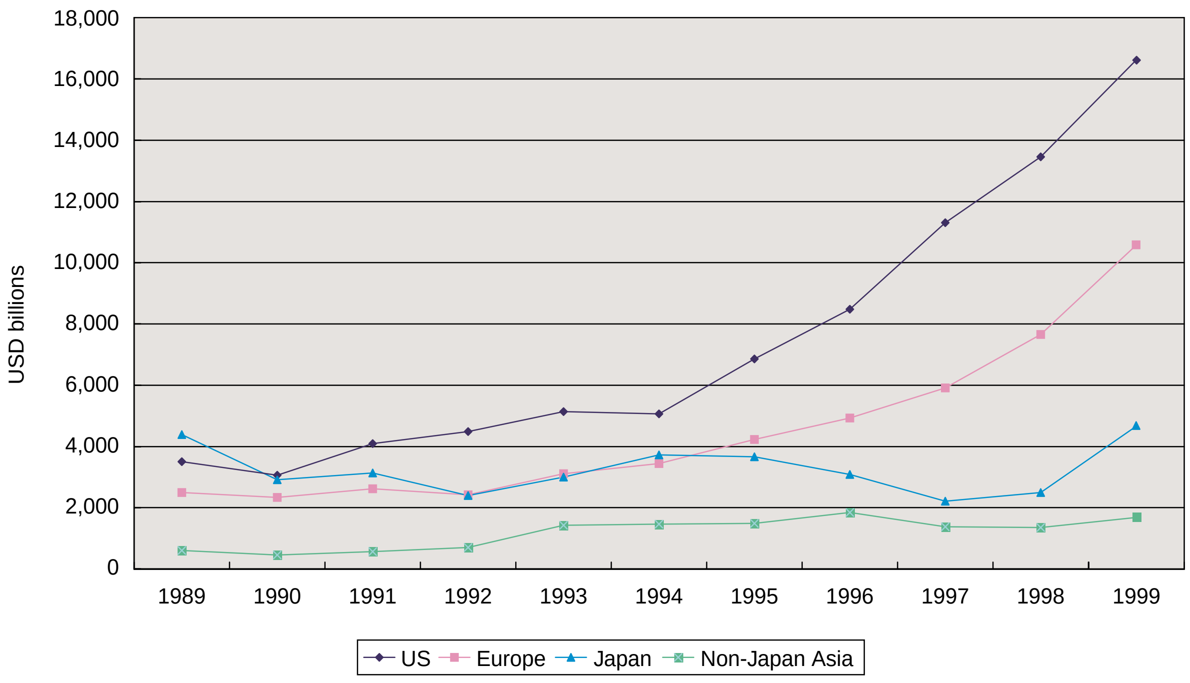
GLOBAL STOCK AND FUTURES MARKETS

Historical growth of the global and Asian markets

With the exception of Japan, the major stock markets around the world have achieved significant growth in the last decade. The combined market capitalisation of world stock markets has increased from approximately US$11.7 trillion at the end of 1989 to approximately US$37.1 trillion at the end of 1999. The market capitalisation of the US markets as a whole has increased approximately 3.7 times from approximately US$3.5 trillion at the end of 1989 to approximately US$16.6 trillion at the end of 1999, while the market capitalisation of the European markets as a whole increased approximately 3.3 times during the same period to approximately US$10.7 trillion. Despite the recent financial crisis, the total market capitalisation of the non-Japan Asia markets has more than tripled since 1989 from approximately US$524 billion to approximately US$1.7 trillion at the end of 1999. Of particular note has been the growth in the stock markets in mainland China since their establishment in 1991. Since that time, the total combined market capitalisation of the Shanghai and Shenzhen markets has grown to approximately US$330.7 billion. The major exception to this growth pattern has been Japan which experienced a reduction in market capitalisation of approximately 43 per cent. from approximately US$4.4 trillion at the end of 1989 to approximately US$2.5 trillion at the end of 1998, before rebounding to approximately US$4.5 trillion at the end of 1999.

Market capitalisation of world stock markets as at 31st December, 1989-1999

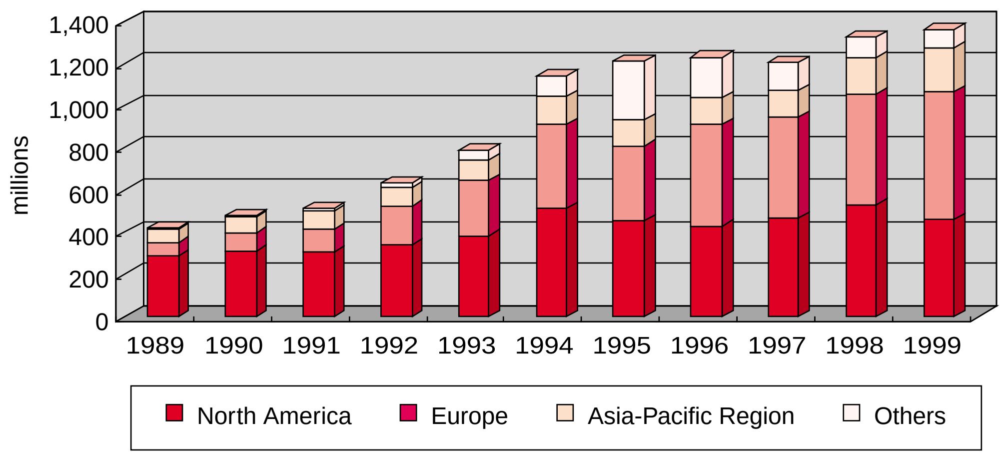


Source: International Finance Corporation: Emerging Stock Markets Factbook 1999/2000

The factors that have led to the growth in the global stock markets over the last decade illustrated above include the following. First, investment funds have grown in both size and number. The total number of equity funds, hybrid funds, bond funds, taxable money market funds and tax exempt money market funds in the US has grown from 3,081 at the end of 1990 to 7,791 at the end of 1999 and the value of these funds has grown from approximately US$1.1 trillion at the end of 1990 to approximately US$6.8 trillion at the end of 1999. Secondly, progressively more governments are privatising state owned assets, particularly in countries that were formerly part of the Union of Soviet Socialist Republics, other countries in central and eastern Europe, and mainland China. Thirdly, advances in technology and the increasing globalisation of world markets have enhanced cross border capital flows and investment. Fourthly, world GDP has increased from approximately US$22.9 trillion at the end of 1990 to approximately US$30.6 trillion at the end of 1999, generating a significantly larger pool of savings for investments.

