



7 December 2006

Dear Shareholder,

As you are probably aware, the current Strategic Plan for Hong Kong Exchanges and Clearing Limited (HKEx, Stock Code: 388) was first introduced in 2004 to cover a three-year period to the end of 2006.

Thanks to the collective efforts of the Government, the SFC, professional associations, market intermediaries, issuers, investors, and all our other stakeholders, the past three years has seen considerable progress and success in the implementation of that plan.

However, amid an increasingly competitive environment with diverse challenges and abundant opportunities, we realise there is still much we can do to further enhance our performance. Thus, following thorough discussion and deliberation, our Board recently agreed on a new roadmap for HKEx for the next three years. It is with great pleasure that I enclose a copy of HKEx's Strategic Plan for 2007-2009 for your reference.

The plan sets forth our priorities in pursuing our mission to be a leading international marketplace for securities and derivatives products focused on Hong Kong, Mainland China and the rest of Asia.

It describes three core strategic themes – reinforcing HKEx's position vis-à-vis the Mainland, further expanding business, and improving service delivery and quality – as well as 16 key initiatives, which will play a part in attaining our objectives.

HKEx looks forward to the continuing active involvement and crucial support of market participants and the investment community in our plan to advance the development of Hong Kong's financial markets and in building an exciting future for us all.

Should you have any comments, please feel free to send them via email to info@hkex.com.hk or in hard copy to Corporate Communications Department, 12/F, One International Finance Centre, 1 Harbour View Street, Central, Hong Kong.

Yours sincerely,

Paul Chow
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HKEx STRATEGIC PLAN 2007-09



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

HKEX STRATEGIC PLAN 2007-09

BACKGROUND

Hong Kong Exchanges and Clearing Limited's (HKEx) Strategic Plan 2007-09 is launched following three years of positive market and structural development under the current strategic plan.

As of early 2003, prior to the commencement of the current strategic plan, HKEx's position was less positive. The company faced adverse market conditions. It was pursuing a number of global diversification initiatives and was also experiencing operational difficulties.

The priority was therefore to keep costs under control and focus on quality in order to establish HKEx as the preferred partner for the Mainland, HKEx's main source of new business and key differentiator from other exchanges. Accordingly, the HKEx Strategic Plan 2004-06 was organised around three overarching themes, Consolidation, Quality Market and Mainland Partner.

Now, three years later, considerable progress has been made on these themes. Costs have been contained. The organisational structure has been streamlined. Market quality has been upgraded through corporate governance reforms and improvements to market infrastructure and systems. And, aided by favourable market conditions, HKEx has made good progress in the listing of Mainland enterprises, including the major state banks and insurance companies. The Hong Kong Government and the Central Government are supportive of Hong Kong's role as an international financial centre. Hong Kong has become the major capital formation centre in the Asian region.

MISSION

HKEx is the operator and frontline regulator of the central securities and derivatives marketplace in Hong Kong. In this role, HKEx works closely with the Securities and Futures Commission (SFC) to regulate listed issuers; administers listing, trading and clearing rules; and provides services at the wholesale level to customers of the exchanges and clearing houses, including issuers and intermediaries – namely investment banks or sponsors, securities and derivatives brokers, custodian banks and information vendors – who service the investor directly. The only exception to HKEx's wholesale role is the Investor Participant Account Service, which is mainly a custody service provided to retail investors as well as institutions.

As an infrastructure provider, HKEx is essentially an IT-based enterprise. HKEx provides services along the core part of the securities and derivatives transaction chains. These services comprise trading, clearing and settlement, depository and nominee services, and information services.

In the strategic plan for 2007-09, HKEx adopts the following mission statement.

To be a leading international marketplace for securities and derivatives products focused on Hong Kong, Mainland China and the rest of Asia.

STRATEGIC ANALYSIS

HKEx has successfully defined itself in international terms as the home market and capital formation centre for Hong Kong and Mainland stocks. HKEx's primary source of new business will continue to be Mainland China. To support the country's continuing economic growth, Mainland issuers need to raise capital for business expansion and international profile. HKEx's market can supply capital within a regulatory framework which is on a par with international standards and practices.

However, the Mainland markets are now better-placed to provide capital formation services themselves. They have undergone share structure reform, have strengthened regulation and accounting, and are becoming more aligned with international practice. The Mainland market now has the capacity to handle large initial public offerings, or IPOs. There is a trend to gradual liberalisation of the renminbi (RMB). Financial futures are to be traded again on the Mainland in a dedicated exchange. The Mainland is also expected to launch a new growth enterprise market.

At the same time, competition for Mainland listings from overseas exchanges is intensifying. And overseas exchanges and over-the-counter, or OTC, markets are trading derivative and structured products based on Mainland securities. Meanwhile, HKEx's markets are constrained by certain policies or rules that pose barriers to expansion, such as the regulatory restrictions on short-selling and the legislative provisions on position limits for derivatives trading that were introduced after the 1998 Asian financial crisis.

