with the statutory and Listing Rules requirements governing disclosure of interests, the dealing in securities, connected transactions, and meeting procedures and practices.

Retirement

None of the Public Interest Directors and the Chief Executive shall whilst holding office as such be subject to retirement by rotation or be taken into account in determining the number of Directors to retire at each annual general meeting after the annual general meeting in 2003. At every annual general meeting subsequent to that in 2003, one-third of the Directors subject to retirement by rotation or, if their number is not three or a multiple of three, then the number nearest to but not exceeding one-third shall retire and are eligible for re-election. The Directors to retire by rotation shall be those who have been longest in office since their last

appointment or re-appointment or those who were appointed by the Board during the year to fill casual vacancy. However, as between persons who became or were last re-appointed on the same day, those to retire shall be determined by drawing of lots (unless they otherwise agree among themselves).

Mr John E Strickland, a Director appointed by the Board to fill a casual vacancy after the 2003 annual general meeting shall retire at the conclusion of the 2004 annual general meeting to be held in March 2004, and Mr Oscar S H Wong, one of the five Elected Directors subject to retirement by rotation shall also retire at the conclusion of the 2004 annual general meeting, as determined by the draw of lots. Both Mr John E Strickland and Mr Oscar S H Wong are eligible for re-appointment.

Remuneration and Indemnification

Shareholders had, at the annual general meeting held on 15 April 2003, approved the Remuneration Committee's recommendation of remunerating Non-executive Directors. The approved remuneration of \$100,000 serves as a recognition of the time and effort contributed by Non-executive Directors to HKEx, and is payable in proportion to the period of service during the period from the conclusion of the 2003 general meeting to the conclusion of the next annual general meeting. The remuneration of the Chief Executive is approved by the Non-executive, independent Directors of the Board. The remuneration, excluding share option benefit, of every Director, including the Chief Executive who is an *ex-officio* member for the year ended 31 December 2003 is set out in Note 9 to the accounts.

Corporate Governance

Pursuant to Article 155 of the Articles of Association, every Director and every member of a committee appointed by the Board shall be entitled to be indemnified, subject to the provision of the Companies Ordinance, by HKEx against all costs, charges, losses, expenses and liabilities incurred by him in the execution and discharge of his duties or in relation thereto. A Directors' and Officers' Liabilities insurance has been arranged for that purpose.

Directors' and Chief Executive's Interests and Short Positions

As at 31 December 2003, the Directors, the Chief Executive and their respective associates had the following interests in the shares and underlying shares of HKEx, as recorded in the register maintained by HKEx pursuant to Section 352 of the SFO:

(i) Shares

Name of Director	Number of shares held			Total
	Personal Interests	Family Interests	Corporate Interests	
Dannis J H Lee	—	—	1,610,000 (note 1)	1,610,000
David M Webb	2 (note 2)	2 (note 3)	6 (note 4)	10
John E Strickland	18,000 (note 5)	—	—	18,000

Notes:

- 1,610,000 shares were owned by DL Brokerage Limited, a private company beneficially wholly owned by Mr Dannis J H Lee, representing approximately 0.15 per cent of the issued share capital of HKEx.
- The shares held by Mr David M Webb as beneficial owner represent approximately 0.00 per cent of the issued share capital of HKEx.
- The shares were owned by the spouse of Mr David M Webb, representing approximately 0.00 per cent of the issued share capital of HKEx.
- The shares were owned by Fundamental Consultants Limited, Member One Limited and Member Two Limited which are under the control of Mr David M Webb, representing approximately 0.00 per cent of the issued share capital of HKEx.
- The shares held by Mr John E Strickland as beneficial owner represent approximately 0.00 per cent of the issued share capital of HKEx.

(ii) Underlying Shares

As at 31 December 2003, the outstanding number of shares issuable under a share option granted pursuant to the Post-Listing Share Option Scheme to Mr Paul M Y Chow, a Director and the Chief Executive of HKEx, was 3,000,000 (2002: Nil), which represents approximately 0.29 per cent of the issued share capital of HKEx. The said option was granted on 2 May 2003, and is exercisable between 2 May 2005 and 1 May 2013 at an exercise price of \$9.05 per share.

During 2003, Mr K C Kwong exercised his option granted under the Pre-Listing Share Option Scheme in June 2000 (for the subscription of 1,454,126 shares at HK\$7.52 each) to subscribe for 362,000 shares at an exercise price of \$7.52 per share (2002: 362,000 shares were subscribed at HK\$7.52). The share option granted to Mr K C Kwong was cancelled, and the remaining shares issuable under the said option (730,126 shares) were forfeited upon his retirement on 15 April 2003.

Other than the holdings disclosed above, no interests and short positions were held or deemed or taken to be held under Part XV of the SFO by any Director or Chief Executive of HKEx or their respective associates in the shares, underlying shares and debentures of HKEx or any of its associated corporations (within the meaning of Part XV of the SFO) which were required to be notified to HKEx and the Stock Exchange pursuant to Part XV of the SFO

or pursuant to the Model Code for Securities Transactions by Directors of Listed Companies or which are required pursuant to Section 352 of the SFO to be entered in the register referred to therein. Nor any of the Directors and the Chief Executive (including their spouses and children under the age of 18) had, as at 31 December 2003, any interest in, or had been granted any right to subscribe for the securities and options of HKEx and its associated corporations within the meaning of the SFO, 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.

Connected Transactions

During the year ended 31 December 2003, the Group had the following connected transactions, details of which are set out below -

- (A) For the year ended 31 December 2003, 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

Corporate Governance

(ii) all services offered by HKEx or its subsidiaries which are ancillary, incidental or otherwise related to the foregoing:

- (1) Mr Paul C H Fan, a former Director of HKEx, was interested in the transactions entered into by Compu-Chart Investment Adviser Limited and Paul Fan Securities Limited, Exchange Participants in which Mr Fan has a 99.99 per cent interest.
- (2) Mr Dannis J H Lee, 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 K C Leong, 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 former 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 2003, 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 Dannis J H Lee, a Director of HKEx, was interested in the Buy-in Transactions entered into by DL Brokerage Limited beneficially wholly owned by Mr Lee. For the year ended 31 December 2003, the total consideration of such transactions, which were transacted on normal commercial terms was \$1,250,838.80.
- (2) Mr Paul C H Fan, a former Director of HKEx, was interested in the Buy-in 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 2003, the total consideration of such transactions, which were transacted on normal commercial terms was \$20,901,129.58.

- (3) Mr Yue Wai Keung, a former Director of HKEx, was interested in the Buy-in 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 2003, the total consideration of such transactions, which were transacted on normal commercial terms was \$2,602,328.75.

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 external 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 applicable facilities, services or goods provided by, or to, the Group and where the rules and regulations do not govern the transaction in full, are 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.

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Attendance

Attendance at Board meetings during 2003 is set out below:

Board member	Attendance at meetings	
Charles Y K Lee (Chairman)	15/15	
John C C Chan	6/6	Retired on 15 April 2003
Paul M Y Chow	8/8	Appointed on 1 May 2003
Henry H L Fan	1/1	Appointed on 15 November 2003
Paul C H Fan	6/6	Retired on 15 April 2003
Fong Hup	9/9	Appointed on 16 April 2003
Tim Freshwater	14/15	
Bill C P Kwok	15/15	
K C Kwong	5/6	Retired on 15 April 2003
Dannis J H Lee	15/15	
Vincent K H Lee	15/15	
Leong Ka Chai	14/15	
Liu Jinbao	3/8	Resigned on 28 May 2003
Lo Ka Shui	15/15	
John G C Seto	5/6	Retired on 15 April 2003
John E Strickland	13/14	Retired on 15 April 2003 and re-appointed on 16 April 2003
Rodney G Ward	5/6	Retired on 15 April 2003
David M Webb	9/9	Elected on 15 April 2003
Oscar S H Wong	9/9	Elected on 15 April 2003
Yue Wai Keung	5/6	Retired on 15 April 2003

15 meetings were held in 2003, and the average attendance rate at Board meetings is 94 per cent.

Committees and Panels

Executive Committee consists of three Non-executive Directors appointed by the Board, the Chief Executive and the Chief Operating Officer. 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, other than the Listing Rules, and conduct regular reviews of the same, recommend, and advise 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.

Attendance

Attendance at the Executive Committee meetings during 2003 is set out below:

Committee member	Attendance at meetings	
Charles Y K Lee (Chairman)	20/20	
Patrick K Conroy	7/7	Appointed on 18 August 2003
Paul M Y Chow	13/13	Appointed on 1 May 2003
Frederick J Grede	7/10	Resigned on 13 June 2003
K C Kwong	6/6	Retired on 15 April 2003
Dannis J H Lee	14/14	Appointed on 16 April 2003
Leong Ka Chai	18/20	
John G C Seto	5/6	Retired on 15 April 2003

20 meetings were held in 2003, and the average attendance rate at the Executive Committee meetings is 94 per cent.

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 quarterly, interim and the final results of the Group prior to recommending them to the Board for approval, and recommends the 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

Corporate Governance

Committee reviews the appointment of HKEx's external auditors on an annual basis including a review of the audit fees. The Audit Committee also, as a good corporate governance practice, sets restrictions on the employment of HKEx's external auditors for non-audit related activities.

During the year, the fees paid to HKEx's external auditors for non-audit related activities amounted to \$1,372,950 comprising taxation services fees of \$673,750, executive secondment to the Listing Unit of \$600,000, and other miscellaneous item of \$99,200.

Attendance

Attendance at the Audit Committee meetings during 2003 is set out below -

Committee member	Attendance at meetings	
John E Strickland (Chairman)	6/6	
Paul C H Fan	2/2	Retired on 15 April 2003
Henry H L Fan	0/0	Appointed on 10 December 2003
Fong Hup	4/4	Appointed on 16 April 2003
Tim Freshwater	2/2	Term expired on 15 April 2003
Leong Ka Chai	2/2	Term expired on 15 April 2003
Liu Jinbao	1/1	Appointed on 16 April 2003, and resigned on 28 May 2003
Vincent K H Lee	3/4	Appointed on 16 April 2003
David M Webb	3/4	Appointed on 16 April 2003
Yue Wai Keung	1/2	Retired on 15 April 2003

6 meetings were held in 2003, and the average attendance rate of the Audit Committee meetings is 89 per cent.

Investment Advisory Committee consists of three Non-executive Directors and one market professional 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.

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Attendance

Attendance at the Investment Advisory Committee meetings during 2003 is set out below:

Committee member	Attendance at meetings	
Tim Freshwater (Chairman)	4/4	
Peter Clarke	1/1	Resigned on 23 May 2003
John G C Seto	1/1	Retired on 15 April 2003
David Sun	3/4	
Patrick Sun	1/1	Resigned on 16 April 2003
David M Webb	3/3	Appointed on 16 April 2003
Oscar S H Wong	2/3	Appointed on 16 April 2003

4 meetings were held in 2003, and the average attendance rate of the Investment Advisory Committee meetings is 88 per cent.

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 to stand for election by shareholders as Directors, make recommendations to shareholders on 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.

Attendance

Attendance at the Nomination Committee meeting during 2003 is set out below:

Committee member	Attendance at meetings	
Charles Y K Lee (Chairman)	1/1	
Paul C H Fan	1/1	Retired on 15 April 2003
Lo Ka Shui	1/1	
Oscar S H Wong	0/0	Appointed on 16 April 2003

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1 meeting was held in 2003, and the average attendance rate of the Nomination Committee meetings is 100 per cent.

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.

Attendance

Attendance at the Remuneration Committee meetings during 2003 is set out below:

Committee member	Attendance at meetings	
Lo Ka Shui (Chairman)	2/2	Appointed on 16 April 2003
John C C Chan	0/0	Retired on 15 April 2003
Dannis J H Lee	1/2	
Vincent K H Lee	2/2	Appointed on 16 April 2003
Rodney G Ward	0/0	Retired on 15 April 2003

2 meetings were held in 2003, and the average attendance rate of the Remuneration Committee meetings is 83 per cent.

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 65 of the SFO to review and formulate policies on risk management matters relating to the activities of HKEx and the exchanges and clearing houses of which HKEx is the controller, and submit such policies to HKEx for its consideration. The Risk Management Committee is aimed

at identifying, measuring, managing and control risks including legal risks, credit risks, market risks, concentration risks, operational risks, environmental risks, behavioral risks, and systemic risks that may have an impact on the securities and derivatives markets in Hong Kong.

Market-wide rehearsals are conducted periodically in conjunction with a number of Government bureaux, regulatory bodies, inter alia, the SFC, Hong Kong Monetary Authority, and Financial Services and Treasury Bureau as part of ongoing efforts to ensure an efficient response to emergency market events, and effective communications among the parties concerned.

Attendance

Attendance at the Risk Management Committee meetings during 2003 is set out below:

Committee member	Attendance at meetings	
Charles Y K Lee (Chairman)	5/5	
John C C Chan (note)	1/1	Term expired on 6 March 2003
Henry H L Fan	0/0	Appointed on 10 December 2003
Mark Dickens (note)	4/4	Appointed on 6 March 2003
Bill C P Kwok	5/5	
Lam Kin (note)	5/5	
James H Lau (note)	4/4	Appointed on 6 March 2003
Leong Ka Chai (note)	4/4	Appointed on 6 March 2003
Liu Jinbao	1/1	Appointed on 16 April 2003, and resigned on 28 May 2003
Andrew T L Sheng (note)	1/1	Term expired on 6 March 2003
John E Strickland	1/1	Term expired on 6 March 2003
Peter T S Wong (note)	5/5	
Joseph C K Yam (note)	1/1	Term expired on 6 March 2003

Note: Appointed by the Financial Secretary under S65 of the SFO.

5 meetings were held in 2003, and the average attendance rate of the Risk Management Committee meetings is 100 per cent.

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. They act as the sounding boards for policy recommendations, strategic initiatives, and major investments in relation to the three markets. Each panel is consisted of two Non-executive Directors and eight members who are respective market participants or industry experts. Executives are invited to attend the panel meetings. Average attendance rate of the Cash Market Consultative Panel, the Clearing Consultation Panel and the Derivatives Market Consultation Panel meetings is 68 per cent, 86 per cent and 85 per cent respectively.

Corporate Governance

Internal Control

The Board has the ultimate responsibility for the Group's internal control system and, through the Audit Committee, has reviewed the effectiveness of the system. The internal control system, which includes a defined management structure with specified limits of authority, is designed to help the achievement of business objectives, safeguard assets against unauthorised use or disposition, ensure the maintenance of proper accounting records for the provision of reliable financial information for internal use or for publication, and ensure compliance with relevant legislation and regulations. The system is designed to provide reasonable, but not absolute, assurance against material misstatement or loss and to manage rather than eliminate risks of failure in operational systems and achievement of the Group's objectives.

The Group Internal Audit Unit conducts periodic independent reviews of the internal control systems, and on-going projects, and performs information technology related audits and evaluations. The reviews include financial, operational, compliance, and risk management aspects. Findings and recommendations are reported to the Audit Committee. Unit heads would be notified of the deficiencies noted, and the Group Internal Audit Unit would be responsible to oversee the rectification process.

The Group Internal Audit Unit provides objective assurance to the Board that a sound internal control system is maintained and operated by the management in compliance

with agreed processes and standards. 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.

The key procedures that the Board established to provide effective internal controls are as follows:

A distinct organisational structure exists with defined lines of authority and control responsibilities. Units head are involved in preparing the strategic plan which laid down the corporate strategies to be pursued in the next five years for achieving the annual operating plan, the annual operational and financial targets. Both the strategic plan and the annual operating plan laid down the foundation for the preparation of the annual budget by which resources are allocated in accordance with identified and prioritised business opportunities. The enterprise balanced scorecard serves to measure performance against targeted results. Other than the strategic plan which was approved by the Board for a five-year period but subject to annual review, the annual operating plan, the annual budget, and the enterprise balanced scorecard are approved by the Board on an annual basis.

A comprehensive management accounting system is in place providing financial and operational performance measure indicators to the management. Variances against

budgets are analysed, and explained, and appropriate actions are taken, if necessary, to rectify deficiencies noted.

The Board has achieved a significant reduction in capital expenditure and rationalisation of human resources during 2003. A major initiative to control and reduce further expenditure is on-going.

Shareholders

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

Details of Minority Controllers as at 31 December 2003, and analysis of the shareholders' structure are set out on pages 59 and 11 respectively.