The growth in the world's stock markets in the last decade has been complemented by the growth in the world's derivatives markets. The total number of derivatives contracts traded on exchanges worldwide has increased from approximately 421 million per annum in 1989 to approximately 1,362 million per annum in 1999. While this growth has been split across all major types of derivatives contracts, the growth in the trading of stock market index futures has been exceptional with the total number of stock market index futures traded on exchanges worldwide increasing from approximately 30 million per annum in 1989 to approximately 205 million per annum in 1999. For the Asia-Pacific region, the total number of derivatives contracts traded has increased from approximately 64 million per annum in 1989 to approximately 208 million per annum in 1999.

Total number of derivative contracts traded, 1989-1999



Sources: *International Monetary Fund: International Capital Markets, September 1999 and Futures Exchange*

The changing global environment for stock and futures exchanges

The world's stock and futures exchanges operate in an increasingly competitive environment:

- as a result of technological advances the entry barriers to establishing new trading platforms have been lowered and this has led to the emergence in recent years, particularly in the US and Europe, of alternative proprietary trading systems which are executing trades outside traditional exchanges. In particular, electronic communication networks (ECNs) have emerged and increased trading volumes are now being executed through them, particularly in the US. In the global derivatives markets, greater information dissemination, the deregulation of financial markets and increased cross-border capital flows are also enabling trading to be redirected to those markets which provide the most efficient pricing and liquidity. This has contributed to a consolidation of liquidity and trading centres, particularly for financial derivatives, which are easily de-linked from the trading centres of the underlying securities;

- institutional investors, which manage an ever-increasing volume of retail and corporate investors' savings and reserves, and the proprietary trading operations of investment banks and securities and commodities trading firms, are looking to diversify their trading through different markets and trading facilities or trading "over the counter" directly among themselves as they search for optimum combinations of transaction costs, liquidity and price discovery. This has resulted in increasing levels of cross-border trading, creating competition among existing exchanges and encouraging the growth of alternative proprietary trading systems. Similarly, retail investors are finding it easier than before to invest cross-border, thus intensifying competition for funds between exchanges; and

- more governments and regulators are opening up their markets to international participation, recognising that this makes their markets more competitive and efficient, brings in a larger and more diverse investor base and enables knowledge and skills transfer to the local market.

The world's more established stock and futures exchanges, however, have certain competitive advantages over alternative trading systems. These advantages include the proven reliability and efficiency of their trading and settlement systems, the regulated environment in which they operate and the depth of pricing and liquidity. In particular in Hong Kong, the Directors believe that because the Stock Exchange has operated on a fully screen-based, order-driven trading platform (AMS) for many years, resulting in comparatively tight stock trading spreads, ECNs do not offer the same level of threat in Hong Kong that they have provided in some other markets.

As a result of the changing global environment, the following trends have emerged among exchanges:

- exchanges are increasingly adopting corporate style ownership and management structures in order to become more commercial, performance-driven and competitive organisations. This contrasts with the traditional structures of exchanges as broker-owned associations where the members governed themselves and their activities through membership rules, and where the ability to trade was linked to membership; and

- the adoption of strategic initiatives intended to promote extended trading hours, lower costs, wider product bases, lower stock trading spreads and increased liquidity. Such initiatives include horizontal (cross-product) and vertical (cross-functional) integration, mergers and the formation of strategic alliances. In addition to the initiatives of the Group, examples of these include:

  Formation of strategic alliances among exchanges

  — LIFFE/CME

  — the announced intention of NASDAQ to develop a technology market in partnership with iX

  Mergers of exchanges

  — the announced intended merger of ParisBourse SBF SA, the Amsterdam Exchanges N.V. and the Brussels Exchanges Limited to form Euronext

  — the announced intended merger of LSE and Deutsche Börse to form iX

  Trading linkages

  — the announced plans of ASX and SES to establish a live electronic link enabling brokers in their respective countries to trade securities on one another's exchange

  — the announced similar plans of Euronext and the NYSE

  Adoption of common derivatives trading and settlement systems

  — EUREX, the common platform developed by DTB and SOFFEX

  — the joint announcement by the London Clearing House and Clearnet to merge to form a single European clearing house

  Integration of national stock and derivatives exchanges

  — the merger of the stock and derivatives operations of OM

  — the merger of SES and SIMEX

  Demutualisations and listings of exchanges

  — ASX has been demutualised and listed on its own board since October 1998

  — SES has been demutualised and has announced its intention to effect an initial public offering.

In addition to bringing competition, technological changes are also changing the way traditional exchanges carry on their business. The extent to which exchanges have adopted automation varies however — while some have only introduced automation in back office clearing and settlement functions but retained a trading floor, others have moved to a fully automated, vertically integrated trading and settlement system. Advances in telecommunications technology have also allowed exchanges to utilise cross-border trading systems.