Overseas, exchange consolidation and business alliance is proceeding across borders. Such consolidation or business alliance may spread into Asia, putting new competitive pressure on HKEx.

Nonetheless, there are also new opportunities. Mainland domestic investors are likely to have continuing interest in participating in the Hong Kong market, eg under the Qualified Domestic Institutional Investor (QDII) scheme. Hong Kong has a small but growing role in RMB transactions. Investors need to manage their Mainland risk exposures, which in turn may lead to demand for HKEx derivative products.

Hong Kong's outstanding performance in capital formation can be leveraged to attract overseas issuers and develop an Asian-focused marketplace. The current scale and liquidity of the Hong Kong market should be able to support a broader product range. Further study is needed to identify new product areas with the greatest potential.

To meet these growing challenges and take up these opportunities, HKEx needs to attain a *higher level of performance* while continuing to improve market quality.

Strategic Stance

HKEx will continue to monitor exchange mergers and acquisition, or M&A, developments but at present it appears to have little synergy in terms of revenue, cost, operations or technology with overseas exchanges. HKEx has good prospects in its existing core businesses, and should demand similar returns from new business or product ventures.

As a commercial entity with public duties, responsible for the operation of the central marketplace, HKEx must carefully consider the broader interests of the market. HKEx has a statutory duty to ensure an orderly, informed and fair market and to act in the public interest. HKEx initiatives should reinforce Hong Kong's standing as an international financial centre.

2007-09 STRATEGIC THEMES

In a more challenging environment, HKEx must further enhance its overall performance. Consonant with its mission and growth strategy, HKEx will adopt the following major themes for its forthcoming strategic plan: *reinforcing its position vis-à-vis the Mainland, further expanding its business, and improving its service delivery and quality.*

Mainland Positioning

HKEx will seek to position itself as China's *international* exchange, *complementing* the Mainland domestic exchanges, and *partnering* the Mainland in its overall economic development.

HKEx will prepare for further opening of the Mainland market. It will endeavour to accommodate the needs of Mainland firms and investors (such as QDII) who wish to participate in the Hong Kong market. HKEx will also seek to work more closely with the relevant authorities to support the regulation of Mainland issuers. Mainland growth enterprises are an important source of future business, and HKEx's markets need to be better able to accommodate them. HKEx needs to be positioned to trade more Mainland-related products, particularly Mainland-related derivatives and RMB-denominated products. To accomplish these initiatives, HKEx will seek improved cooperation and coordination with the Mainland authorities. Internally, HKEx will ensure that its organisation is resourced to deal with increasing Mainland activities.

Business Expansion

There is considerable untapped potential in both HKEx's existing customers and products and possible new customers and products. HKEx must grasp these opportunities.

HKEx will seek to expand its business by reducing market barriers, rationalising its fee structure, and enhancing its products and services and promoting these to customers of the exchanges and clearing houses. The listing facility will be expanded to include more overseas jurisdictions and will be promoted to selected markets in order to develop an Asian focus. At the same time HKEx will seek to provide more user-friendly market infrastructure in order to attract overseas securities firms to its markets.

Growth will also be sought in new product areas, particularly where settlement is in cash in Hong Kong dollars. Areas to be explored include commodity futures such as agriculture, energy and precious as well as non-precious metals; climate-related products; and RMB-related products such as RMB-Hong Kong dollar futures and RMB-US dollar futures.

To do this will require the right organisational resources – the right talent, and the right alignment of front-office functions such as product development and marketing. Appropriate resources will be allocated for staff development and training to build talent. At the same time, accountability for business results within the enterprise will be reinforced and an improved succession plan for senior positions implemented. This will require HKEx to continuously recruit, reward and retain talent. Providing management with better access to and analysis of information on key customer segments will also be necessary. A Management Information System, or MIS, is being developed to provide HKEx management with financial and Participant information more efficiently.

Further business expansion will require HKEx to manage its business prudently, with attention to risk. Market education is also essential to market quality; hence improved training programmes will be organised. To better protect investor assets and facilitate further development of the brokerage industry, HKEx will seek to improve its investor account services.

Effective issuer regulation is crucial to maintaining market quality, which in turn supports business expansion. Structural changes are expected as a result of the Government's 'statutory backing' initiative. HKEx's Listing function will focus on further improving internal efficiency and effectiveness on the monitoring and enforcement side. Enhancements will be made in the areas of disclosure, corporate governance and IPO process.

Service Improvement

To be effective, business promotion must be supported by good service delivery. HKEx has successfully established a robust liquidity pool for Mainland enterprises over the past decade. Now, in a more challenging environment, to continue to attract customers HKEx must offer cost-effective and quality service. As sole operator of the central securities marketplace, HKEx has an obligation to provide services of a standard that meets users' expectation.