HKEx conducts regular dialogue with institutional investors. The Board is committed to providing clear and updated performance information of the Group to all shareholders, as soon as it is available, through the publication of quarterly, interim, and annual reports, which are also made accessible on HKEx's website. In addition to sending circulars, notices, financial reports

to shareholders, a range of other information and services for shareholders is provided on the Investor Relations Corner of the HKEx's website < www.hkex.com.hk > for the purpose of keeping direct communication with shareholders and investors. In addition, the quarterly publication of the magazine "Exchange" serves 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 related financial information. The Chairman had demanded poll voting on all proposed resolutions at the annual general meeting in 2003. Poll voting results were announced at the conclusion of the 2003 annual general meeting, and were also made available on HKEx's website so as to provide shareholders with information regarding the level of support and opposition to each resolution. For the sake of good corporate governance practice, the Chairman intends to demand poll voting at future general meetings for all resolutions set out in the relevant notice of meeting so as to allow shareholders to have one vote for every share held. Minutes of annual general meetings have also been posted on HKEx's website for access by shareholders and other interested parties.

Corporate Governance

Employees' Relationship

Human Resources Planning

Amidst the challenging business environment in 2003, the human resources strategy continues to focus on having the optimum number of employees with the appropriate skill, expertise, and experience to carry out the various functions with the aim of achieving the corporate objectives. As at 31 December 2003, HKEx had a team of 803 employees including 38 temporary staff (2002: 877 employees including 80 temporary staff). The Board has a primary role in ensuring that adequate thought is given to planning for succession to executive director and senior management positions, whilst every Unit Head is required to conduct a thorough review of the operations, structure, and manpower of respective units and furnish an annual manpower plan to be approved by the Board.

Both internal and external sourcing for appropriate candidates would be pursued. Internal transfer or promotion is encouraged before pursuing external recruitment, as it gives employees opportunities to widen their exposures and enables HKEx to deploy employees to areas where they can best contribute to.

Training

Training and development programmes are in place for staff members, which include staff exchange programmes set up with other exchanges, in-house programmes, offering of sponsorship to employees to attend external programmes for pursuing academic and professional qualifications. During 2003, 49 in-house training courses and seminars

had been arranged for the staff covering topics such as customer service, products, information technology, and market development.

HKEx is a recognised institution for providing continuous professional training (CPT). Training sessions are organised for staff of HKEx to update their knowledge and skills while meeting their CPT requirements.

Communication

HKEx believes that effective communication is crucial to foster staff commitment to the Group. Starting from May 2003, the Chief Executive delivers and explains key policies and development of the Group to executives at Monthly Executive Forum, and the Group's quarterly performance to all staff at grade 7 and above at the CEO Quarterly Presentation, where staff are free to raise any questions relating to the Group's activities.

Employee Benefits

HKEx sponsors two staff provident fund schemes which are registered under the Occupational Retirement Schemes Ordinance (ORSO) and have obtained Mandatory Provident Fund (MPF) exemption for all full-time permanent employees. With effect from 1 January 2004, investment choices are built into the schemes, and employees may make up to four investment switches per annum.

In addition, HKEx has participated in a master trust MPF scheme to provide retirement benefits for all temporary employees or those full-time employees who elect not to join the ORSO schemes.

Other benefits include medical insurance, dental insurance, life and personal accident insurance, employees' compensation insurance, and business travel insurance.

Performance Development Process (PDP)

PDP is a systematic approach to maximizing both individual and organisational performance. Performance is defined as a combination of Results (achievement of objectives) and Behaviours (competency development). HKEx uses a "cascading objectives" system which links individual objectives to Unit's objectives, and ultimately to HKEx's strategic objectives. Balanced scorecard is used to specify and measure objectives aiming at having a balanced view of performance.

HKEx's competency model is directly linked to the Group's core values and vision/mission. By linking individual competencies to HKEx core values, employees are focused on the right behaviours which are important for the success of the organisation, and enhanced contribution to the Group.

Individual's performance is evaluated annually through an individual assessment interview between employees and their appraiser. Pre-established performance expectations, and objectives provide a foundation for evaluating performance and determining rewards to employees.

The Group's remuneration policy is subject to review by the Remuneration Committee on an annual basis. The policy is aimed at providing fair and equitable remuneration to employees in relation to responsibility and performance in order to attract, motivate and retain a high-calibre team.

Guidelines on dealings

As the controller of the front-line regulators of the securities and futures markets, HKEx has laid down a code of conduct for securities and derivatives transactions of employees. Employees are required to file declarations with the Head of Human Resources Unit through the employee's Unit Head, the Chief Executive or the Chairman, as the case may be on their investment in securities and derivatives upon joining the Group. Before entering into any securities or derivatives transactions, employees shall seek prior written approval from their respective Unit Head or the Chief Executive, as the case may be. The Chief Executive and his related person who wish to buy or sell securities and derivatives shall obtain the prior written approval of the Chairman. Details of the code of conduct for securities and derivatives transactions are set out in the Human Resources Manual issued to every employee of the Group.

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 in relation to soliciting and accepting advantages have been worked out in consultation with the Independent Commission Against Corruption, and set out in the Human Resources Manual.

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Top Five Paid Employees

The top five paid employees, and the Chief Executive who is an *ex-officio* member of the Board for the year ended 31 December 2003 are:

Chief Executive	Salary HK\$	Performance bonus HK\$	Compensation for loss of office HK\$	Others benefits HK\$ (note 1)	Employer's contribution to provident fund HK\$ (note 2)	Total HK\$
Paul M Y Chow	4,800,000	200,000	–	43,823	600,000	5,643,823

Name of Employee	Salary HK\$	Performance bonus HK\$	Compensation for loss of office HK\$	Others benefits HK\$ (note 1)	Employer's contribution to provident fund HK\$ (note 2)	Total HK\$
Frederick J Grede (note 3)	3,675,000	–	1,575,000	298,954	367,500	5,916,454
Lawrence K M Fok	4,791,690	150,000	–	78,110	598,961	5,618,761
Mary M L Kao	3,420,000	142,500	–	57,004	399,000	4,018,504
Karen K Y Lee	3,300,000	68,750	–	35,849	412,500	3,817,099
Walter A Reisch (note 4)	2,333,360	–	875,010	38,250	291,670	3,538,290

Notes:

- Other benefits include leave pay, relocation and passages allowance, insurance premium, and club membership.
- The employee who retires before normal retirement age is eligible to 18 per cent of the employer's contribution to the provident fund after completion of 2 years of service. The rate of vested benefit increases at an annual increment of 18 per cent thereafter reaching 100 per cent after completion of 7 years of service.
- Mr Frederick J Grede resigned on 13 June 2003.
- Mr Walter A Reisch resigned on 8 August 2003.

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As a result of the new executive appointments during the second half of 2003, and on the assumption of full-year service of existing staff, the remuneration of the Chief Executive and the top five paid employees in 2004 would be as follows:

Chief Executive	Salary HK\$	Other benefits HK\$ (note 1)	Employer's contribution to provident fund HK\$ (note 2)	Total HK\$
Paul M Y Chow	7,200,000	85,379	900,000	8,185,379

Name of Employee	Salary HK\$	Other benefits HK\$ (note 1)	Employer's contribution to provident fund HK\$ (note 2)	Total HK\$
Patrick K Conroy (note 3)	5,460,000	109,857	682,500	6,252,357
Lawrence K M Fok	4,500,000	78,318	562,500	5,140,818
Richard G Williams (note 4)	3,504,000	74,524	438,000	4,016,524
Stewart S C Shing (note 5)	3,504,000	57,788	438,000	3,999,788
Mary M L Kao	3,420,000	58,081	427,500	3,905,581

Notes:

1. Other benefits include leave pay, insurance premium, and club membership.
2. The employee who retires before normal retirement age is eligible to 18 per cent of the employer's contribution to the provident fund after completion of 2 years of service. The rate of vested benefit increases at an annual increment of 18 per cent thereafter reaching 100 per cent after completion of 7 years of service.
3. Mr Patrick K Conroy joined as the Chief Operating Officer on 18 August 2003.
4. Mr Richard G Williams was appointed the Head of Listing on 23 June 2003. Mr Williams is a member of a pension scheme operating in United Kingdom, and he is exempted under Section 4(3) of the Mandatory Provident Fund Schemes Ordinance from participating in HKEx's provident fund scheme. The vesting scale of retirement benefits is not applicable to Mr Williams.
5. Mr Stewart S C Shing joined as the Chief Executive of HKSCC and the Head of the Clearing Business Unit on 15 December 2003.

Corporate Governance

Pre-Listing and Post-Listing Share Option Schemes

Shareholders had, on 31 May 2000, approved two share option schemes, the Pre-Listing Share Option Scheme which governs the grant of share option to eligible employees, including Executive Directors, before 27 June 2000, the date of first listing of HKEx shares,

and the Post-Listing Share Option Scheme which governs the grant of share option after 27 June 2000. Terms and conditions of the Post-Listing Share Option Scheme were amended by shareholders on 17 April 2002 in compliance with changes to the Listing Rules. The key terms of the two schemes can be found on pages 45 to 49.

During 2003, changes to the share options granted to the top five paid employees are as follows:

Name of Employee	Date of grant	Exercise Price HK\$	No. of shares issuable under the option granted	No. of shares subscribed during 2003	No. of shares forfeited during 2003	Exercise Period
Frederick J Grede	20 June 2000	7.52	1,211,079	302,000	607,079 (note)	–
Lawrence K M Fok	20 June 2000	7.52	693,146	–	–	6 March 2002 to 30 May 2010
Mary M L Kao	20 June 2000	7.52	637,248	–	–	6 March 2002 to 30 May 2010
Karen K Y Lee	20 June 2000	7.52	402,472	–	–	6 March 2002 to 30 May 2010
Walter A Reisch	–	–	–	–	–	–

Note: Mr Frederick J Grede exercised his option also in March 2002 to subscribe for 302,000 shares.

A share option was granted to Mr Patrick K Conroy on 18 August 2003 for the subscription of 1,800,000 shares with an exercise price at \$13.65 per share. Exercise period is from 18 August 2005 to 17 August 2013.

A share option was granted to Mr Richard G Williams on 14 August 2003 for the subscription of 1,000,000 shares with an exercise price at \$13.60 per share. Exercise period is from 14 August 2005 to 13 August 2013.

A share option was granted to Mr Stewart S C Shing on 14 January 2004 for the subscription of 1,000,000 shares with an exercise price at \$18.90 per share. Exercise period is from 15 January 2006 to 14 January 2014.

Social Responsibilities

Environment

HKEx is committed to conduct 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 encouraged listed companies to send or make available corporate communications to holders of securities and to the Stock Exchange by electronic means. HKEx has also published press releases and all notices filed with the Stock Exchange on the HKEx's website.

Education and training

HKEx is one of the five supporting organisations for a Professional Diploma in Corporate Governance & Directorship programme that began in early June until the end of August 2003. HKEx and the SFC had sponsored a continuing professional development forum for directors of listed companies organised by the Hong Kong Institute of Directors and the Hong Kong Securities Institute. The forum is designed to help directors of listed companies maintain their standards in a changing business environment.

Other than providing training sessions to internal staff, HKEx, as a recognised institution for providing CPT, also organises CPT sessions to help industry participants enhance their professional expertise. 21 investors seminars were organised in 2003.

Donations

HKEx supports various charitable institutions in Hong Kong through donations and sponsorship. In 2003, HKEx raised \$13.1 million for the Community Chest through balloting of special stock codes for new listed companies on both the Main Board and the GEM.

Changes to the Memorandum and Articles of Association

HKEx had, with the approval of shareholders at the 2003 annual general meeting, and the subsequent approval of the SFC, amended the Memorandum and Articles of Association to cope with changes brought by the SFO which was effective from 1 April 2003. The revised Memorandum and Articles of Association can be found on HKEx's website.

By Order of the Board

Joseph Mau

Company Secretary

26 February 2004



Auditors' Report

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 85 to 153 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 solely to you, as a body, in accordance with section 141 of the Hong Kong Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

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 2003 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, 26 February 2004

Consolidated Financial Statements

CONSOLIDATED PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2003

(Financial figures are expressed in Hong Kong dollars)

	Note	2003 \$'000	As restated 2002 \$'000
INCOME			
Trading fees and trading tariff	3	485,211	331,729
Stock Exchange listing fees	4	333,786	320,033
Clearing and settlement fees		254,907	181,424
Depository, custody and nominee services fees		211,726	211,413
Income from sale of information		264,239	293,735
Investment income	5	311,307	284,984
Other income	6	158,649	184,772
	2	<u>2,019,825</u>	<u>1,808,090</u>
OPERATING EXPENSES			
Staff costs and related expenses	11	525,573	492,549
Information technology and computer maintenance expenses		246,648	262,700
Premises expenses		84,033	101,234
Product marketing and promotion expenses		7,891	14,728
Legal and professional fees		28,873	39,613
Depreciation and amortisation		183,488	163,139
Payment to SFC under dual filing regime		15,000	—
Other operating expenses	7	130,635	90,694
	2	<u>1,222,141</u>	<u>1,164,657</u>
OPERATING PROFIT	2	797,684	643,433
SHARE OF PROFITS LESS LOSSES OF ASSOCIATED COMPANIES	2	7,664	6,141
PROFIT BEFORE TAXATION	2/8	805,348	649,574
TAXATION	2/12(a)	(113,583)	(61,069)
PROFIT ATTRIBUTABLE TO SHAREHOLDERS	2/31	<u>691,765</u>	<u>588,505</u>

Consolidated Financial Statements

CONSOLIDATED PROFIT AND LOSS ACCOUNT (continued) FOR THE YEAR ENDED 31 DECEMBER 2003

(Financial figures are expressed in Hong Kong dollars)

	Note	2003 \$'000	As restated 2002 \$'000
DIVIDENDS		629,263	532,220
SPECIAL DIVIDEND		1,762,318	—
		<u>2,391,581</u>	<u>532,220</u>
Earnings per share	13	<u>\$0.66</u>	<u>\$0.56</u>
Dividends per share			
Interim dividend paid		\$0.18	\$0.08
Final dividend declared		\$0.42	\$0.43
		<u>\$0.60</u>	<u>\$0.51</u>
Dividend payout ratio		<u>91%</u>	<u>91%</u>
SPECIAL DIVIDEND DECLARED PER SHARE		<u>\$1.68</u>	<u>—</u>

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CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2003

(Financial figures are expressed in Hong Kong dollars)

	Note	2003 \$'000	As restated 2002 \$'000
Total equity at 1 Jan, as previously reported		5,496,392	5,235,407
Effect of adopting SSAP 12	1(s)	(6,028)	(2,853)
Total equity at 1 Jan, as restated		5,490,364	5,232,554
Change in valuation of investment property	27	—	(1,500)
Change in valuation of other properties	27	(3,503)	(16,850)
Change in fair value of non-trading securities	27	15,353	14,548
Deferred tax arising from change in valuation of other properties	1(s)/27	(71)	2,696
Deferred tax arising from change in fair value of non-trading securities	1(s)/27	(87)	(1,408)
Net surplus/(deficits) not recognised in the consolidated profit and loss account		11,692	(2,514)
Profit attributable to shareholders	31	691,765	588,505
Realisation of change in fair value of non-trading securities on maturity and disposal	27	4,840	(6,015)
2002/2001 final dividend	31	(448,740)	(260,166)
2003/2002 interim dividend	31	(188,452)	(83,450)
Dividend on shares issued for employee share options exercised after declaration of 2002/2001 final dividend	31	(647)	(448)
Dividend on shares issued for employee share options exercised after declaration of 2003/2002 interim dividend	31	(231)	(30)
Proceeds from issue of shares under employee share option schemes	26	40,744	21,928
Forfeiture of defaulted Clearing Participants' contributions		1,928	—
Total equity at 31 Dec		5,603,263	5,490,364

Consolidated Financial Statements

CONSOLIDATED BALANCE SHEET AT 31 DECEMBER 2003

(Financial figures are expressed in Hong Kong dollars)

	Note	2003 \$'000	As restated 2002 \$'000
NON-CURRENT ASSETS			
Fixed assets	14(a)	585,627	748,108
Investments in associated companies	15	34,002	35,536
Clearing House Funds	16	1,551,330	980,748
Compensation Fund Reserve Account	17	36,859	35,827
Cash and Derivatives Market Development Fund	18	925	914
Non-trading securities	19	77,258	87,604
Other assets		4,814	—
		<u>2,290,815</u>	<u>1,888,737</u>
CURRENT ASSETS			
Margin funds on derivatives contracts	20	7,874,510	4,551,601
Accounts receivable, prepayments and deposits	21(a)	4,644,680	3,118,199
Taxation recoverable		1,558	1,774
Trading securities	22	3,212,998	3,490,046
Bank balances and time deposits		1,777,703	985,114
		<u>17,511,449</u>	<u>12,146,734</u>
CURRENT LIABILITIES			
Bank loans	35(b)(ii)	50,286	49,456
Margin deposits and securities received from			
Clearing Participants on derivatives contracts	20	7,874,510	4,551,601
Accounts payable, accruals and other liabilities	21(b)	4,779,904	3,007,392
Participants' admission fees received	23	4,100	3,350
Deferred revenue		257,068	269,774
Taxation payable		57,370	29,051
Provisions	24(a)	25,011	28,863
		<u>13,048,249</u>	<u>7,939,487</u>
NET CURRENT ASSETS		<u>4,463,200</u>	<u>4,207,247</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>6,754,015</u>	<u>6,095,984</u>