Impact of the new environment on the Asian exchanges

Within the Asian time zones the changing global environment is evident as, supported by their governments, the Asian region's securities and futures exchanges (particularly Singapore, Seoul, Kuala Lumpur and Taipei) are investing increasing amounts to take advantage of domestic growth opportunities, and are keen to capture regional business. In particular:

- governments are lifting restrictions on foreign ownership of shares of domestic companies and opening up their markets generally to international investors and intermediaries;
- governments and exchanges are upgrading the regulatory frameworks to international standards;
- exchanges are investing in new technology to improve the efficiency of their trading and clearing and settlement systems;
- exchanges are being segmented into sector-specific markets and into main and second boards, and developing their product ranges to include off-shore and regional derivative instruments and debt instruments;
- exchanges are reducing their trading and associated transaction costs; and
- exchanges are extending their trading hours.

The changing global environment for stock and futures exchanges is changing the relationship between the exchanges situated within the Asian time zones and those which are situated outside them. Although these exchanges are increasingly in competition with each other as described above, the technological changes and globalisation are also making possible, and providing the incentive for, the formation of strategic alliances and the entering into of other cooperative arrangements between exchanges operating in different time zones aimed at enabling products traded on them to be traded across multiple time zones, widening the product bases traded on each exchange, lowering stock trading spreads and increasing overall global liquidity.

HONG KONG'S STOCK AND FUTURES MARKETS

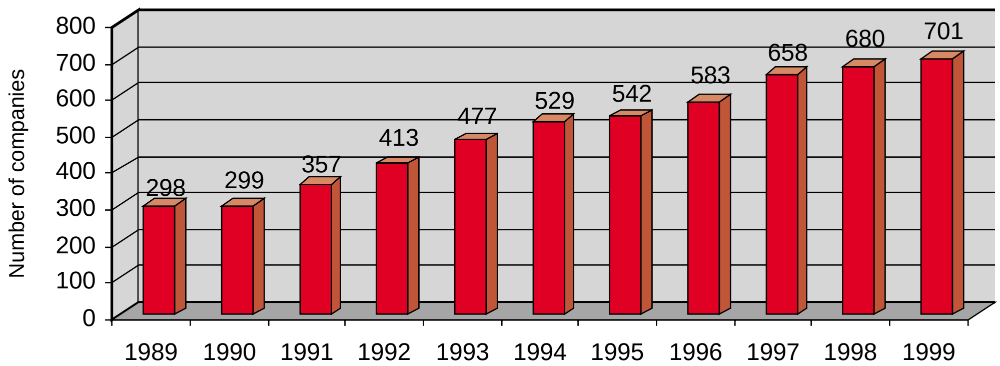
Growth of Hong Kong's markets

The exchange-based securities and futures markets in Hong Kong have both seen substantial growth over the last decade. Set out below is an overview of this trend. A more detailed analysis in relation to recent years is set out in the section of this document headed "Financial Information — management's discussion and analysis of financial condition and results of operations".

(a) *Stock Exchange*

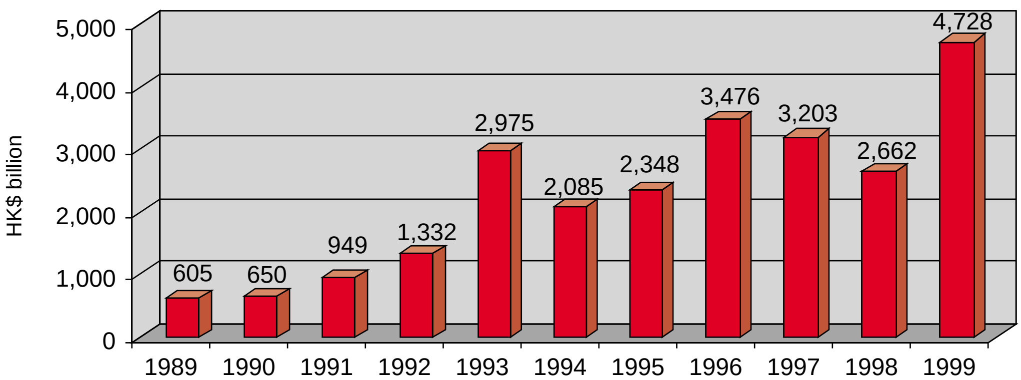
Between 1989 and 1999, the size of the Stock Exchange in terms of the number of companies having shares listed on it more than doubled while its total market capitalisation has increased by more than six times to approximately HK$4,728 billion as at 31st December, 1999, more than three times the size of Hong Kong's 1999 GDP.

Number of companies with shares listed on the main board of the Stock Exchange as at 31st December, 1989-1999



Source: *Stock Exchange*

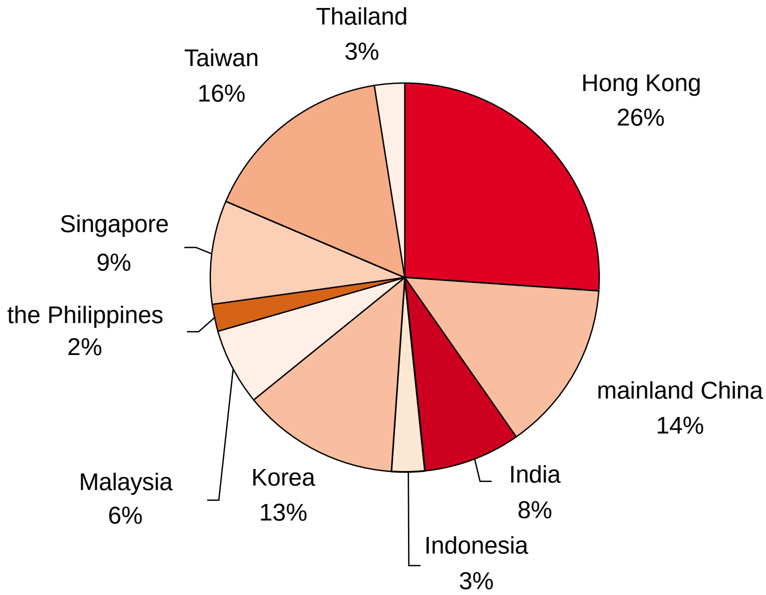
Market capitalisation of the main board of the Stock Exchange as at 31st December, 1989-1999



Source: *Stock Exchange*

As at 31st December, 1999, the Stock Exchange was the largest stock exchange in non-Japan Asia in terms of market capitalisation.