Quality customer service is based upon an enterprise-wide service culture. This requires internal as well as frontline departments to develop a consistent service mindset, and to deliver service in an efficient and effective manner. Customer requests producing marginal commercial or public benefits should not be allowed to absorb disproportionate resources. The right organisation structure and talent are needed. And internal operations need to become more efficient, reliable and transparent through further streamlining and automation.

RESOURCES AND SUPPORT

This plan sets the direction and anticipated key initiatives over the coming three years. Further initiatives will arise from time to time which will require resources. Resource needs will be identified in the course of the annual budget and operating plan exercises.

The plan cannot be successfully implemented without extensive support from the Government, the SFC, professional associations and market intermediaries. HKEx looks forward to their continuing support, and will work closely with them in implementation of the plan.

CONCLUSION

By the end of implementation of its Strategic Plan 2007-09, HKEx should have substantially improved its overall performance level. By the end of 2009, HKEx should have:

- Further strengthened its position vis-à-vis the Mainland, including capturing more Mainland-related listings, trading more Mainland-related products, and engaging more Mainland-related participants and investors;
- Expanded its business into new areas, including developing an Asian focus and diversifying into new product types;
- Become a more business-orientated organisation, with accountability for business results more directly assigned to senior management, and market mechanisms and procedures that better facilitate business flow; and
- Improved its service offering and strengthened the internal infrastructure supporting service delivery.

KEY INITIATIVES

The Strategic Plan will be brought into effect by initiatives. These initiatives will be confirmed through the annual budget and operating plan exercises to be conducted over the three-year period. Nonetheless, at the outset, 16 key initiatives are identified which are likely to play a major part in attaining the objectives of the Strategic Plan.

	Key initiatives
Listing	1. <i>Complete GEM review and related market development</i> – The review of GEM will be taken forward and the proposals subjected to market consultation and subsequently implemented, as appropriate.
	2. <i>Implement ‘statutory backing’</i> – The Stock Exchange will prepare for the embodiment of certain key Listing Rules into statute by the Government, including proposals on any necessary realignment of the Listing function and modifications to the existing operational arrangements.
	3. <i>Open the equity listing regime to issuers from overseas jurisdictions</i> – HKEx will facilitate the listing of issuers from a broader range of jurisdictions than at present, and promote this in overseas markets.
Trading	4. <i>Improve trading rights regime</i> – A review will be conducted to bring the regime more into line with international practice and better facilitate access to HKEx’s markets.
	5. <i>Address barriers to Cash Market trading</i> – A review will be conducted and efforts made to address existing barriers to expansion of the Cash Market.
	6. <i>Address barriers to Derivatives Market trading</i> – A review will be conducted and efforts made to address existing barriers to expansion of the Derivatives Market.
	7. <i>Introduce further Mainland-related and RMB-denominated products</i> – HKEx will seek to develop and promote derivative products, including RMB futures contracts, that capture local and global interest in Mainland China. In the Cash Market, HKEx will endeavour to facilitate intermediaries’ product development efforts by providing an appropriate and flexible market structure.
	8. <i>Explore new product and service areas</i> in order to diversify the product range and develop an Asian focus. Consultants will be engaged as appropriate to study the feasibility and potential for trading commodity futures and climate-related products in Hong Kong.
Clearing	9. <i>Facilitate overseas-based Clearing Participants</i> – A review will be conducted and appropriate mechanisms will be considered to facilitate access by firms based overseas. The facility will be promoted in overseas markets.
	10. <i>Improve Investor Participant Account Service and Stock Segregated Account Service</i> – To better protect investor assets and facilitate the further development of the brokerage industry, HKEx will seek to further improve its Investor Participant Account Service and Stock Segregated Account with Statement Service.

	Key initiatives
Corporate	11. <i>Strengthen the accountability regime within HKEx</i> – The conclusions of the consultancy review conducted in mid-2006 will be implemented and a regime established that links management rewards more directly to the achievement of business results. An improved succession plan for senior positions will be implemented progressively. Appropriate resources will be allocated for staff development and training to build talent.
	12. <i>Review HKEx organisation structure and deployment of resources</i> – In order to support the strategic themes of the plan, a review will be conducted to realign the structure and human resources towards business expansion and customer service.
	13. <i>Further develop HKEx MIS</i> – To support improved and profitable service provision, HKEx's customer-related MIS and finance MIS will be further developed.
	14. <i>Work towards consolidation of HKEx offices and data centres</i> – A review will be conducted, and steps taken to consolidate the various offices and data centres to the extent feasible.
	15. <i>Review fee structure</i> – HKEx will review its fees and charges so as to achieve better alignment with value added and international practice.
IT	16. <i>Review HKEx IT systems and services for possible efficiency improvement</i> – While maintaining existing high levels of system reliability and security, a review will be conducted to seek further improvements in the efficiency of applications, IT service offerings and the time-to-market of IT-enabled functions, and the findings implemented as appropriate.

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