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CONSOLIDATED BALANCE SHEET (continued) AT 31 DECEMBER 2003

(Financial figures are expressed in Hong Kong dollars)

	Note	2003 \$'000	As restated 2002 \$'000
NON-CURRENT LIABILITIES			
Participants' admission fees received	23	84,950	86,800
Participants' contributions to Clearing House Funds	16	984,045	425,440
Deferred tax liabilities	30(a)	58,665	73,281
Provisions	24(a)	23,092	20,099
		<u>1,150,752</u>	<u>605,620</u>
NET ASSETS		<u>5,603,263</u>	<u>5,490,364</u>
CAPITAL AND RESERVES			
Share capital	26	1,048,999	1,043,581
Share premium	26	54,338	19,012
Revaluation reserves	27	46,431	29,899
Designated reserves	28	689,657	727,811
Retained earnings	31	1,560,940	3,221,321
Proposed and declared dividend	31	2,202,898	448,740
SHAREHOLDERS' FUNDS		<u>5,603,263</u>	<u>5,490,364</u>

Approved by the Board of Directors on 26 February 2004

LEE Yeh Kwong, Charles
Director

CHOW Man Yiu, Paul
Director

Consolidated Financial Statements

HONG KONG EXCHANGES AND CLEARING LIMITED (HKEx)

BALANCE SHEET

AT 31 DECEMBER 2003

(Financial figures are expressed in Hong Kong dollars)

	Note	2003 \$'000	As restated 2002 \$'000
NON-CURRENT ASSETS			
Fixed assets	14(b)	36,858	43,598
Investments in subsidiaries	25(a)	4,145,198	4,145,198
Other assets		3,088	5,729
		<u>4,185,144</u>	<u>4,194,525</u>
CURRENT ASSETS			
Accounts receivable, prepayments and deposits	21(a)	18,995	20,337
Amounts due from subsidiaries	25(b)	408,250	489,019
Bank balances and time deposits		13,840	10,139
		<u>441,085</u>	<u>519,495</u>
CURRENT LIABILITIES			
Accounts payable, accruals and other liabilities	21(b)	61,726	70,343
Amounts due to subsidiaries	25(b)	59,402	3,111
Taxation payable		128	—
Provisions	24(b)	23,825	23,826
		<u>145,081</u>	<u>97,280</u>
NET CURRENT ASSETS		<u>296,004</u>	<u>422,215</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>4,481,148</u>	<u>4,616,740</u>
NON-CURRENT LIABILITIES			
Deferred tax liabilities		150	219
Provisions	24(b)	235	—
		<u>385</u>	<u>219</u>
NET ASSETS		<u>4,480,763</u>	<u>4,616,521</u>
CAPITAL AND RESERVES			
Share capital	26	1,048,999	1,043,581
Share premium	26	54,338	19,012
Merger reserve	29	2,997,115	2,997,115
(Accumulated losses)/retained earnings	31	(1,822,587)	108,073
Proposed and declared dividend	31	2,202,898	448,740
SHAREHOLDERS' FUNDS		<u>4,480,763</u>	<u>4,616,521</u>

Approved by the Board of Directors on 26 February 2004

LEE Yeh Kwong, Charles
Director

CHOW Man Yiu, Paul
Director

Consolidated Financial Statements

CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2003

(Financial figures are expressed in Hong Kong dollars)

	Note	2003 \$'000	2002 \$'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Net cash inflow/(outflow) from operating activities	32(a)	<u>1,408,746</u>	<u>(100,386)</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Payments for purchases of fixed assets		(51,635)	(130,733)
Proceeds from sales of fixed assets		190	34
Payment for purchases of non-trading securities		—	(32,305)
Increase in time deposits with original maturity more than three months		(117,155)	(57,060)
Net cash outflow from investments in associated companies and disposal of a subsidiary		—	(31,546)
Dividends received from an associated company		4,800	—
Dividends received from non-trading securities		14,097	2,482
Interest received from non-trading securities		13,644	16,623
Interest paid on bank loan		(827)	(1,051)
Repayment of loan receivable from an associated company		<u>2,000</u>	<u>—</u>
Net cash outflow from investing activities		<u>(134,886)</u>	<u>(233,556)</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issue of shares under employee share option scheme		40,744	21,928
Admission fees received less refunds to Participants		(1,100)	(15,900)
Dividends paid		<u>(638,070)</u>	<u>(344,094)</u>
Net cash outflow from financing activities		<u>(598,426)</u>	<u>(338,066)</u>
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS			
		675,434	(672,008)
Cash and cash equivalents at the beginning of the year		<u>679,956</u>	<u>1,351,964</u>
Cash and cash equivalents at the end of the year	32(b)	<u>1,355,390</u>	<u>679,956</u>

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), requirements of the Hong Kong Companies Ordinance and 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.

In the current year, the Group has adopted the new Hong Kong Statement of Standard Accounting Practice (SSAP) 12: Income Taxes, issued by the HKSA, which is effective for accounting periods commencing on or after 1 January 2003. The effects of adopting the new accounting standard are set out in 1(s) below.

(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.

A subsidiary is an entity in which HKEx, directly or indirectly, controls the composition of the board of directors, controls more than half of the voting power or holds more than half of the issued share capital.

1. PRINCIPAL ACCOUNTING POLICIES (continued)

(c) Group accounting (continued)

(i) Consolidation (continued)

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.

(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 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, investment income (including investment income net of interest expenses of Clearing House Funds) and other income, which are disclosed as **Income** in the consolidated profit and loss account.

1. PRINCIPAL ACCOUNTING POLICIES (continued)

(e) Revenue recognition

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

- (i) Trading fees 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.
- (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.

1. PRINCIPAL ACCOUNTING POLICIES (continued)

(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.

(ii) Equity compensation benefits

Share options under the Pre-listing and Post-listing Share Option Schemes have been granted to two Executive Directors 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 26).

(iii) Retirement benefit costs

Contributions to the defined contribution provident fund regulated under the Occupational Retirement Schemes Ordinance (ORSO) and operated by the Group and the AIA-JF Premium MPF Scheme are expensed as incurred. Forfeited contributions of the provident fund in respect of employees who leave before the contributions are fully vested 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 fund and the AIA-JF Premium MPF Scheme are held separately from those of the Group and are independently administered.

Consolidated Financial Statements

1. PRINCIPAL ACCOUNTING POLICIES (continued)

(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.

(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	over the remaining life of the leases
Buildings	4%
Leasehold improvements	over the remaining life of the leases but not exceeding 5 years
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%

1. PRINCIPAL ACCOUNTING POLICIES (continued)

(i) Fixed assets (continued)

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.

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

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.

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 (SEOCH) 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, the accumulated investment income net of expenses of these funds appropriated from retained earnings and forfeiture of defaulted Clearing Participants' contributions 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.

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.

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.

1. PRINCIPAL ACCOUNTING POLICIES (continued)

(s) Deferred taxation

Under the new SSAP 12: Income Taxes, deferred taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the accounts. Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Tax rates enacted or substantively enacted by the balance sheet date are used to determine deferred tax assets and liabilities. As a result, deferred tax assets and liabilities in 2002 are computed using a tax rate of 16 per cent and deferred tax assets and liabilities in 2003 using the higher tax rate of 17.5 per cent announced in the March 2003 Hong Kong Budget. As outstanding deferred tax liabilities brought forward from 2002 have to be recomputed at the higher tax rate in 2003, the change in tax rate has resulted in an increase in deferred tax liabilities of which \$6,040,000 was absorbed as an additional deferred tax charge in 2003.

In prior year, deferred taxation was 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 was expected to be payable or recoverable in the foreseeable future. The adoption of the new SSAP 12 represents a change in accounting policy, which has been applied retrospectively and the comparatives presented have been restated to conform to the changed policy. As a result, total deferred tax liabilities as at 31 December 2001 and 2002 increased by \$2,853,000 (with a corresponding reduction of \$5,369,000 in revaluation reserves and an increase of \$2,516,000 in retained earnings) and \$6,028,000 (with a corresponding reduction of \$4,081,000 in revaluation reserves and reduction of \$1,947,000 in retained earnings) respectively. Therefore, as detailed in note 31 to the accounts, opening consolidated retained earnings at 1 January 2002 and 2003 have increased by \$2,516,000 and decreased by \$1,947,000 respectively. The change has reduced the consolidated profit for the year ended 31 December 2002 by \$4,463,000 (from \$592,968,000 to \$588,505,000).

(t) Deferred revenue

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

1. PRINCIPAL ACCOUNTING POLICIES (continued)

(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.

(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.

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1. PRINCIPAL ACCOUNTING POLICIES (continued)

(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

Business segment assets consist primarily of fixed assets, assets of the Clearing House Funds, Compensation Fund Reserve Account, CDMD Fund and margin funds. Business segment liabilities comprise operating liabilities. Non-business segment assets and liabilities include taxation recoverable and payable, deferred tax liabilities and unclaimed dividends. 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.

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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 2003 \$'000	Derivatives Market 2003 \$'000	Clearing Business 2003 \$'000	Information Services 2003 \$'000	Others 2003 \$'000	Group 2003 \$'000
Income	847,074	317,421	589,017	266,313	–	2,019,825
Costs	590,854	174,947	362,183	94,157	–	1,222,141
Segment results	256,220	142,474	226,834	172,156	–	797,684
Share of profits of associated companies	1	–	7,663	–	–	7,664
Segment profits before taxation	256,221	142,474	234,497	172,156	–	805,348
Taxation						(113,583)
Profit attributable to shareholders						691,765
Segment assets	2,407,862	9,179,156	8,131,719	81,969	1,558	19,802,264
Segment liabilities	551,468	7,948,646	5,543,371	30,070	125,446	14,199,001
Segment capital expenditures	13,154	5,493	12,430	5,170	–	36,247
Segment depreciation and amortisation	91,344	21,222	60,571	13,013	–	186,150
Segment other non-cash expenses	22,489	18,847	3,305	1,459	–	46,100

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2. SEGMENT INFORMATION (continued)

	Cash Market 2002 \$'000	Derivatives Market 2002 \$'000	Clearing Business 2002 \$'000	Information Services 2002 \$'000	Others 2002 \$'000	Group 2002 \$'000
Income	721,892	269,243	520,516	296,439	—	1,808,090
Costs	568,984	145,867	334,995	114,811	—	1,164,657
Segment results	152,908	123,376	185,521	181,628	—	643,433
Share of profits/(losses) of associated companies	(103)	—	6,244	—	—	6,141
Segment profits before taxation	152,805	123,376	191,765	181,628	—	649,574
Taxation						(61,069)
Profit attributable to shareholders						588,505
Segment assets	2,206,360	5,839,940	5,894,579	92,818	1,774	14,035,471
Segment liabilities	435,596	4,597,581	3,365,127	38,386	108,417	8,545,107
Segment capital expenditures	12,068	27,522	92,987	14,093	—	146,670
Segment depreciation and amortisation	89,112	16,401	49,701	9,493	—	164,707
Segment other non-cash expenses	(688)	234	1,914	789	—	2,249

2. SEGMENT INFORMATION (continued)

- (a) The **Cash Market** business 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, trading tariff and listing fees. Direct costs of the Listing Function (which were previously included under the Others Segment) are treated as segment costs under the Cash Market Segment. Comparatives for 2002 have been reclassified retrospectively to conform to this practice. Costs of the Listing Function are further explained in note 4.

The **Derivatives Market** business 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 comprises trading fees and net interest income on the margin funds received.

The **Clearing Business** refers to the operations of the three Clearing Houses, namely HKSCC, SEIOCH and HKCC, which are responsible for clearing, settlement and custodian activities and the related risk management of the cash and derivatives markets operated by the Group. Its income is derived primarily from interest earned on the Clearing House Funds and fees from providing clearing, settlement, depository and nominee services.

The **Information Services Segment** is responsible for developing and promoting e-commerce products, compiling and developing index and statistical data, and sales and business development of market data. Its income comprises primarily income from sale of Cash Market and Derivatives Market information. Since Information Services activities share similar business risks as the Cash and Derivatives Market segments, results of Information Services activities were previously grouped under the two business segments based on the nature of their business risks (e.g., income from sales of Cash market information under the Cash Market). As Information Services activities generate a significant amount of income for the Group, from 2003 onwards, their results are disclosed under a separate Information Services Segment. Accordingly, comparatives for 2002 have been reclassified to conform to the new disclosure.

In addition to the above, central income (mainly investment income of corporate funds) and central costs (mainly costs of the support functions that centrally provide services to all of the business segments) are allocated to the business segments and included in the segment income and costs. Accordingly comparatives for 2002 have been reclassified to conform to this practice.

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2. SEGMENT INFORMATION (continued)

Assets and liabilities under the **Others Segment** represent mainly taxation recoverable and payable, deferred tax liabilities and unclaimed dividends. Comparatives for 2002 have been reclassified to conform to this practice.

3. TRADING FEES AND TRADING TARIFF

	2003 \$'000	2002 \$'000
Trading fees and trading tariff are derived from:		
Securities and options traded on the Stock Exchange	318,251	215,871
Derivatives contracts traded on the Futures Exchange	166,960	115,858
	<u>485,211</u>	<u>331,729</u>

4. STOCK EXCHANGE LISTING FEES

Stock exchange listing fees comprise the following:

Income	2003			2002		
	Equity \$'000	Debt & derivatives \$'000	Total \$'000	Equity \$'000	Debt & derivatives \$'000	Total \$'000
Annual listing fees	235,327	3,124	238,451	226,363	4,239	230,602
Initial listing fees	50,990	34,053	85,043	36,550	39,809	76,359
Prospectus vetting fees	3,190	—	3,190	4,770	—	4,770
Other listing fees	7,102	—	7,102	8,302	—	8,302
	<u>296,609</u>	<u>37,177</u>	<u>333,786</u>	<u>275,985</u>	<u>44,048</u>	<u>320,033</u>

Listing fee income is fees paid by issuers to enable them to gain access to the Stock Exchange and enjoy the privileges and facilities by being admitted, listed and traded on the Stock Exchange.

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4. STOCK EXCHANGE LISTING FEES (continued)

Costs of Listing Function	2003 \$'000	2002 \$'000
Staff costs and related expenses	98,312	86,289
Information technology and computer maintenance expenses	2,477	2,576
Premises expenses	7,205	8,538
Depreciation and amortisation	14,772	12,763
Legal and professional fees	14,114	12,053
Payment to SFC under the dual filing regime	15,000	—
Other expenses	5,825	10,291
	<u>157,705</u>	<u>132,510</u>

The costs listed above are regulatory in nature, which comprise direct costs of the Listing Function on vetting IPOs and enforcing the Listing Rules, disseminating information relating to listed companies, and payments to the Securities and Futures Commission under the dual filing regime. Other indirect costs, comprising costs incurred by other units on building the reputation of the Stock Exchange (e.g., marketing and promotion, brand-building, and providing an efficient market infrastructure and market access facilities) to attract issuers to list on the Stock Exchange, which contribute to the stock exchange listing fee income above, are not included as they are part and parcel of the activities of the Group and cannot be separately quantified. Moreover, the costs do not cover costs of support services and other central overheads attributable to the Listing Function.

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5. INVESTMENT INCOME

	2003 \$'000	2002 \$'000
Interest income from		
- Bank deposits and cash margin deposits	66,830	90,761
- Listed securities	40,187	41,013
- Unlisted securities	105,612	129,227
	<u>212,629</u>	<u>261,001</u>
Interest expenses	(2,153)	(5,797)
Net interest income	<u>210,476</u>	<u>255,204</u>
Accommodation income on securities deposited by Participants as alternatives to cash deposits of the margin funds	<u>5,163</u>	<u>5,611</u>
Non-interest investment income		
Net realised gain/(loss) on investments		
- listed trading and non-trading securities	9,733	(8,789)
- unlisted trading and non-trading securities	11,197	1,360
- exchange difference	13,883	(6,346)
Net unrealised gain/(loss) on investments		
- listed trading securities	33,267	(9,836)
- unlisted trading securities	(4,810)	14,732
- exchange difference	14,284	28,071
Dividend income		
- non-trading securities	14,096	2,482
- trading securities	4,018	2,495
	<u>95,668</u>	<u>24,169</u>
Total investment income	<u>311,307</u>	<u>284,984</u>
Total investment income is derived from:		
Corporate funds (note (i))	214,869	178,613
Margin funds	78,732	82,238
Clearing House Funds	17,706	24,133
	<u>311,307</u>	<u>284,984</u>

- (i) Corporate funds include investment income of Compensation Fund Reserve Account of \$714,000 (2002: \$680,070) and CDMD Fund of \$56,000 (2002: \$42,000).