Proportionate shares of the aggregate market capitalisation of non-Japan Asia's stock exchanges as at 31st December, 1999

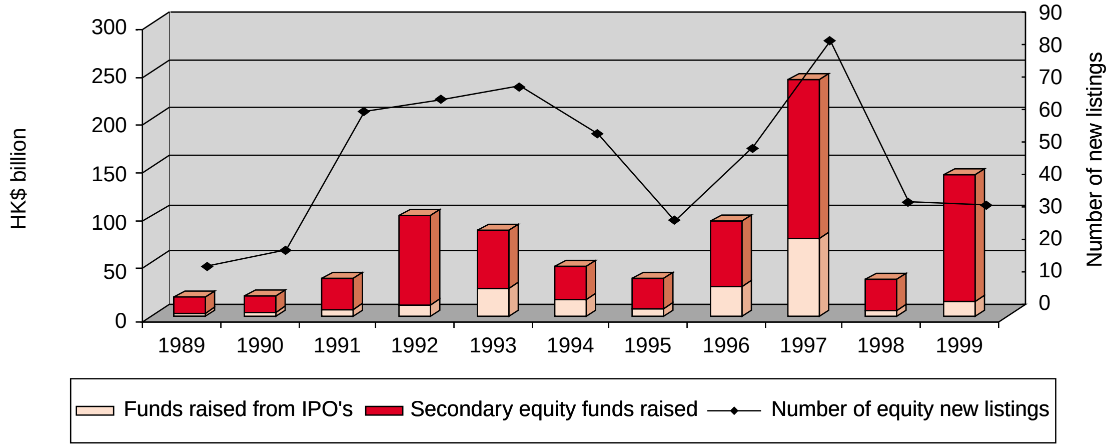


Note: The proportionate shares of Bangladesh, Pakistan and Sri Lanka are immaterial and not shown due to rounding.

Source: International Finance Corporation: Emerging Stock Markets Factbook 1999/2000

Between 1989 and 1999 approximately HK$901 billion in total was raised by companies listed on the Stock Exchange through primary and secondary equity fund raisings. A noticeable peak in both primary and secondary fund raisings occurred in 1997, the year when trading on the Stock Exchange was most active (as discussed in the section of this document headed "Financial information — management's discussion and analysis of financial condition and results of operations").

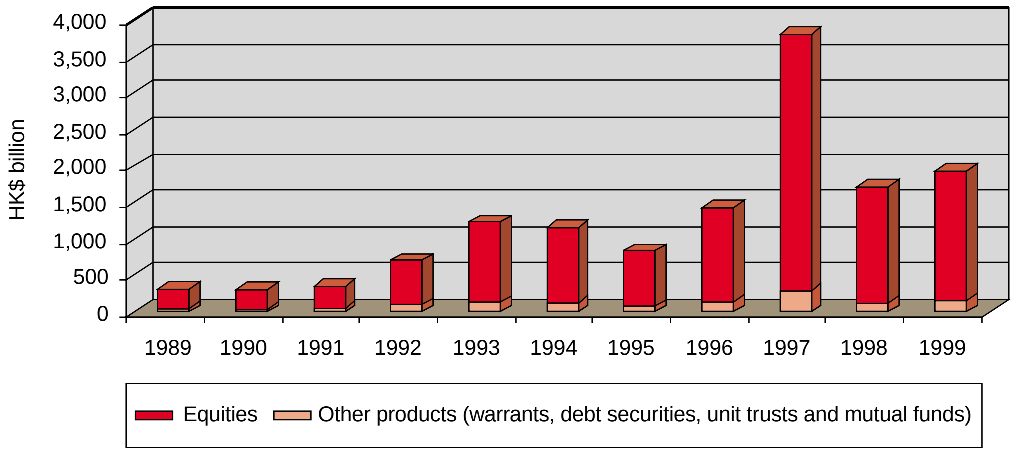
Number of equity new listings and equity funds raised by companies listed on the main board of the Stock Exchange for the years 1989-1999



Source: Stock Exchange

Between 1989 and 1999 total annual volume on the main board of the Stock Exchange, as measured by dollar value, rose to approximately HK$3,789 billion in 1997, fell to approximately HK$1,701 billion in 1998 due to the financial crisis but increased to approximately HK$1,916 billion in 1999.

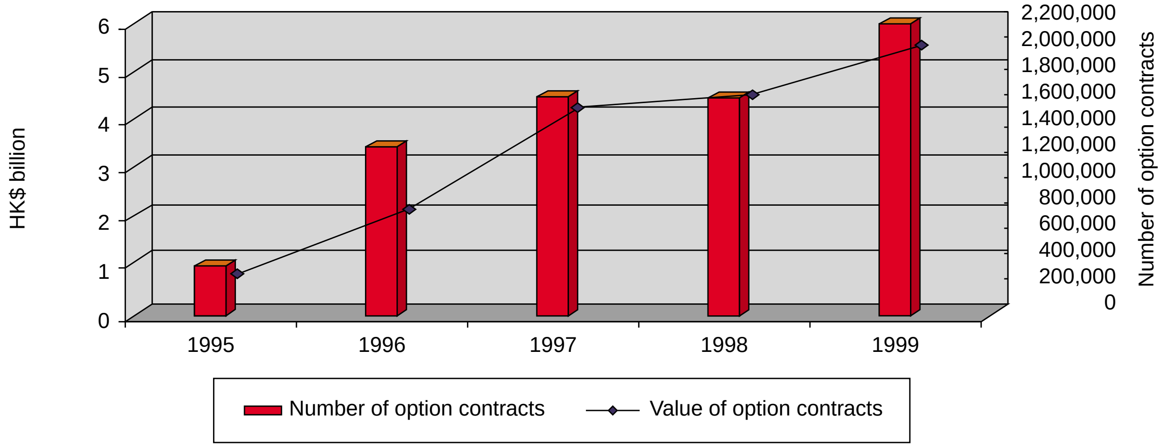
Total annual volume on the main board of the Stock Exchange for the years 1989-1999



Source: Stock Exchange

Trading of stock options was introduced on the Stock Exchange in September, 1995 with the establishment of its stock options market. As illustrated below, the total annual volume, as measured by dollar value, of stock options trading has experienced steady growth, although remaining very small when compared to trading volume on the main board of the Stock Exchange.

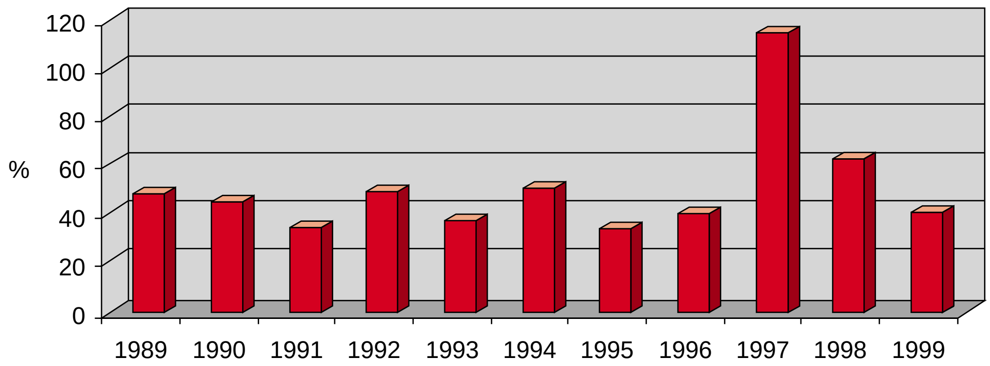
Total annual volume of stock option contracts traded on the Stock Exchange for the years 1995 (date of inception) - 1999



Source: Stock Exchange

A key feature of any market is liquidity as this facilitates efficient price discovery and the ability to trade in and out of the market. Between 1989 and 1999 (excluding 1997), annual turnover velocity on the Stock Exchange (as measured by annual equity turnover in dollar terms as a percentage of market capitalisation as at 31st December in the relevant year) remained relatively steady, around an average of approximately 42 per cent., notwithstanding the significant increase over this period in the Stock Exchange's market capitalisation. The exception to this was the very high turnover velocity, caused by significantly increased trading volumes, during 1997.

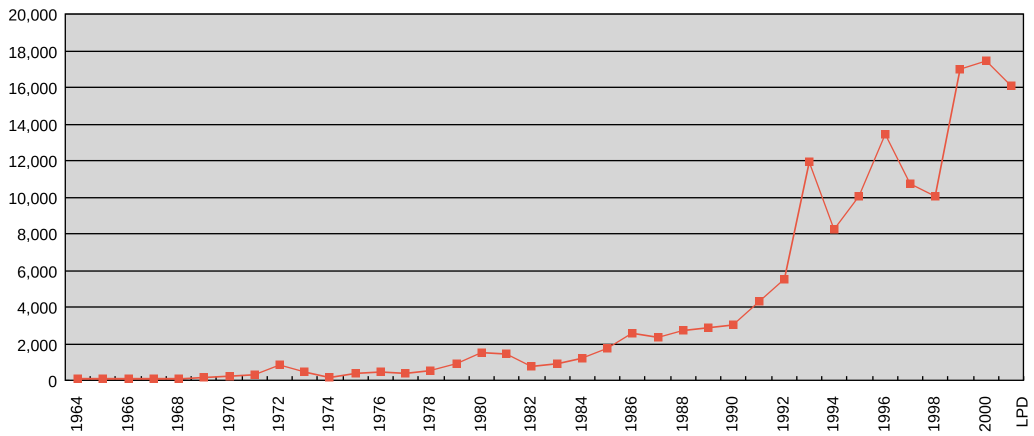
Annual turnover velocity on the main board of the Stock Exchange as at 31st December, 1989-1999



Source: Stock Exchange

There are a number of indices published that track the performance of different groupings of companies whose shares are listed on the Stock Exchange. Of these the most frequently cited is the Hang Seng Index, which utilises a base value of 100 as at 31st July, 1964, and which by the Latest Practicable Date had increased by a factor of approximately 160. The highest level the Hang Seng Index has ever reached was 18,302 on 28th March, 2000.