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6. OTHER INCOME

	2003 \$'000	2002 \$'000
Exchange network, terminal user, dataline and software sub-license fees	101,491	97,500
Participants' subscription and application fees	36,227	40,767
Share registration services fees	1,600	18,500
Brokerage on direct IPO applications	11,618	18,973
Miscellaneous income	7,713	9,032
	<u>158,649</u>	<u>184,772</u>

7. OTHER OPERATING EXPENSES

	2003 \$'000	2002 \$'000
Write-down of strategic investments (note (i))	32,667	—
Retirement of redundant IT systems	10,133	2,791
Provision for/(reversal of provision for) doubtful debts	1,789	(900)
Insurance	11,780	12,877
Financial data subscription fees	8,978	9,098
Custodian and fund management fees	8,445	8,625
Bank charges	7,135	4,102
Repair and maintenance	7,373	7,061
Other miscellaneous expenses	42,335	47,040
	<u>130,635</u>	<u>90,694</u>

- (i) Includes a 100 per cent write-down (\$32,303,000) of the Group's investment in BondsInAsia Limited under non-trading securities following a review of the Group's business strategy and operations in May 2003.

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8. PROFIT BEFORE TAXATION

	2003 \$'000	2002 \$'000
Profit before taxation is stated after crediting/(charging):		
Auditors' remuneration		
- audit fees	(1,620)	(1,438)
- non-audit fees	(1,373)	(740)
Interest on bank loans and overdrafts repayable within five years	(827)	(1,736)
Operating lease rentals		
- land and buildings	(48,485)	(64,716)
- computer systems and equipment	(39,323)	(72,275)
Net rental income	295	294
Amortisation of goodwill (included in share of profits less losses of associated companies)	(2,662)	(1,568)
Impairment of investment in associated companies (included in other operating expenses)	(364)	—
Depreciation	(183,488)	(163,139)
Impairment of club debenture (included in other operating expenses)	(860)	—
Loss on disposal/write-off of fixed assets		
- retirement of redundant IT systems	(10,133)	(2,791)
- others	(1,414)	(358)

9. DIRECTORS' EMOLUMENTS

Fifteen out of twenty Directors, including two Executive Directors, received emoluments during the year (2002: None of the fifteen Directors, except the Executive Director, received any emoluments during the year). Total emoluments of the two Executive Directors, excluding share option benefits, for the year amounted to \$9,780,557 (2002: \$7,947,000) of which \$8,725,350 (2002: \$7,072,000) was attributable to salaries, other allowances and benefits in kind. Employer's contribution to retirement scheme for the year amounted to \$855,207 (2002: \$875,000). \$200,000 of discretionary bonus was paid for 2003 (2002: \$Nil) and \$840,912 of directors' fees were accrued for thirteen Non-executive Directors (2002: \$Nil).

The emoluments of the Directors are within the following bands:

	2003 Number of Directors	2002 Number of Directors
\$1 - \$500,000	13	—
\$4,000,001 - \$4,500,000	1	—
\$5,500,001 - \$6,000,000	1	—
\$7,500,001 - \$8,000,000	—	1
	<u>15</u>	<u>1</u>

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9. DIRECTORS' EMOLUMENTS (continued)

The remuneration, excluding share option benefit, of every Director, including the Chief Executive who is an ex-officio member for the year ended 31 December 2003 is set out below:

Name of Director	Fees HK\$	Salary HK\$	Bonus HK\$	Others benefits HK\$ (note 1)	Employer's contribution to provident fund HK\$ (note 2)	Total HK\$
Charles Y K Lee	74,148	—	—	—	—	74,148
John C C Chan (note 3)	—	—	—	—	—	—
Paul M Y Chow (note 4)	—	4,800,000	200,000	43,823	600,000	5,643,823
Paul C H Fan (note 3)	—	—	—	—	—	—
Henry H L Fan (note 5)	13,352	—	—	—	—	13,352
Fong Hup	74,148	—	—	—	—	74,148
Tim Freshwater	74,148	—	—	—	—	74,148
Bill C P Kwok	74,148	—	—	—	—	74,148
K C Kwong (note 3)	—	2,041,655	—	1,839,872	255,207	4,136,734
Dannis J H Lee	74,148	—	—	—	—	74,148
Vincent K H Lee	74,148	—	—	—	—	74,148
Leong Ka Chai	74,148	—	—	—	—	74,148
Liu Jinbao (note 6)	11,932	—	—	—	—	11,932
John G C Seto (note 3)	—	—	—	—	—	—
Lo Ka Shui	74,148	—	—	—	—	74,148
John E Strickland	74,148	—	—	—	—	74,148
Rodney G Ward (note 3)	—	—	—	—	—	—
David M Webb	74,148	—	—	—	—	74,148
Oscar S H Wong	74,148	—	—	—	—	74,148
Yue Wai Keung (note 3)	—	—	—	—	—	—

Notes:

- Other benefits include leave pay, insurance premium, and club membership.
- The employee who retires before normal retirement age is eligible to 18% of the employer's contribution to the provident fund after completion of 2 years of service. The rate of vested benefit increases at an annual increment of 18% thereafter reaching 100% after completion of 7 years of service.
- Retired on 15 April 2003.
- Appointed on 1 May 2003.
- Appointed on 15 November 2003.
- Resigned on 28 May 2003.

9. DIRECTORS' EMOLUMENTS (continued)

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

10. FIVE TOP-PAID EMPLOYEES

Two (2002: one) of the five top-paid employees were Directors, whose emoluments are disclosed in note 9. Details of the emoluments of the other three (2002: four) top-paid employees are as follows:

	2003 \$'000	2002 \$'000
Salaries, other allowances and benefits in kind	12,321	19,309
Performance award	293	—
Retirement scheme contributions by employer	1,365	2,174
Compensation for loss of office	1,575	—
	<u>15,554</u>	<u>21,483</u>

The emoluments of these five employees are within the following bands:

	2003 Number of employees	2002 Number of employees
\$4,000,001 - \$4,500,000	2	2
\$5,500,001 - \$6,000,000	3	1
\$7,000,001 - \$7,500,000	—	1
\$7,500,001 - \$8,000,000	—	1
	<u>5</u>	<u>5</u>

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.

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11. STAFF COSTS AND RELATED EXPENSES

(a) Details of staff costs and related expenses are as follows:

	2003 \$'000	2002 \$'000
Salaries, other allowances and benefits	463,697	441,629
Unutilised annual leave	4,275	2,674
Termination benefits	12,040	176
Retirement scheme contributions by employer	45,561	48,070
	<u>525,573</u>	<u>492,549</u>

(b) Retirement Benefit Costs

The Group has sponsored a defined contribution provident fund scheme, namely the Hong Kong Exchanges and Clearing Provident Fund Scheme (the ORSO Plan), which is registered under ORSO and has obtained Mandatory Provident Fund (MPF) exemption. The ORSO Plan is for all full-time permanent employees. Contributions to the ORSO Plan 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 ORSO Plan. Contributions to the MPF Scheme are in accordance with the statutory limits prescribed by the MPF Ordinance.

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

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11. STAFF COSTS AND RELATED EXPENSES (continued)

(b) Retirement Benefit Costs (continued)

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

	2003 \$'000	2002 \$'000
Forfeited contributions during the year and retained in the ORSO Plan	<u>8,799</u>	<u>2,981</u>

12. TAXATION

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

	2003 \$'000	As restated 2002 \$'000
Provision for Hong Kong Profits Tax for the year	125,503	68,741
Under/(over) provision in respect of prior years	<u>1,170</u>	<u>(5,422)</u>
	126,673	63,319
Deferred taxation (note 30 and note (ii))	<u>(14,774)</u>	<u>(3,559)</u>
	111,899	59,760
Share of taxation of associated companies	<u>1,684</u>	<u>1,309</u>
Taxation charge	<u>113,583</u>	<u>61,069</u>

- (i) Hong Kong Profits Tax has been provided for at 17.5 per cent (2002: 16 per cent) on the estimated assessable profit for the year.
- (ii) As explained in note 1(s), under the new SSAP 12, deferred tax assets and liabilities in 2002 are computed using a tax rate of 16 per cent and deferred tax assets and liabilities in 2003 using the higher tax rate of 17.5 per cent announced in the March 2003 Hong Kong Budget. Deferred taxation for 2003 includes a one-off deferred tax charge of \$6,040,000, which arose from recomputing outstanding deferred tax liabilities brought forward from 2002 using the higher tax rate of 17.5 per cent.

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12. TAXATION (continued)

- (b) The taxation on the Group's profit before taxation differs from the theoretical amount that would arise using the taxation rate of 17.5 per cent (2002: 16 per cent) as follows:

	2003 \$'000	2002 \$'000
Profit before taxation (excluding share of profit of associated companies)	797,684	643,433
Calculated at a taxation rate of 17.5 per cent (2002: 16 per cent)	139,595	102,949
Income not subject to taxation	(41,121)	(47,347)
Expenses not deductible for taxation purposes	10,561	5,567
Utilisation of previously unrecognised tax losses	(4,952)	721
Deferred tax assets arising from tax losses not recognised	(22)	(423)
Adjustment of deferred tax	231	3,715
Under/(over) provision in respect of prior years	1,170	(5,422)
Increase in opening net deferred tax liabilities resulting from an increase in tax rate	6,040	—
Effect of different taxation rates in other countries	397	—
Taxation charge before share of taxation of associated companies	111,899	59,760
Share of taxation of associated companies	1,684	1,309
Taxation charge	113,583	61,069

13. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the profit attributable to shareholders of \$691,765,000 (2002: \$588,505,000) and the weighted average of 1,046,494,819 shares (2002: 1,042,665,487) in issue during the year.

The employee share options outstanding as set out in note 26 did not have a material dilutive effect on the basic earnings per share.

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14. 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	Leasehold Other improvements, computer hardware and software \$'000	furniture, equipment and motor vehicles \$'000	Total \$'000
Cost or valuation						
At 1 Jan 2003	10,000	117,000	1,462,366	380,773	239,201	2,209,340
Additions	—	—	13,431	16,775	6,041	36,247
Revaluation	—	(6,000)	—	—	—	(6,000)
Disposals/write-off	—	—	(130,394)	(50,163)	(13,723)	(194,280)
At 31 Dec 2003	10,000	111,000	1,345,403	347,385	231,519	2,045,307
Representing						
At cost	—	—	1,345,403	347,385	231,519	1,924,307
At valuation						
- 31 Dec 2003	10,000	111,000	—	—	—	121,000
	10,000	111,000	1,345,403	347,385	231,519	2,045,307
Accumulated depreciation						
At 1 Jan 2003	—	—	1,018,134	275,469	167,629	1,461,232
Charge for the year	—	2,497	109,510	39,703	31,778	183,488
Revaluation	—	(2,497)	—	—	—	(2,497)
Disposals/write-off	—	—	(126,920)	(43,504)	(12,119)	(182,543)
At 31 Dec 2003	—	—	1,000,724	271,668	187,288	1,459,680
Net book value						
At 31 Dec 2003	10,000	111,000	344,679	75,717	44,231	585,627
At 31 Dec 2002	10,000	117,000	444,232	105,304	71,572	748,108

14. FIXED ASSETS (continued)

(a) Group (continued)

The cost of investment property was \$8,229,000 (2002: \$8,229,000). The investment property was revalued as at 31 December 2003 on the basis of its open market value by Jones Lang LaSalle, an independent firm of qualified property valuers. The value remained unchanged during 2003 (2002: deficit of \$1,500,000 was charged to the investment properties revaluation reserve) (note 27).

Land and buildings were revalued as at 31 December 2003 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 \$3,503,000 was charged to other properties revaluation reserve during 2003 (2002: deficit of \$16,850,000) (note 27).

The total cost of land and buildings of the Group was \$101,087,000 (2002: \$101,087,000). The carrying value of these land and buildings as at 31 December 2003 would have been \$79,309,000 (2002: \$80,973,000) had they been carried at cost less accumulated depreciation.

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14. FIXED ASSETS (continued)

(b) HKEx

	Other computer hardware and software \$'000	Leasehold improvements, furniture, equipment and motor vehicles \$'000	Total \$'000
Cost			
At 1 Jan 2003	44,229	11,893	56,122
Additions	8,935	4,346	13,281
Disposals/write-off	(9,886)	(13)	(9,899)
At 31 Dec 2003	43,278	16,226	59,504
Accumulated depreciation			
At 1 Jan 2003	7,977	4,547	12,524
Charge for the year	9,259	4,438	13,697
Disposals/write-off	(3,570)	(5)	(3,575)
At 31 Dec 2003	13,666	8,980	22,646
Net book value			
At 31 Dec 2003	29,612	7,246	36,858
At 31 Dec 2002	36,252	7,346	43,598

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15. INVESTMENTS IN ASSOCIATED COMPANIES

	Group	
	2003	2002
	\$'000	\$'000
Share of net assets of associated companies	11,707	8,215
Goodwill on acquisition of shares in associated companies less amortisation and impairment (note a)	22,295	25,321
	34,002	33,536
Loan receivable from an associated company (note c)	—	2,000
	34,002	35,536

(a) Goodwill

	\$'000
Cost	
At 1 Jan 2003 and 31 Dec 2003	26,889
Accumulated amortisation and impairment	
At 1 Jan 2003	1,568
Charge for the year (note 8)	2,662
Impairment loss (note 8)	364
At 31 Dec 2003	4,594
Net book value	
At 31 Dec 2003	22,295
At 31 Dec 2002	25,321

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

(c) The loan was unsecured with interest payable semi-annually at prime rate per annum and was repaid before its maturity date of 31 May 2004.

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15. INVESTMENTS IN ASSOCIATED COMPANIES (continued)

(d) Details of the unlisted associated companies as at 31 December 2003 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%
ADP Wilco Processing Services Limited (formerly known as Wilco International Processing Services Limited)	Hong Kong	Provision of transaction processing services to Stock Exchange Participants	6 Class B ordinary shares	30%

ADP Wilco 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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16. CLEARING HOUSE FUNDS

	Group	
	2003	2002
	\$'000	\$'000
Net asset values of the Clearing House Funds are as follows:		
HKSCC Guarantee Fund	371,289	372,352
SEIOCH Reserve Fund	131,274	134,185
HKCC Reserve Fund	1,048,767	474,211
	<u>1,551,330</u>	<u>980,748</u>
Net assets of the Clearing House Funds are composed of:		
Unlisted non-trading securities, at fair value		
- debt securities	125,643	155,688
Contributions receivable from Clearing Participants fully secured by bank guarantees	92,234	31,490
Bank balances and time deposits	1,349,644	806,401
	<u>1,567,521</u>	<u>993,579</u>
Less: Other liabilities	<u>(16,191)</u>	<u>(12,831)</u>
	<u>1,551,330</u>	<u>980,748</u>
The Clearing House Funds are funded by:		
Clearing Participants' contributions:		
- cash	891,811	393,950
- bank guarantees	92,234	31,490
Clearing houses' contributions	320,200	320,200
Forfeiture of defaulted Clearing Participants' contributions	1,928	—
Accumulated investment income net of expenses included in designated reserves attributable to:		
- Clearing Participants' contributions	183,305	176,643
- Clearing houses' contributions	60,233	58,465
Revaluation reserve (note 27(b))	<u>1,619</u>	<u>—</u>
	<u>1,551,330</u>	<u>980,748</u>

16. CLEARING HOUSE FUNDS (continued)

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.

For the HKSCC Guarantee Fund, investment income was insufficient to cover the fund's expenses during the year. As a result, a loss of \$2,262,000 arose and was included in the Group's retained earnings as at 31 December 2003. Future surplus investment income net of expenses of the fund will be offset against this loss before appropriation from the Group's retained earnings to the fund.

In prior years, temporary fluctuations in fair value of investments were 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.

17. COMPENSATION FUND RESERVE ACCOUNT

The Securities and Futures Commission (SFC) is responsible for maintaining the Unified Exchange Compensation Fund (Compensation Fund). By virtue of Schedule 10 of the Securities and Futures Ordinance (SFO), the Stock Exchange's obligation under the repealed 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 remains. 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 35(a)(i).

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18. CASH AND DERIVATIVES MARKET DEVELOPMENT FUND

	Group	
	2003	2002
	\$'000	\$'000
Net asset value of HKCC's CDMD Fund	925	914
The Fund is composed of:		
Unlisted non-trading securities, at fair value		
- debt securities	925	914
The Fund represents:		
Accumulated investment income net of expenses		
appropriated from retained earnings	914	914
Revaluation reserve (note 27(b))	11	—
	925	914

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.