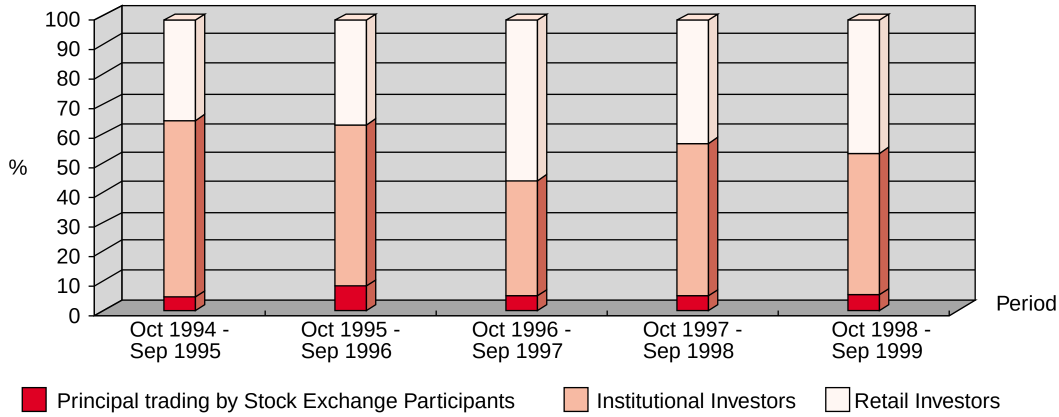
Hang Seng Index as at 31st December, 1964-1999, and Latest Practicable Date



Source: Datastream

Over the five year period ended 30th September, 1999 the balance between retail and institutional trading has shifted slightly with retail trading in the most recent period accounting for approximately half of total dollar trading volume.

Composition of investors by total dollar trading volume on the Stock Exchange during the years ended 30th September, 1995-1999

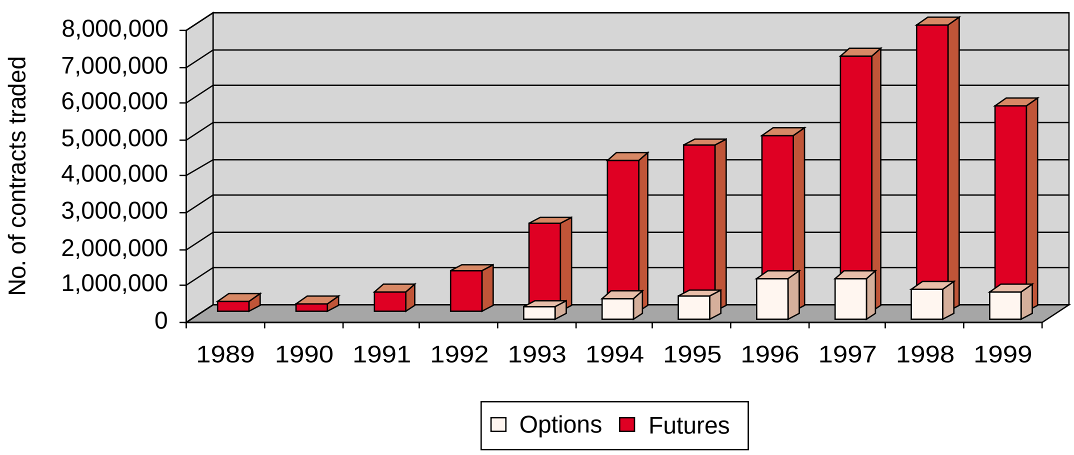


Source: Stock Exchange surveys

(b) *Futures Exchange*

The growth in the Stock Exchange in the last decade has been complemented by the growth in the Futures Exchange. The total annual number of derivative contracts traded on the Futures Exchange has increased by more than 25 times from approximately 236,000 in 1989 to approximately 6.3 million in 1999.

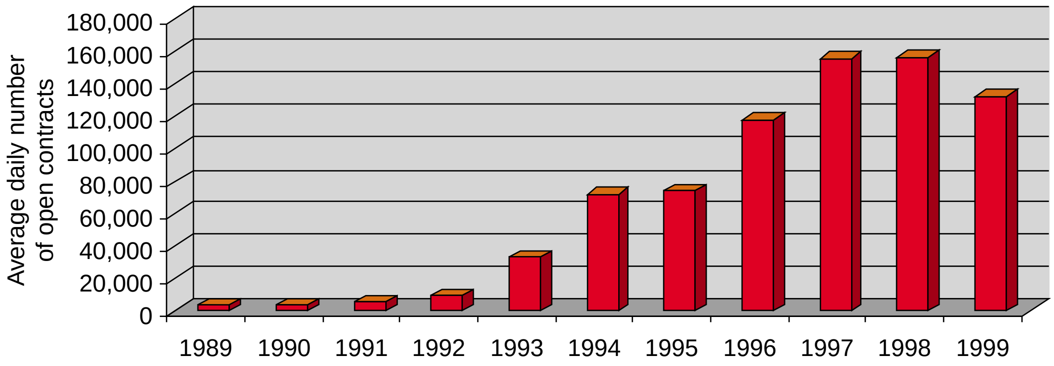
Total futures contracts and option contracts traded on the Futures Exchange for the years 1989-1999



Source: Futures Exchange

The major portion of the income of the Futures Exchange Group comprises interest income on margin held by HKCC as part of its risk management measures. Margin is collected by HKCC, predominantly in cash, on open contracts.

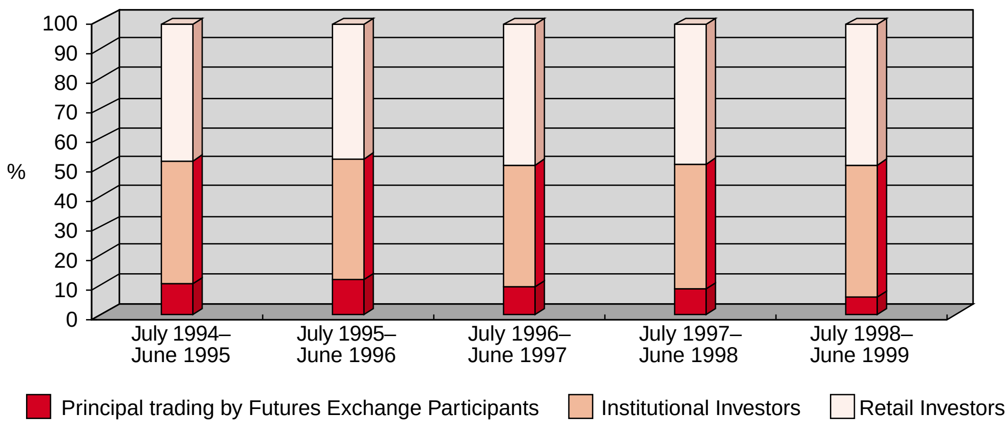
Average daily open contracts on the Futures Exchange for the years 1989-1999



Source: Futures Exchange

Over the five year period ended 30th June, 1999 the respective proportions of trading in Hang Seng Index futures contracts attributable to retail and institutional investors have remained fairly constant.