In prior years, temporary fluctuations in fair value of investments were 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.

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19. NON-TRADING SECURITIES

	Group	
	2003	2002
	\$'000	\$'000
Analysis of non-trading securities:		
Non-current	77,258	87,604
	<u>77,258</u>	<u>87,604</u>
Non-trading securities, at fair value:		
Equity securities		
- listed outside Hong Kong	77,258	55,301
- unlisted	—	32,303
	<u>77,258</u>	<u>87,604</u>

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20. MARGIN FUNDS ON DERIVATIVES CONTRACTS

	Group	
	2003	2002
	\$'000	\$'000
The margin funds comprise:		
SEOCH Clearing Participants' margin funds	1,083,679	757,333
HKCC Clearing Participants' margin funds	6,790,831	3,794,268
	<u>7,874,510</u>	<u>4,551,601</u>
The assets of the margin funds comprise:		
Bank balances and time deposits	4,900,011	2,148,753
Listed securities deposited as alternatives to cash deposits, at market value	805,430	1,119,682
Margin receivable from Clearing Participants	—	3,198
Listed non-trading securities, at fair value		
- debt securities	102,780	173,907
Unlisted non-trading securities, at fair value		
- money market fund	—	162,484
- debt securities	2,066,289	943,577
	<u>7,874,510</u>	<u>4,551,601</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>7,874,510</u>	<u>4,551,601</u>

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

(a) Accounts receivable, prepayments and deposits

	Group		HKEx	
	2003	2002	2003	2002
	\$'000	\$'000	\$'000	\$'000
Receivable from Exchange and Clearing Participants:				
- CNS money obligations	4,059,677	2,647,591	—	—
- transaction levy, stamp duty and fee receivable	215,907	94,237	—	—
- others	20,842	4,239	—	—
Other fees receivable	217,359	229,094	—	—
Interest receivable	62,309	61,598	—	—
Other receivables, prepayments and deposits	68,586	81,440	18,995	20,337
	<u>4,644,680</u>	<u>3,118,199</u>	<u>18,995</u>	<u>20,337</u>

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

(b) Accounts payable, accruals and other liabilities

	Group		HKEx	
	2003	2002	2003	2002
	\$'000	\$'000	\$'000	\$'000
Payable to Exchange and Clearing Participants:				
- CNS money obligations	4,027,540	2,647,066	—	—
- cash collateral and others	191,252	30,994	—	—
- arising from stock option activities	32,287	577	—	—
- others	80,171	37,905	—	—
Transaction levy payable to the SFC	50,369	16,146	—	—
Unclaimed dividends (note c)	120,853	105,574	9,411	6,085
Stamp duty payable	118,862	22,817	—	—
Deposits received	22,188	23,994	—	—
Other payables and accruals	136,382	122,319	52,315	64,258
	<u>4,779,904</u>	<u>3,007,392</u>	<u>61,726</u>	<u>70,343</u>

- (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 87 per cent (2002: 85 per cent) of the total accounts receivable, prepayments and deposits. CNS money obligations payable represents 84 per cent (2002: 88 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.

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22. TRADING SECURITIES

	Group	
	2003	2002
	\$'000	\$'000
Equity securities, at fair value		
- listed in Hong Kong	133,745	40,775
- listed outside Hong Kong	147,019	66,251
	<u>280,764</u>	<u>107,026</u>
Debt securities, at fair value		
- listed in Hong Kong	96,906	99,182
- listed outside Hong Kong	1,016,580	982,757
	<u>1,113,486</u>	<u>1,081,939</u>
Unlisted debt securities, at fair value	<u>1,818,748</u>	<u>2,301,081</u>
	<u>3,212,998</u>	<u>3,490,046</u>

23. 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.

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24. PROVISIONS

(a) Group

	Reinstatement costs \$'000	Employee benefit costs \$'000	Total \$'000
At 1 Jan 2003	25,136	23,826	48,962
Provision for the year	82	31,234	31,316
Amount used during the year	—	(26,573)	(26,573)
Unused amount reversed during the year	(178)	—	(178)
Amount paid during the year	(462)	(4,962)	(5,424)
At 31 Dec 2003	<u>24,578</u>	<u>23,525</u>	<u>48,103</u>
		2003 \$'000	2002 \$'000
Analysis of provisions:			
Current		25,011	28,863
Non-current		<u>23,092</u>	<u>20,099</u>
		<u>48,103</u>	<u>48,962</u>

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24. PROVISIONS (continued)

(b) HKEx

	Reinstatement costs \$'000	Employee benefit costs \$'000	Total \$'000
At 1 Jan 2003	—	23,826	23,826
Provision for the year	535	31,234	31,769
Amount used during the year	—	(26,573)	(26,573)
Amount paid during the year	—	(4,962)	(4,962)
At 31 Dec 2003	<u>535</u>	<u>23,525</u>	<u>24,060</u>
		2003 \$'000	2002 \$'000
Analysis of provisions:			
Current		23,825	23,826
Non-current		<u>235</u>	<u>—</u>
		<u>24,060</u>	<u>23,826</u>

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

(a) Investments in subsidiaries

	HKEx	
	2003 \$'000	2002 \$'000
Investments in unlisted shares, at cost	<u>4,145,198</u>	<u>4,145,198</u>

(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

HKEx had direct or indirect interests in the following subsidiaries as at 31 December 2003, all of which are wholly-owned private companies incorporated and operating in Hong Kong except for HKEx (China) Limited, which operates mainly in the Mainland. 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 Securities and Futures Ordinance	100%
Hong Kong Futures Exchange Limited	Ordinary \$19,600,000 Standard \$850,000	Operates a futures and options exchange	100%

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25. 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)			
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%
HKEx (Singapore) Limited	Ordinary \$2	Investment holding	100%
HKEx (China) Limited	Ordinary \$2	Promotes HKEx products and services in the Mainland	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%

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25. 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)			
The Stock Exchange Nominee Limited	Ordinary \$2	Nominee services	100%
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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26. SHARE CAPITAL AND SHARE PREMIUM

		2003	2002	
		\$'000	\$'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 2002	1,040,664,846	1,040,665	—	1,040,665
Shares issued under employee share option schemes	<u>2,916,000</u>	<u>2,916</u>	<u>19,012</u>	<u>21,928</u>
At 31 Dec 2002	1,043,580,846	1,043,581	19,012	1,062,593
Shares issued under employee share option schemes	<u>5,418,000</u>	<u>5,418</u>	<u>35,326</u>	<u>40,744</u>
At 31 Dec 2003	1,048,998,846	1,048,999	54,338	1,103,337

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.

Under the Post-Listing Share Option Scheme of HKEx, share options were granted to an executive director on 2 May 2003 which are exercisable between 2 May 2005 and 1 May 2013 at an exercise price of \$9.05 per share. In addition, share options were granted to an employee on 14 August 2003 which are exercisable between 14 August 2005 and 13 August 2013 at an exercise price of \$13.60 per share. On 18 August 2003, share options were granted to another employee which are exercisable between 18 August 2005 and 17 August 2013 at an exercise price of \$13.65 per share.

During the year, Pre-Listing employee share options were exercised to subscribe for 5,418,000 shares (2002: 2,916,000) 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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26. SHARE CAPITAL AND SHARE PREMIUM (continued)

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

	Number of shares issuable under the employee share options outstanding as at 1 Jan 2003	Number of shares issuable under the employee share options lapsed	Number of shares issuable under the employee share options granted	Number of shares issuable under the employee share options exercised	Number of shares issuable under the employee share options outstanding as at 31 Dec 2003
Pre-Listing Share Option Scheme	23,253,020	3,663,394	—	5,418,000	14,171,626
Post-Listing Share Option Scheme	—	—	5,800,000	—	5,800,000
	<u>23,253,020</u>	<u>3,663,394</u>	<u>5,800,000</u>	<u>5,418,000</u>	<u>19,971,626</u>

No specific accounting guidance has been issued by the 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 finalised as an International Financial Reporting Standard (IFRS) in the first quarter of 2004.

In line with other countries/regions (e.g., USA, European Union, etc), Hong Kong is working towards harmonising 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 SSAP so that the SSAPs maintain conformity with the IASB standards.

When the employee 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 employee share options to the profit and loss account. Had all the outstanding employee share options been fully exercised on 31 December 2003, the Group would have received \$171,890,628 in proceeds. The market value of the shares issued based on the closing price of \$16.85 per share on that date was \$336,521,898. The employees concerned under the Pre-Listing Share Option Scheme would have made a gain of \$9.33 per share, or, in aggregate, \$132,221,271. The executive director concerned under the Post-Listing Share Option Scheme would have made a gain of \$7.80 per share, or, in aggregate, \$23,400,000. The two employees concerned under the Post-Listing Share Option Scheme would have made a gain of \$3.25 per share, or, in aggregate, \$3,250,000 and \$3.20 per share, or, in aggregate, \$5,760,000 respectively.

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27. REVALUATION RESERVES

	Group			
	Investment properties revaluation reserve \$'000	Other properties revaluation reserve \$'000	Investment revaluation reserve \$'000	Total \$'000
At 1 Jan 2002, as previously reported	3,271	33,633	6,893	43,797
Effect of adopting SSAP 12				
- provision for net deferred tax liabilities (note 1(s))	—	(5,237)	(132)	(5,369)
At 1 Jan 2002, as restated	3,271	28,396	6,761	38,428
Change in valuation of properties	(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)
Deferred tax arising from change in valuation of properties	—	2,696	—	2,696
Deferred tax arising from change in fair value of non-trading securities	—	—	(1,408)	(1,408)
At 31 Dec 2002, as restated	1,771	14,242	13,886	29,899
At 1 Jan 2003, as previously reported	1,771	16,783	15,426	33,980
Effect of adopting SSAP 12				
- provision for net deferred tax liabilities (note 1(s))	—	(2,541)	(1,540)	(4,081)
As at 1 Jan 2003, as restated	1,771	14,242	13,886	29,899
Change in valuation of properties (note 14(a))	—	(3,503)	—	(3,503)
Change in fair value of non-trading securities	—	—	15,353	15,353
Realisation of change in fair value of non-trading securities on maturity and disposal	—	—	4,840	4,840
Deferred tax arising from change in valuation of properties	—	(71)	—	(71)
Deferred tax arising from change in fair value of non-trading securities	—	—	(87)	(87)
At 31 Dec 2003	1,771	10,668	33,992	46,431

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27. REVALUATION RESERVES (continued)

- (a) The revaluation reserves are segregated for their respective specific purposes.
- (b) Included in investment revaluation reserve is \$1,619,000, \$11,000 and \$318,000 which are attributable to investments of the Clearing House Funds, the CDMD Fund and the Compensation Fund Reserve Account respectively (31 December 2002: \$Nil for all funds).

28. DESIGNATED RESERVES

	Group	
	2003 \$'000	2002 \$'000
Clearing House Funds reserves (note a)		
- HKSCC Guarantee Fund reserve	255,912	255,912
- SEOCH Reserve Fund reserve	48,571	47,185
- HKCC Reserve Fund reserve	261,183	252,211
	<u>565,666</u>	<u>555,308</u>
Compensation Fund Reserve Account reserve (note b)	36,541	35,827
CDMD Fund reserve (note c)	914	914
Development reserve (note d)	86,536	135,762
	<u>689,657</u>	<u>727,811</u>

28. DESIGNATED RESERVES (continued)

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 2002	254,428	44,837	220,929	520,194
Investment income net of expenses of Clearing House Funds transferred from retained earnings	1,484	2,348	31,282	35,114
At 31 Dec 2002	255,912	47,185	252,211	555,308
Investment income net of expenses of Clearing House Funds transferred from retained earnings	—	1,386	7,044	8,430
Forfeiture of defaulted Clearing Participants' contributions	—	—	1,928	1,928
At 31 Dec 2003	255,912	48,571	261,183	565,666

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28. DESIGNATED RESERVES (continued)

(b) Compensation Fund Reserve Account reserve

	\$'000
At 1 Jan 2002	35,146
Investment income net of expenses of Compensation Fund Reserve Account transferred from retained earnings	681
At 31 Dec 2002	35,827
Investment income net of expenses of Compensation Fund Reserve Account transferred from retained earnings	714
At 31 Dec 2003	36,541

(c) CDMD Fund reserve

There were no movements in 2002 and 2003.

(d) Development reserve

	\$'000
At 1 Jan 2002 and 31 Dec 2002	135,762
Transfer to retained earnings (note (i))	(49,226)
At 31 Dec 2003	86,536

- (i) The reserve was set aside for systems development for the Stock Exchange. Of the transfer to retained earnings, \$21,109,000 relates to qualifying projects completed in 2003 and \$28,117,000 in 2002.

29. 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 31(c).

30. DEFERRED TAXATION

Deferred taxation is calculated in full on temporary differences under the liability method using a principal taxation rate of 17.5 per cent (2002: 16 per cent).

(a) The movements on the deferred tax liabilities account were as follows:

	Group	
	2003	As restated
	\$'000	2002
		\$'000
At 1 Jan, as previously reported	67,253	75,275
Effect of adopting SSAP 12 (note 1(s))	6,028	2,853
At 1 Jan, as restated	73,281	78,128
Transfer to the consolidated profit and loss account (note 12(a))	(14,774)	(3,559)
Transfer from/(to) shareholders' equity (note b)	158	(1,288)
At 31 Dec	58,665	73,281

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30. DEFERRED TAXATION (continued)

(b) The deferred taxation transfer from/(to) shareholders' equity during the year was as follows:

	Group	
	2003	As restated
	\$'000	2002
		\$'000
Fair value reserves in shareholders' equity		
- other properties revaluation reserve (note 27)	71	(2,696)
- investment revaluation reserve (note 27)	87	1,408
	<u>158</u>	<u>(1,288)</u>

(c) Deferred tax assets are recognised for tax losses carried forward to the extent that realisation of the related tax benefit through the future taxable profits is probable. The Group has unrecognised tax losses of \$181,769,000 as at 31 December 2003 (2002: HK\$192,271,000) to carry forward against future taxable income.

(d) The movement in deferred tax liabilities during the year was as follows:

Deferred tax liabilities

	Accelerated tax depreciation		Revaluation of other properties		Tax loss		Revaluation of non-trading securities		Employee benefit		Total	
	2003	2002	2003	2002	2003	2002	2003	2002	2003	2002	2003	2002
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
	As restated	As restated	As restated	As restated	As restated	As restated	As restated	As restated	As restated	As restated	As restated	As restated
At 1 Jan, as previously reported	70,682	78,939	—	—	(3,429)	(3,664)	—	—	—	—	67,253	75,275
Effect of adopting SSAP 12 (note 1(s))	11,988	3,735	5,401	8,182	(12,901)	(9,196)	1,540	132	—	—	6,028	2,853
At 1 Jan, as restated	82,670	82,674	5,401	8,182	(16,330)	(12,860)	1,540	132	—	—	73,281	78,128
Charged/(credited) to profit and loss account	(17,934)	(4)	(184)	(85)	7,474	(3,470)	—	—	(4,130)	—	(14,774)	(3,559)
Charged to equity	—	—	71	(2,696)	—	—	87	1,408	—	—	158	(1,288)
At 31 Dec	<u>64,736</u>	<u>82,670</u>	<u>5,288</u>	<u>5,401</u>	<u>(8,856)</u>	<u>(16,330)</u>	<u>1,627</u>	<u>1,540</u>	<u>(4,130)</u>	<u>—</u>	<u>58,665</u>	<u>73,281</u>

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31. RETAINED EARNINGS

	Note	Group		HKEx	
		2003 \$'000	As restated 2002 \$'000	2003 \$'000	As restated 2002 \$'000
At 1 Jan					
Retained earnings, as previously reported		3,223,268	3,198,763	108,292	28,252
Effect of adopting SSAP 12	1(s)	(1,947)	2,516	(219)	1,995
Retained earnings, as restated		3,221,321	3,201,279	108,073	30,247
Proposed and declared dividend		448,740	260,166	448,740	260,166
Profit for the year		691,765	588,505	461,568	610,494
Investment income net of expenses of Clearing House Funds transferred to Clearing House Funds reserves		(8,430)	(35,114)	—	—
Investment income net of expenses of Compensation Fund Reserve Account transferred to Compensation Fund Reserve Account reserve		(714)	(681)	—	—
Transfer from Development reserve		49,226	—	—	—
Dividends paid:					
2002/2001 final dividend		(448,740)	(260,166)	(448,740)	(260,166)
2003/2002 interim dividend		(188,452)	(83,450)	(188,452)	(83,450)
Dividend on shares issued for employee share options exercised after declaration of 2002/2001 final dividend		(647)	(448)	(647)	(448)
Dividend on shares issued for employee share options exercised after declaration of 2003/2002 interim dividend		(231)	(30)	(231)	(30)
At 31 Dec		<u>3,763,838</u>	<u>3,670,061</u>	<u>380,311</u>	<u>556,813</u>
Representing:					
Retained earnings/(accumulated losses)		1,560,940	3,221,321	(1,822,587)	108,073
Proposed and declared dividend		2,202,898	448,740	2,202,898	448,740
At 31 Dec		<u>3,763,838</u>	<u>3,670,061</u>	<u>380,311</u>	<u>556,813</u>

- (a) Profit attributable to shareholders includes a profit of \$461,568,000 (2002: \$610,494,000) 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 \$6,938,000 (2002: \$14,480,000).
- (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 29) and retained earnings of \$1,119,321,000.

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32. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

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

	2003 \$'000	2002 \$'000
Profit before taxation	805,348	649,574
Adjustments for:		
Net interest income	(210,476)	(255,204)
Accommodation income	(5,163)	(5,611)
Dividends received from non-trading securities	(14,097)	(2,482)
Gain on trading securities and exchange differences on investments	(70,583)	(19,192)
Depreciation and amortisation	183,488	163,139
Impairment of non-trading securities	32,303	—
Impairment of investments in associated companies	364	—
Impairment of club debenture	860	—
Provisions for bad debts	1,789	(900)
Changes in provisions	(763)	—
Share of profits less losses of associated companies	(7,664)	(6,141)
Loss on retirement of redundant IT systems	10,133	2,791
Loss on disposal of other fixed assets	1,414	358
Operating profit before working capital changes	726,953	526,332
Net decrease/(increase) in trading securities	385,709	(290,645)
Settlement of amount transferred from retained earnings to Clearing House Funds and Compensation Fund Reserve Account	(9,144)	(35,795)
Increase in accounts receivable, prepayments and deposits	(1,535,771)	(763,911)
Increase in other current liabilities	1,738,705	281,112
Net cash inflow/(outflow) from operations	1,306,452	(282,907)
Interest received	196,761	230,593
Accommodation income	5,163	5,611
Interest paid	(1,492)	(5,125)
Hong Kong Profits Tax paid	(98,138)	(57,877)
Refund of Hong Kong Profits Tax	—	9,319
Net cash inflow/(outflow) from operating activities	1,408,746	(100,386)

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32. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (continued)

(b) Analysis of cash and cash equivalents

	2003 \$'000	2002 \$'000
Time deposits with original maturity within three months	1,134,255	629,776
Cash at bank and in hand	221,135	50,180
Cash and cash equivalents at the end of the year	<u>1,355,390</u>	<u>679,956</u>

- (c) The net assets of the Clearing House Funds, Compensation Fund Reserve Account 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.

33. COMMITMENTS

(a) Commitments in respect of capital expenditures:

	Group		HKEx	
	2003 \$'000	2002 \$'000	2003 \$'000	2002 \$'000
Contracted but not provided for	18,359	36,454	1,791	2,994
Authorised but not contracted for	<u>72,275</u>	<u>57,170</u>	<u>8,273</u>	<u>13,222</u>
	<u>90,634</u>	<u>93,624</u>	<u>10,064</u>	<u>16,216</u>

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

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33. COMMITMENTS (continued)

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

	Group		HKEx	
	2003 \$'000	2002 \$'000	2003 \$'000	2002 \$'000
Land and buildings, payable				
- within one year	47,552	73,697	1,149	74
- in the second to fifth years	49,345	114,493	2,457	—
	<u>96,897</u>	<u>188,190</u>	<u>3,606</u>	<u>74</u>
Computer systems and equipment, payable				
- within one year	59,022	55,694	40,202	28,455
- in the second to fifth years	56,458	46,899	27,499	16,510
- after five years	—	3,357	—	—
	<u>115,480</u>	<u>105,950</u>	<u>67,701</u>	<u>44,965</u>
	<u>212,377</u>	<u>294,140</u>	<u>71,307</u>	<u>45,039</u>

As at 31 December 2003, 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.

In addition to the above, the Group had a commitment to contribute additional capital of up to \$5,600,000 (2002: \$5,600,000) to an associated company, ADP Wilco Processing Services Limited, when it signs up the first client or when its cash balances fall below a certain level.

34. 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 2003, the total nominal value of outstanding forward foreign exchange contracts amounted to HK\$322 million (2002: HK\$197 million). All contracts will mature within three months.

35. CONTINGENT LIABILITIES

(a) Group

- (i) The Compensation Fund is a fund set up under the repealed 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 2003, there were outstanding claims received in respect of 13 defaulted Stock Exchange Participants (2002: 14).

Pursuant to the SFO, the Stock Exchange issued a notice on 3 April 2003 inviting for claims against the Compensation Fund in relation to any default of a Stock Exchange Participant occurring before 1 April 2003. The claims period expired on 3 October 2003 and no claims had been received in response to that notice. Claims made after the claims period shall, unless the Stock Exchange otherwise determines, be barred. As at 31 December 2003, no such claims had been received.

35. CONTINGENT LIABILITIES (continued)

(a) Group (continued)

Under the new compensation arrangements implemented under the SFO, a new Investor Compensation Fund has replaced 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. In accordance with the provisions of the SFO, deposits to the Commodity Exchange Compensation Fund had been returned to the Futures Exchange by the SFC in January 2004. The Futures Exchange had in turn reimbursed holders of Futures Exchange Trading Rights their contributions to the Commodity Exchange Compensation Fund. Existing deposits to the Unified Exchange Compensation Fund would be returned to the Stock Exchange in accordance with the provisions of the SFO. There is no requirement for the Stock Exchange to replenish the Investor Compensation Fund.

- (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 437 trading Participants as at 31 December 2003 (2002: 471) default, the maximum contingent liability of the Stock Exchange under the indemnity will amount to \$87 million (2002: \$94 million).
- (iii) 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.

35. CONTINGENT LIABILITIES (continued)

(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 2003 and 31 December 2002, 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 2003, SGD11 million (equivalent to HK\$50 million) of the facility was drawn down (2002: SGD11 million, equivalent to HK\$49 million). The loan will mature within one year and has a fixed rate of interest.

36. 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) Exchange Participants for buying shares on behalf of HKSCC. 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 Exchange Participants for buying shares on behalf of HKSCC and 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 Exchange Participants for buying shares on behalf of HKSCC.

In addition to the transactions mentioned above, \$862,285 (2002: \$2,521,807) of consultancy fee was paid during the year to Goldman Sachs (Asia) LLC where Mr Tim Freshwater, an independent non-executive director of HKEx is a director. The transaction was carried out in the ordinary course of business on normal commercial terms.

36. MATERIAL RELATED PARTY TRANSACTIONS (continued)

During the year, one of the subsidiaries, the Futures Exchange, has entered into a lease agreement with Shine Hill Development Limited, a subsidiary of Great Eagle Holdings Limited whose group managing director, Dr K S Lo is an independent non-executive director of HKEx, to lease office space for a period of two years commencing 1 January 2003. The rental payment for the year amounted to \$3,785,169 (2002: \$7,650,904) and the lease was entered into on normal commercial terms. In addition, \$647,313 (2002: \$910,616) was paid during the year for air conditioning services and \$54,950 (2002: \$67,274) for premises cleaning services to The Great Eagle Properties Management Co Limited (formerly known as Selex Properties Management Ltd) and Sun Fook Kong Housing Services Ltd respectively of which Dr K S Lo was a director.

During the year, bank charges of \$3,332,119 (2002: \$2,612,905), \$346,561 (2002: \$338,253) and \$268,843 (2002: \$428,253) were paid to The Hongkong & Shanghai Banking Corporation Limited, Bank of China (Hong Kong) Limited, and Hang Seng Bank Limited where Dr K S Lo, Dr Liu Jinbao (resigned from HKEx Board on 28 May 2003) and Mr John C C Chan (retired from HKEx Board on 15 April 2003) were directors of the aforesaid banks respectively. Dr K S Lo and Mr John C C Chan are non-executive directors of The Hongkong & Shanghai Banking Corporation Limited and Hang Seng Bank Limited respectively.

In May 2002, two loans amounted to \$12,500,000 were made to an associated company, Computershare Hong Kong Investor Services Limited (CHIS). \$5,000,000 was unsecured, interest free and was fully repaid before 30 September 2002. The remaining \$7,500,000 was unsecured with interest payable semi-annually at prime rate per annum and was fully repaid in March 2003. Total dividend and interest received in 2003 were \$4,800,280 and \$20,653 respectively (2002: \$Nil and \$183,723 respectively). In addition, share registration service fees amounted to \$516,127 (2002: \$120,547) were paid to CHIS during the year.

37. 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.

38. BANKING FACILITIES WITH ASSETS PLEDGED

The Group did not have any assets pledged as at 31 December 2002 and 31 December 2003.



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 Wednesday, 31 March 2004 at 4:30 p.m. for the following purposes:

1. To receive and consider the Audited Accounts for the year ended 31 December 2003 together with the Reports of the Directors and Auditors thereon.
2. To declare a Final Dividend.
3. To declare a Special Dividend.
4. To elect Directors.
5. To re-appoint Auditors and to authorise the Directors to fix their remuneration.
6. 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, subject to and in accordance with the requirements of the Rules Governing the Listing of Securities on the Stock Exchange as amended from time to time, 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;

Notice of Annual General Meeting

(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),
- (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

Notice of Annual General Meeting

- (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 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;

Notice of Annual General Meeting

(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 6(I) and 6(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 6(I) set out in the notice convening this meeting be and is hereby extended by the addition thereto of an amount representing the aggregate nominal amount of shares in the capital of HKEx repurchased by HKEx under the authority granted pursuant to Resolution 6(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.”

Notice of Annual General Meeting

(V) “THAT conditional upon:

- (a) the passing of a resolution at this meeting to approve the payment of a special cash dividend to shareholders;
- (b) the per share amount of such special cash dividend payable to shareholders of HKEx being not less than 2 per cent of the closing price of the shares of HKEx on the Stock Exchange as stated in the Stock Exchange’s daily quotations sheet on the day the announcement of the proposal to pay such special cash dividend is published in Hong Kong newspapers or, if such day is not a trading day, the first trading day thereafter; and

(c) obtaining the consent of the relevant option holder,

(i) the subscription price per share (“Pre-Listing Option Subscription Price”) and the contract size for the unexercised portion of each option that has been granted under the pre-listing share option scheme (“Pre-Listing Share Option Scheme”) of HKEx adopted on 31 May 2000 but not fully exercised on the date of the passing of this Resolution and (ii) the subscription price per share (“Post-Listing Option Subscription Price”) and the contract size for the unexercised portion of each option that has been granted under the share option scheme (“Post-Listing Share Option Scheme”) of HKEx adopted on 31 May 2000 and amended on 17 April 2002 but not fully exercised on the date of the passing of this Resolution, be adjusted as follows:

Adjusted Subscription Price

$$ASP = OSP \times \frac{S - OD - CD}{S - OD}$$

Adjusted Contract Size

$$ACS = \frac{OSP \times \text{Old Contract Size}}{ASP}$$

Notice of Annual General Meeting

where:

ACS = the contract size of the option (being the number of shares which are the subject matter of the option (insofar as it is unexercised)) adjusted in accordance with this Resolution

ASP = (i) in the case of an option granted under the Pre-Listing Share Option Scheme, the Pre-Listing Option Subscription Price of the option adjusted in accordance with this Resolution; and

(ii) in the case of an option granted under the Post-Listing Share Option Scheme, the Post-Listing Option Subscription Price of the option adjusted in accordance with this Resolution

OSP = (i) in the case of an option granted under the Pre-Listing Share Option Scheme, the original Pre-Listing Option Subscription Price of the option prior to adjustment in accordance with this Resolution; and

(ii) in the case of an option granted under the Post-Listing Share Option Scheme, the original Post-Listing Option Subscription Price of the option prior to adjustment in accordance with this Resolution

CD = the per share amount of the special cash dividend approved by shareholders at the 2004 annual general meeting of HKEx

OD = the per share amount of any ordinary cash dividend approved by shareholders at the 2004 annual general meeting of HKEx

S = the closing price of HKEx shares on the Stock Exchange as stated in the Stock Exchange's daily quotations sheet on the last trading day on which the HKEx shares are traded cum the special cash dividend,

and, for the avoidance of doubt, any refusal to give consent on the part of an option holder shall not affect the adjustment of the Pre-Listing Option Subscription Price, the Post-Listing Option Subscription Price and/or the contract size in accordance with this Resolution in relation to the options held by other option holders who consent to such adjustment.”

Notice of Annual General Meeting

Special Resolution

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

- (a) Article 2 of the Articles of Association of HKEx be amended by adding the following new definition:

“associate has the same meaning as in the Rules Governing the Listing of Securities on the Stock Exchange;”

- (b) Article 70(1) of the Articles of Association of HKEx be deleted in its entirety and replaced by the following:

“(1) Subject to the rules prescribed by any Relevant Exchange from time to time, at every general meeting a resolution put to the vote of the meeting shall be decided on a show of hands, unless (before or upon the declaration of the result of the show of hands) a poll be demanded by:

- (a) the chairman of the meeting; or
- (b) at least three members present in person or by proxy having the right to vote on the resolution; or
- (c) a member or members present in person or by proxy representing in aggregate not less than one-tenth of the total voting rights of all the members having the right to attend and vote at the meeting; or
- (d) a member or members present in person or by proxy holding shares conferring the right to attend and vote at the meeting on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all the shares conferring that right;

and a demand for a poll by a person as proxy for a member shall be as valid as if the demand were made by the member himself.”

Notice of Annual General Meeting

- (c) A new Article 79A be added to the Articles of Association of HKEx as follows:

“79A. Voting restrictions under Listing Rules

Where any member is, under the Rules Governing the Listing of Securities on the Stock Exchange, required to abstain from voting on any particular resolution or restricted to voting only for or only against any particular resolution, any votes cast by or on behalf of such member in contravention of such requirement or restriction shall not be counted.”

- (d) Article 90(2)(b) of the Articles of Association of HKEx be deleted in its entirety and replaced by the following:

“(b) not earlier than the day after the despatch of the notice of the meeting and not later than 7 days prior to the date appointed for the meeting there has been given to the Secretary, by a member (other than the person to be proposed) entitled to vote at the meeting, notice of his intention to propose a resolution for the appointment or reappointment of that person and a notice executed by that person of his willingness to be appointed or re-appointed, provided however that this provision shall not apply in respect of:

- (i) the first general meeting called to appoint Directors after the date on which these Articles become effective; and
- (ii) any general meeting at which a person is to be appointed a Director to fill any vacancy created by an Inaugural Elected Director prior to the expiration of his term in 2003.”

- (e) Article 94(1) of the Articles of Association of HKEx be deleted in its entirety and replaced by the following:

“(1) The Company may by ordinary resolution remove any Director (other than a Public Interest Director or the Chief Executive) before his period of office has expired notwithstanding anything in these Articles or in any agreement between him and the Company.”

Notice of Annual General Meeting

- (f) Article 95(h) of the Articles of Association of HKEx be deleted in its entirety and replaced by the following:

“(h) in the case of a Director other than a Public Interest Director, if he is removed by ordinary resolution of the Company in accordance with the Statutes.”