Composition of investors by number of Hang Seng Index futures contracts traded on the Futures Exchange for the years ended 30th June, 1995-1999



Source: Futures Exchange surveys

Structure and regulation of Hong Kong's securities and futures markets

(a) *Hong Kong Regulatory Structure*

(i) SFC

The principal regulator of Hong Kong's securities and futures markets is the SFC, which was established in 1989 under the Securities and Futures Commission Ordinance.

The functions of the SFC are, in summary, to supervise the marketplace, regulate the securities and futures industry, provide investor protection, suppress financial crime and market misconduct, cooperate with other securities and futures regulators, promote Hong Kong's competitiveness as a financial centre, and provide expert support to the Government.

The SFC is divided into four operating divisions:

- the *Supervision of Markets Division*, which is responsible for market oversight and in particular oversight of the operations of the Exchanges and the Clearing Houses to ensure the sound functioning and development of their trading, settlement and operational systems. It also oversees and manages two statutory investor compensation funds, the Unified Exchange Compensation Fund and the Futures Exchange Compensation Fund, further details of which are set out in the section of this document headed "Business — business of the Group";

- the *Corporate Finance Division*, which is responsible for regulating takeovers and mergers and share buy-backs of public companies, administering securities legislation relating to listed companies and supervising the listing-related activities of the Stock Exchange;

- the *Intermediaries and Investment Products Division*, which comprises three departments:

  — *Licensing*, which administers the licensing requirements for securities and commodities dealers, investment advisers and their representatives, including matters relating to the fitness and properness of registered persons;

  — *Intermediaries Supervision*, which supervises licensed dealers and investment advisers to ensure that they are financially sound, adhere to good business practices and are in compliance with registration requirements; and

  — *Investment Products*, which is responsible for regulating the marketing to the public of unit trusts, mutual funds and other collective investment schemes; and

- the *Enforcement Division*, which is responsible for undertaking inquiries into alleged breaches of relevant Ordinances and Codes, including possible insider dealing and market manipulation offences.

(ii) HKEx

HKEx is the holding company of the Exchanges and Clearing Houses and is, pursuant to the Merger Ordinance, a recognised exchange controller.

(iii) Stock Exchange

The Stock Exchange has the exclusive right, under the Stock Exchanges Unification Ordinance, to establish, operate and maintain a stock market in Hong Kong (defined in the Securities Ordinance as a place where persons regularly meet together to negotiate sales and purchases of securities (including prices), or a place at which facilities are provided for bringing together sellers and purchasers of securities, but does not include the office of *(i)* a Stock Exchange Participant, *(ii)* a registered dealing partnership of which a Stock Exchange Participant is a partner, or *(iii)* a recognised clearing house). It is the primary regulator for Stock Exchange Participants with respect to trading matters. It is also the primary regulator of companies listed on the main board of the Stock Exchange and GEM. Further information regarding the regulatory functions of the Stock Exchange is set out in the section of this document headed "Business — business of the Group".

(iv) Futures Exchange

The Futures Exchange is the entity licensed, under the Commodities Trading Ordinance, to establish and operate a commodity exchange and is permitted to provide and maintain a place for the trading of the futures contracts specified in that Ordinance. It is the primary regulator for Futures Exchange Participants with respect to trading matters. Further information regarding the regulatory functions of the Futures Exchange is set out in the section of this document headed "Business — business of the Group".

(v) Clearing Houses

The SFC has declared HKSCC, SEOCH and HKCC to be recognised clearing houses for the purposes of the Clearing Houses Ordinance. HKSCC and SEOCH provide services for the clearing and settlement of securities and stock option transactions, respectively, including trades and transactions effected on, or subject to the rules of, the Stock Exchange (unlisted securities traded through facilities maintained at the office of a Stock Exchange Participant are not required to be cleared and settled through HKSCC). HKCC provides services for the clearing and settlement of transactions on the Futures Exchange. Further information regarding the regulatory functions of the Clearing Houses is set out in the section of this document headed "Business — business of the Group".

(b) *Regulation of the markets*

(i) Legislative framework

The securities and futures industry in Hong Kong is currently governed by ten different Ordinances (plus parts of the Companies Ordinance).

The core piece of legislation governing the securities industry is the Securities Ordinance which controls trading in securities and the business of advising on making investments in securities, and provides for the protection of investors and associated matters. The core piece of legislation governing the futures industry is the Commodities Trading Ordinance which controls commodities trading and the business of advising on the purchase or sale of futures contracts. The other legislation comprises the Protection of Investors Ordinance which provides protection for investors in securities and other property, the Securities (Insider Dealing) Ordinance, the SDI Ordinance, the Leveraged Foreign Exchange Trading Ordinance and the Ordinances referred to in (a) above.

(ii) Trading Rights

By law, any person carrying on a business of dealing in securities, or carrying on a business of trading commodity futures contracts in Hong Kong, has to be licensed by the SFC or fall within one of the licensing exemptions.