- (g) Articles 101(7) to (10) of the Articles of Association of HKEx be deleted in its entirety and replaced by the following:

“(7) A Director shall also not vote (or be counted in the quorum at a meeting) in relation to any resolution relating to any contract or arrangement or other proposal in which he has an interest which (taken together with any interest of any of his associates) is to his knowledge a material interest and, if he purports to do so, his vote shall not be counted, but this prohibition shall not apply and a Director may vote (and be counted in the quorum) in respect of any resolution concerning any one or more of the following matters:

- (a) the giving to him or any of his associates of any guarantee, indemnity or security in respect of money lent or obligations undertaken by him or any of them at the request of or for the benefit of the Company or any of its subsidiaries;
- (b) the giving to a third party of any guarantee, indemnity or security in respect of a debt or obligation of the Company or any of its subsidiaries for which he himself or any of his associates has assumed responsibility in whole or in part and whether alone or jointly under a guarantee or indemnity or by the giving of security;
- (c) where the Company or any of its subsidiaries is offering securities in which offer the Director or any of his associates is or may be entitled to participate as a holder of securities or in the underwriting or sub-underwriting of which any of them is to participate;

Notice of Annual General Meeting

- (d) any contract in which he or any of his associates is interested in the same manner as other holders of shares or debentures or other securities of the Company by virtue only of his or their interest in shares or debentures or other securities of the Company;
 - (e) any contract concerning any other company (not being a company in which the Director and any of his associates in aggregate own 5 per cent. or more) in which he or any of his associates is interested directly or indirectly as an officer or shareholder;
 - (f) any contract concerning the adoption, modification or operation of a pension fund or retirement, death or disability benefits scheme which relates both to Directors, their associates and employees of the Company or of any of its subsidiaries and does not provide in respect of any Director or any of his associates as such any privilege or advantage not accorded to the employees to which the fund or scheme relates;
 - (g) any contract for the benefit of employees of the Company or of any of its subsidiaries under which the Director or any of his associates benefits in a similar manner to the employees and which does not accord to any Director or any of his associates as such any privilege or advantage not accorded to the employees to whom the contract relates; and
 - (h) any contract for the purchase or maintenance for any Director or Directors of insurance against any liability.
- (8) A company shall be deemed to be one in which a Director and any of his associates in aggregate own 5 per cent. or more if and so long as (but only if and so long as) they are (either directly or indirectly) the holder of or beneficially interested in 5 per cent. or more of any class of the equity share capital of that company (or of any third company through which the interest of the Director or that of his associate is derived) or of the voting rights available to members of that company. For the purpose of this paragraph of this Article there shall be disregarded any shares held by the Director or any of his associates as bare or custodian trustee and in which he and his associates

Notice of Annual General Meeting

have no beneficial interest, any shares comprised in a trust in which the interest of him and his associates is in reversion or remainder if and so long as some other person is entitled to receive the income of the trust and any shares comprised in an authorised unit trust scheme in which he or any of his associates is interested only as a unit holder.

- (9) Where a company in which a Director and any of his associates in aggregate own 5 per cent. or more is materially interested in a contract, he also shall be deemed materially interested in that contract.
- (10) If any question arises at any meeting as to the materiality of an interest of a Director (other than the chairman of the meeting) and any of his associates or as to the entitlement of any Director (other than the chairman of the meeting) to vote and the question is not resolved by his voluntarily agreeing to abstain from voting, the question shall be referred to the chairman of the meeting and his ruling in relation to the Director concerned shall be final and conclusive except in a case where the nature or extent of the interest of the Director or any of his associates concerned, so far as known to him, has not been fairly disclosed. If any question shall arise in respect of the chairman of the meeting or any of his associates and is not resolved by his voluntarily agreeing to abstain from voting, the question shall be decided by a resolution of the Directors (for which purpose the chairman shall be counted in the quorum but shall not vote on the matter) and the resolution shall be final and conclusive except in a case where the nature or extent of the interest of the chairman or any of his associates, so far as known to him, has not been fairly disclosed.”

By Order of the Board

HONG KONG EXCHANGES AND CLEARING LIMITED

Joseph Mau

Company Secretary

Hong Kong, 26 February 2004

Notice of Annual General Meeting

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 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 Friday, 26 March 2004 to Wednesday, 31 March 2004, both days inclusive, during which period no transfer of shares will be effected. In order to qualify for the proposed final and special dividends, 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 Thursday, 25 March 2004.
- (5) Concerning Resolutions 6(I) and 6(II), the Board wishes to state that there is 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 two elected Director vacancies to be filled at the forthcoming annual general meeting. A circular containing further information concerning the election of Directors and Resolutions 6(I) to 6(VI) will be sent to shareholders together with HKEx's 2003 Annual Report.
- (7) For the sake of good corporate governance practice, the Chairman intends to demand poll voting for all the resolutions set out in the notice of the annual general meeting.



Market Statistics

(Financial figures are expressed in Hong Kong dollars)

Market Performance (as at year-end)

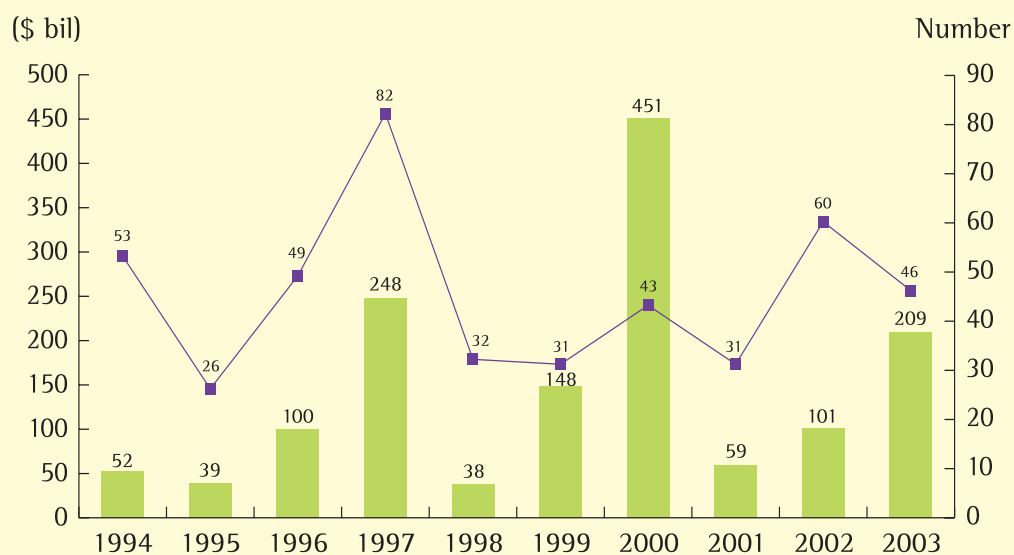
	MAIN BOARD			GEM		
	2003	2002	change (%)	2003	2002	change (%)
IPO funds raised (\$bil)	57	45	27	2	7	-70
Market capitalisation (\$bil)	5,478	3,559	54	70	52	34
Number of listed companies	852	812	5	185	166	11
Number of listed securities	1,598	1,416	13	187	170	10
Total turnover for year (\$bil)	2,546	1,599	59	38	44	-13
Average daily turnover (\$mil)	10,265	6,474	59	154	178	-14

Closing Indices (as at year-end)

	2003	2002	change (%)
S&P/HKEx LargeCap Index	13645.19	10165.52	34
Hang Seng Index	12575.94	9321.29	35
Hang Seng Composite Index	1621.61	1130.24	43
Hang Seng China Enterprises Index (H shares)	5020.18	1990.44	152
Hang Seng China-affiliated Corporations Index (Red chips)	1427.71	1011.13	41
S&P/HKEx GEM Index	1186.06	950.53	25

MAIN BOARD

Total Equity Funds Raised and Number of Newly Listed Companies

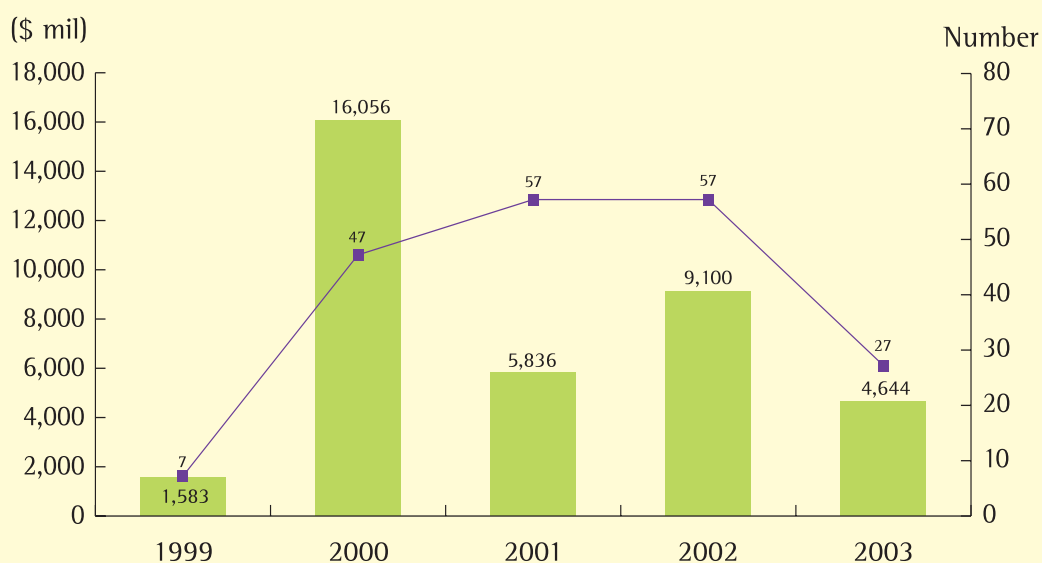


■ Funds Raised

—■— Newly Listed Companies

GEM

Total Equity Funds Raised and Number of Newly Listed Companies



Note: The first listing was in November 1999

■ Funds Raised

—■— Newly Listed Companies

Market Statistics

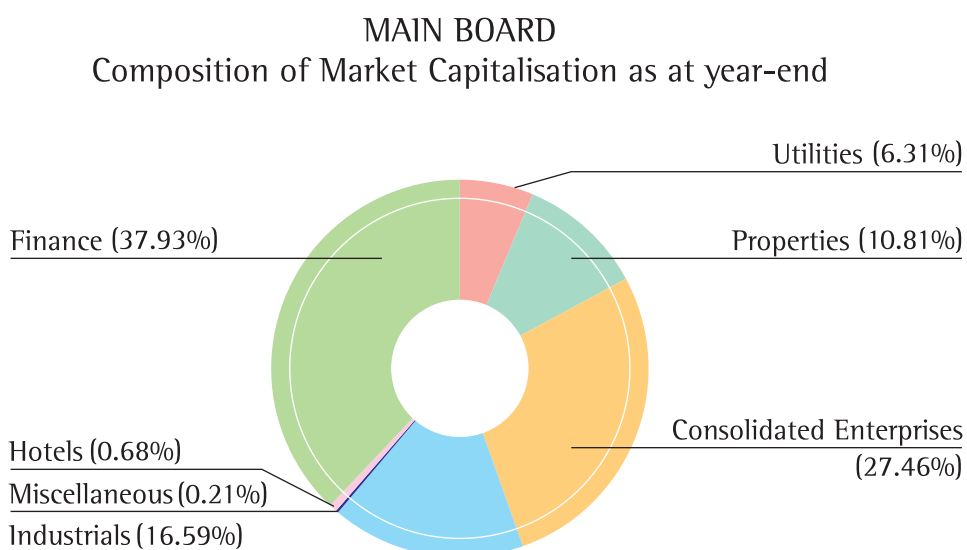
MAIN BOARD New Listings

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Newly Listed Companies	53	26	49	82	32	31	43	31	60	46
New Warrants										
- Equity Warrants	64	39	80	101	31	51	46	31	27	10
- Derivative Warrants	49	55	201	351	157	162	279	181	644	678
Total	113	94	281	452	188	213	325	212	671	688
New Equity Linked Instrument	-	-	-	-	-	-	-	-	25	16
New Debt Securities	71	58	84	61	21	87	20	21	18	20
New Unit Trusts	4	1	1	0	0	1	0	1	1	1

Note : Equity Linked Instrument commenced trading on 5 August 2002

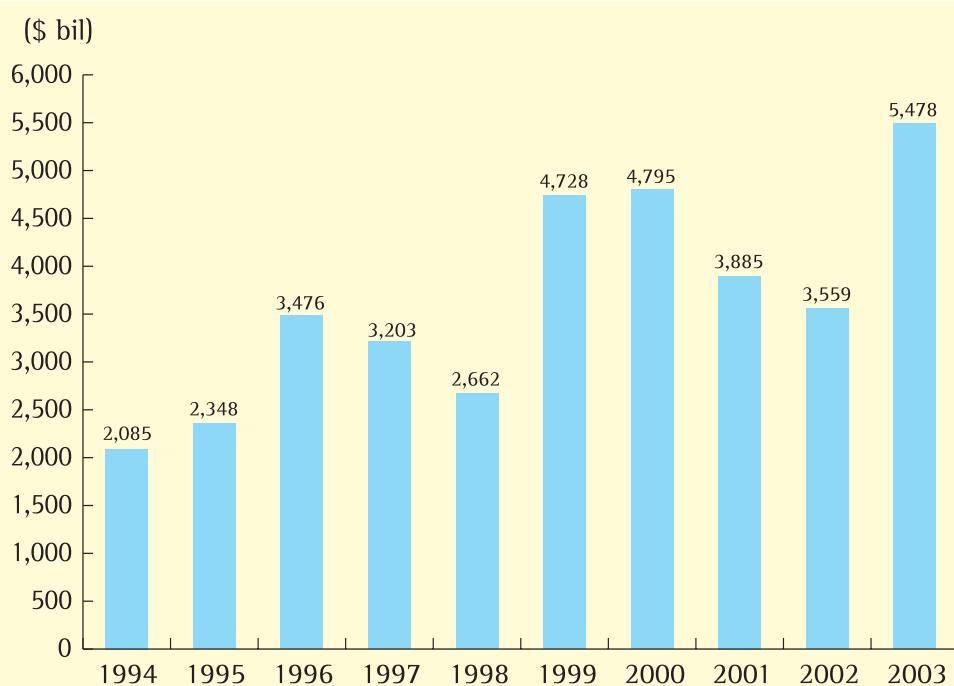
MAIN BOARD Number of Listed Companies

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Finance	60	58	58	56	55	51	60	59	71	75
Utilities	11	11	13	14	14	14	12	11	13	14
Properties	85	87	96	105	109	108	106	97	98	98
Consolidated Enterprises	167	174	182	203	210	218	227	240	257	269
Industrials	183	190	212	256	269	288	308	327	354	378
Hotels	14	14	14	14	13	13	14	14	14	13
Miscellaneous	9	8	8	10	10	9	9	8	5	5
Total	529	542	583	658	680	701	736	756	812	852



MAIN BOARD

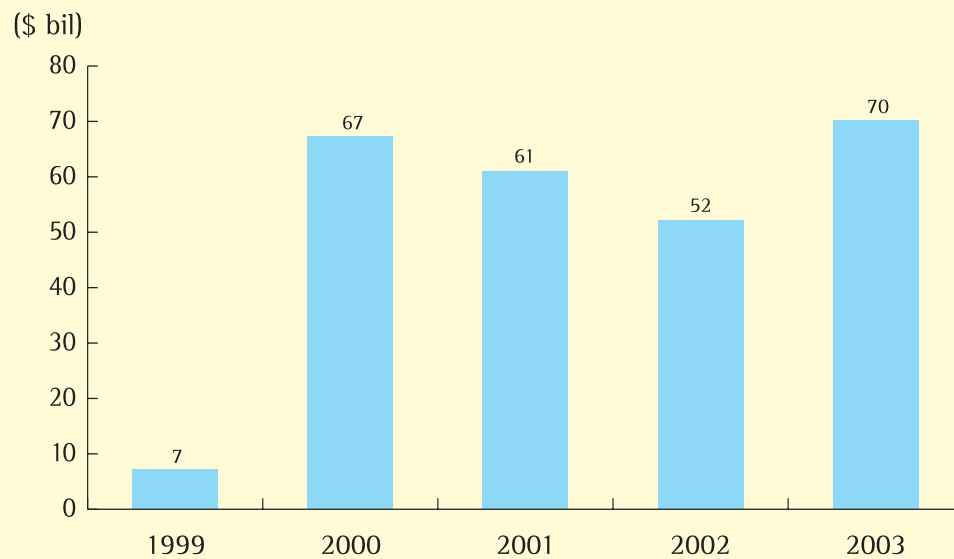
Market Capitalisation (as at year-end)



Market Statistics

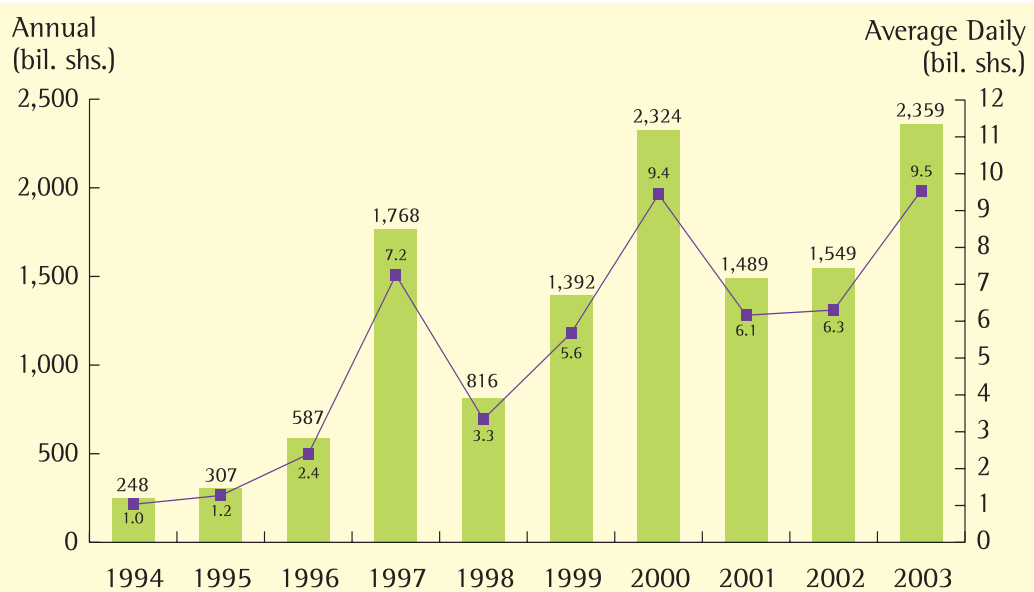
GEM

Market Capitalisation (as at year-end)



MAIN BOARD

Total Annual Trading Volume

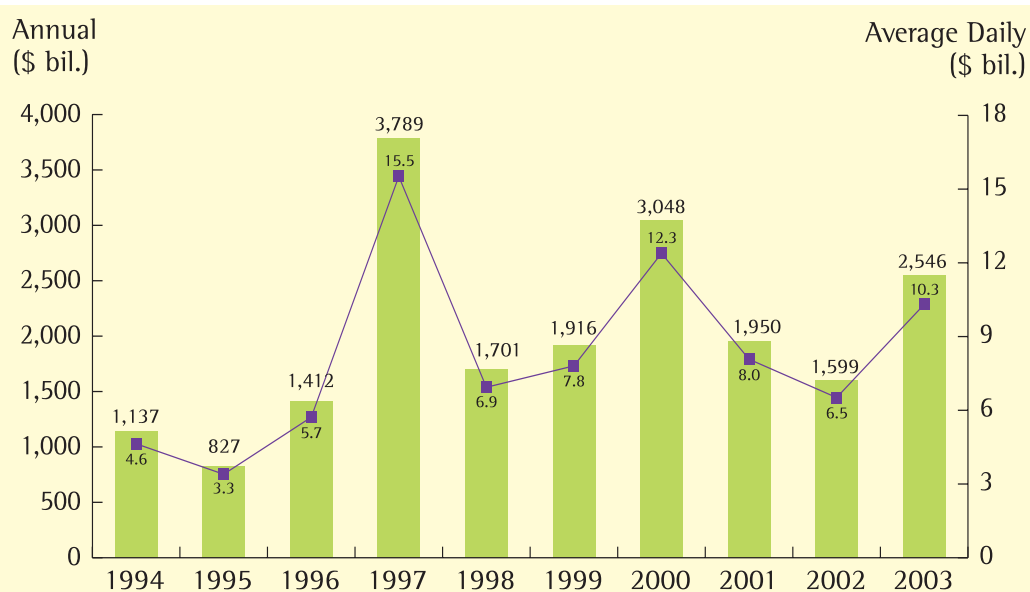


■ Annual

—■— Average Daily

MAIN BOARD

Total Annual Trading Value

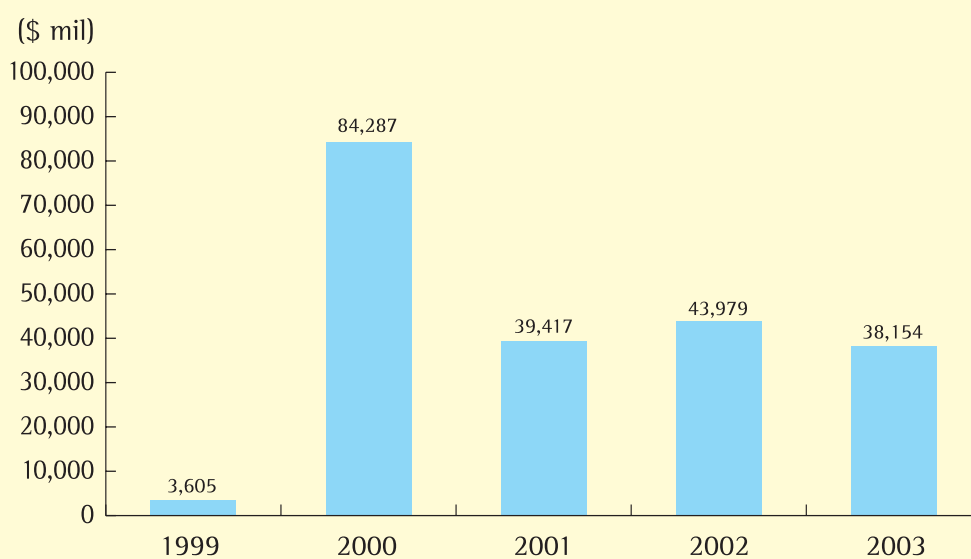


■ Annual

—■— Average Daily

GEM

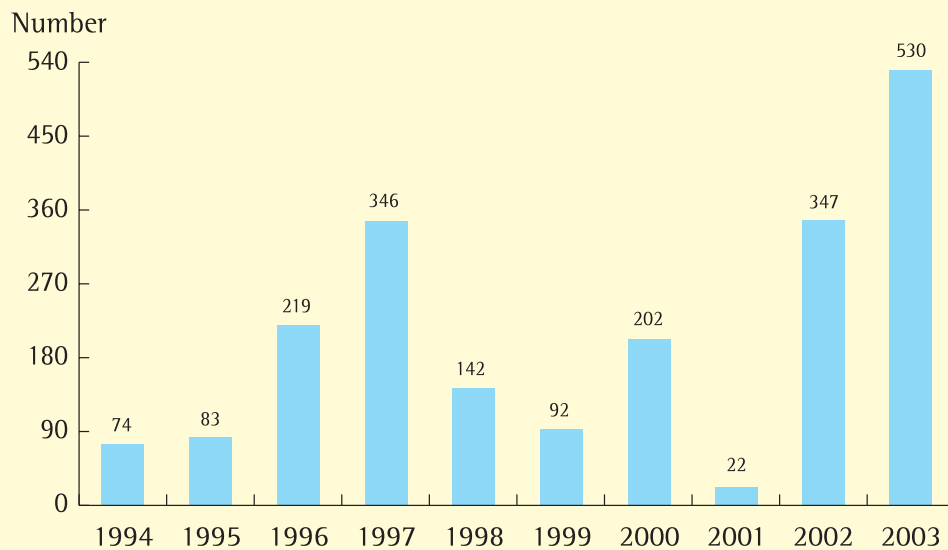
Total Annual Trading Value



Market Statistics

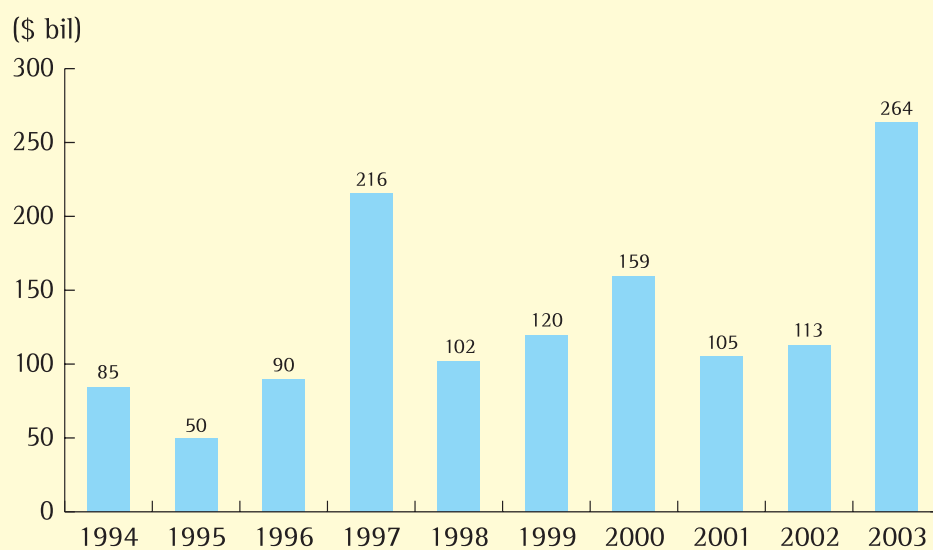
MAIN BOARD

Number of Derivative Warrants (as at year end)



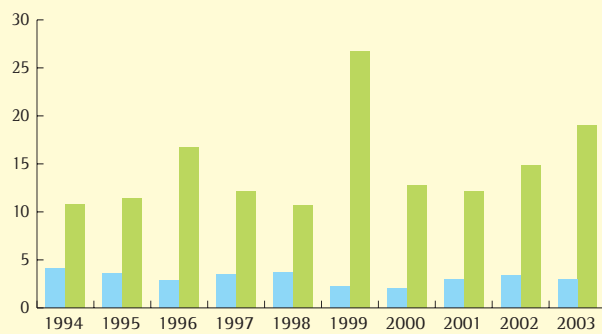
MAIN BOARD

Total Annual Trading Value of Derivative Warrants



MAIN BOARD

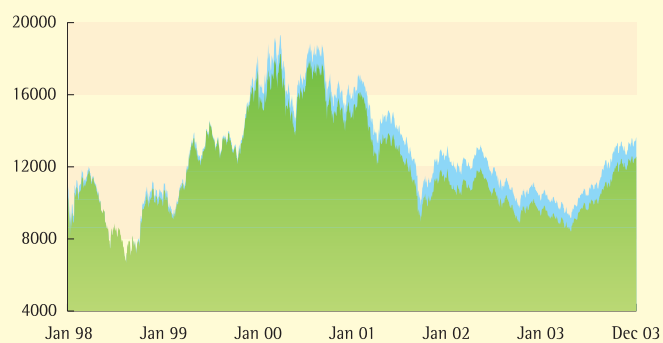
Average Yield & P/E Ratio (year-end figures)



Yield (%) P/E (times)

Hang Seng Index and S&P/HKEx LargeCap Index

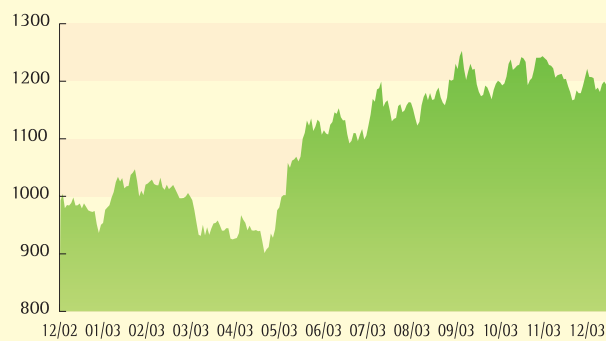
1/1998 to 12/2003



HSI S&P/HKEx LargeCap Index

S&P/HKEx GEM Index

12/2002-12/2003



Market Statistics

DERIVATIVES MARKET STATISTICS (as at year-end)

	2003		2002	
	Volume (Contracts)	Period-end Open Interest	Volume (Contracts)	Period-end Open Interest
Futures				
Hang Seng Index Futures	6,800,360	91,941	4,802,422	48,469
Mini-Hang Seng Index Futures	1,248,295	1,905	1,107,964	2,473
H-shares Index Futures ⁽¹⁾	47,941	6,299	-	-
MSCI China Free Index Futures	190	-	1,869	8
Dow Jones Industrial Average Futures ⁽²⁾	9,091	88	6,773	54
Stock Futures	18,654	1,020	21,006	405
International Stock Futures ⁽³⁾	-	-	50	-
Three-month HIBOR Futures	47,799	4,485	280,257	13,806
One-month HIBOR Futures	310	85	970	20
Three-year Exchange Fund Note Futures	2,012	200	3,673	-
Options				
Hang Seng Index Options	2,118,792	72,469	1,070,431	66,813
Mini-Hang Seng Index Options ⁽⁴⁾	32,131	330	6,176	768
Stock Options	4,220,638	553,896	3,724,705	370,891
International Stock Options ⁽⁵⁾	-	-	55	-

⁽¹⁾ Commenced trading on 8 December 2003

⁽²⁾ Commenced trading on 6 May 2002

⁽³⁾ Suspended trading with effect from 29 May 2003

⁽⁴⁾ Commenced trading on 18 November 2002

⁽⁵⁾ Suspended trading with effect from 29 May 2003

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

	Stock Exchange	Futures Exchange
Participants ⁽¹⁾	499	129
Trading	437	129
Non-trading	62	0
Trading Right Holders ⁽¹⁾	33	65
Corporate	2	56
Individual	31	9
Average no. of trading rights held by		
Participants and Trading Rights Holders ⁽²⁾	1.74	1.17

⁽¹⁾ Participants and Trading Right Holders were Members of the two exchanges before the merger of the exchanges 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 Right Holders.

NUMBER OF CCASS PARTICIPANTS (as at year-end)

Broker Participants	443
Custodian Participants	41
Stock Pledgee Participants	8
Clearing Agency Participants	1
Total	493

Market Statistics

CCASS STATISTICS

	2003	2002
Average Daily Exchange Trades Handled by CCASS		
- Number of Trades	116,142	83,144
- Value of Trades	\$10.4 billion	\$6.7 billion
- Share Quantity Involved	9.7 billion	6.5 billion
Average Daily Settlement Instructions (SIs) Settled by CCASS		
- Number of SIs	19,586	15,889
- Value of SIs	\$25.1 billion	\$18.6 billion
- Share Quantity Involved	9.1 billion	7.4 billion
Average Daily Investor Settlement Instructions (ISIs) Settled by CCASS		
- Number of ISIs	449	360
- Value of ISIs	\$86.0 million	\$267.6 million
- Share Quantity Involved	78.5 million	87.6 million
Average Daily Settlement Efficiency of CNS		
Stock Positions on Due Day (T+2)	99.69%	99.65%
Average Daily Settlement Efficiency of CNS		
Stock Positions on the Day following the Due Day (T+3)	99.97%	99.96%
Average Daily Buy-ins Executed on T+3		
- Number of Brokers Involved	9	5
- Number of Buy-ins	10	6
- Value of Buy-ins	\$2.5 million	\$1.8 million
Shares Deposited in the CCASS Depository		
- Number of Shares	1,012.8 billion	953.0 billion
- Percentage of Total Issued Share Capital of the Admitted Securities	57.86%	54.58%
- Value of Shares	\$1,915.5 billion	\$1,116.7 billion
- Percentage of the Total Market Capitalisation of the Admitted Securities	32.91%	29.62%



Market Highlights

As at 2003 year-end

(Financial figures are expressed in Hong Kong dollars)

Securities Market

	Main Board	GEM	Total
Market capitalisation	\$5,478 billion	\$70 billion	\$5,548 billion
Funds raised	\$209 billion	\$5 billion	\$214 billion
Funds raised by IPOs	\$57 billion	\$2 billion	\$59 billion
Funds raised in secondary markets	\$152 billion	\$3 billion	\$155 billion
Funds raised in H share and red chips markets [#]	\$52 billion	\$1 billion	\$53 billion
Number of IPOs	46 [*]	27	73
Number of listed companies	852	185	1,037
Total turnover	\$2,546 billion	\$38 billion	\$2,584 billion

Derivatives Market

	Volume (Contracts)
Futures	
Hang Seng Index Futures	6,800,360
Mini-Hang Seng Index Futures	1,248,295
H-shares Index Futures	47,941 ^{**}
Options	
Hang Seng Index Options	2,118,792
Stock Options	4,220,638

Notes: Figures have been rounded

[#] Includes IPO and post-listing funds raised

^{*} Of which six were transfer of listing from GEM

^{**} Commenced trading on 8 December 2003

Financial Highlights



(Financial figures are expressed in Hong Kong dollars)

	2003	2002	Change
KEY MARKET STATISTICS			
Average daily turnover value on the Stock Exchange	\$10.4 billion	\$6.7 billion	55%
Average daily number of derivatives contracts traded on the Futures Exchange	41,889	30,038	39%
Average daily number of stock options contracts traded on the Stock Exchange	17,122	15,203	13%
	\$'000	As restated \$'000	
RESULTS			
Income	2,019,825	1,808,090	12%
Operating expenses	1,222,141	1,164,657	5%
Operating profit	797,684	643,433	24%
Share of profits less losses of associated companies	7,664	6,141	25%
Profit before taxation	805,348	649,574	24%
Taxation	(113,583)	(61,069)	86%
Profit attributable to shareholders	691,765	588,505	18%
Shareholders' funds	5,603,263	5,490,364 [#]	2%
Total assets*	19,802,264	14,035,471	41%
Earnings per share	\$0.66	\$0.56	18%
Interim dividend per share	\$0.18	\$0.08	125%
Final dividend declared per share	\$0.42	\$0.43	-2%
	\$0.60	\$0.51	18%
Dividend payout ratio	91%	91%	
SPECIAL DIVIDEND DECLARED PER SHARE	\$1.68	—	

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

[#] Audited and restated (down by \$6 million) as at 31 December 2002 due to the implementation of the new Hong Kong Statements of Standard Accounting Practice 12: Income Taxes



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