In addition to this, the rules promulgated by each Exchange require any person who wishes to trade on or through the facilities of an Exchange to hold a Trading Right for that Exchange. The Trading Right confers on its holder the eligibility to trade on the relevant Exchange. However, the holding of a Trading Right does not, of itself, permit the holder to actually trade on or through the relevant Exchange. In order to do this, it is also necessary for the person to be authorised as an Exchange Participant in accordance with the rules of the relevant Exchange, including those requiring compliance with all relevant legal and regulatory requirements.

One Trading Right for each share held in either of the Exchanges was conferred by the relevant Exchange on each person who held such a share or shares immediately prior to 6th March, 2000, the date on which the merger of the Exchanges and Clearing Houses under HKEx became effective. In order to permit such former shareholders to realise their investment in having access to the trading facilities of the Exchanges, and in order to allow those who wish to enter the marketplace to gain access, Trading Rights which were automatically conferred on such former shareholders upon completion of the merger are transferable. However, any such transfer must take place before 6th March, 2010 and such rights may only be transferred once.

Under the rules of the relevant Exchanges, the following are deemed not to be transfers for these purposes:

(a) the transmission of a Trading Right to a person in consequence of the death of its recorded holder;

(b) the assignment of a Trading Right from an individual to a company of which he is the sole beneficial owner; and

(c) a liquidator, receiver or trustee in bankruptcy taking possession of a Trading Right in such capacity (however, any subsequent sale by the liquidator, receiver or trustee in bankruptcy will be treated as a transfer).

Furthermore, a transfer of a Trading Right will be deemed to occur if there is a change in control of a company (or of any holding company of such company) which holds a Trading Right where the company which holds the Trading Right is not, at the time of the change in control, a Stock Exchange Participant or Futures Exchange Participant (as applicable). For this purpose, "control" means the holding of or the right to exercise more than half of the voting power of a company. For the avoidance of doubt, any direct or indirect (as described above) change in control of a company which is a Stock Exchange Participant or Futures Exchange Participant (as applicable) at the time of the change in control will not be deemed to be a transfer of the Trading Right held by that company.

A Trading Right is only permitted to be transferred to a person who is, or who simultaneously with completion of the transfer becomes, a Stock Exchange Participant or Futures Exchange Participant (as applicable).

Save for Trading Rights issued in respect of alliances with other stock exchanges or futures exchanges, no further Trading Rights will be granted before 6th March, 2002. Thereafter, between 6th March, 2002 and 5th March, 2004, save as aforesaid, no Stock Exchange Trading Right will be granted for less than HK$3.0 million and no Futures Exchange Trading Right will be granted for less than HK$1.5 million.

(c) *Reform of the markets*

In addition to the merger of the Exchanges and Clearing Houses described in the section of this document headed "Business — history and development", in his budget speech of 3rd March, 1999, the Financial Secretary announced that, in order for Hong Kong to respond to the challenges it faced, it needed to embrace state-of-the-art technology in order to remain in the premier league of world financial services, and to undertake a comprehensive reform of the regulation of Hong Kong's securities and futures markets.

(i) Embracing state-of-the-art technology

SCEFI was convened by the Financial Secretary in March, 1999 and delivered its report in September, 1999. The report recommended that Hong Kong's goal should be to have an overall financial infrastructure incorporating the following elements:

- *a single clearing arrangement* — this was recommended in order to improve risk management for market participants, the Exchanges, the Clearing Houses and regulatory authorities by providing a holistic view of risks across markets, products and users, to simplify and improve the efficiency of money settlement through the interbank real time gross settlement system and to allow more efficient use of capital and liquidity through unified money settlement, cross margining and cross-collateralisation;

- *straight through processing* — this would involve electronically capturing and processing financial transactions in one pass, from the point of "deal" to final settlement and confirmation. The current obstacles to this are mainly the incompatibility of the systems used by market participants and a lack of consistency in the timing and procedures for trade confirmation; and

- *a scripless securities market* — this was recommended in order to provide the enabling environment for straight through processing, eliminate the risks associated with scrip, reduce the cost of ownership transfer and enhance the processing efficiency of securities transactions.

(ii) Reform of the regulation of Hong Kong's securities and futures markets

It is proposed that a Securities and Futures Bill will be introduced into the Legislative Council in October, 2000, following a three-month public consultation process. This will consolidate, update and amend the ten Ordinances that currently govern the securities and futures industry in Hong Kong.

It is anticipated that the key policy proposals that will be included in the Securities and Futures Bill will include:

- laying the groundwork for regulating electronic trading facilities;
- creating a Market Misconduct Tribunal to deal responsively and effectively with cases of insider dealing, market manipulation and other market misconduct;
- enhancing the disclosure of interests regime as the foundation for investors making informed decisions;
- ensuring that the legislation allows for effective regulation of all types of investment products and arrangements; and
- establishing a unified framework to facilitate a future new compensation scheme for investors who suffer losses as a result of the failure of an intermediary.

There is no certainty, however, as to what the provisions of any bill will be, or as to when (or whether) any bill will be passed into law.

(d) *Checks and balances in the operations of the Group*

The Group operates the only exchange-based stock and futures markets in Hong Kong. Accordingly, the Group's performance has a direct bearing on the success of Hong Kong as an international financial centre. As regards market integrity, the clearing and settlement units within the Group are one of the most important components of the financial infrastructure of Hong Kong with the Group having the responsibility to ensure that the risks of the market are properly managed and reduced as far as possible. Any material failure of the clearing units would be detrimental to the market and the Group's reputation, as well as to the confidence of market users and investors.

Given the Group's status as the sole operator of the exchange-based stock and futures markets in Hong Kong, its strategic importance to Hong Kong's success as an international financial centre and the need to ensure that the Group discharges its responsibilities in regard to safeguarding the integrity of the market, a comprehensive framework of checks and balances has been put in place:

- *corporate governance* — a corporate governance structure for the Group is being implemented that is intended to enable HKEx to balance its public functions and its commercial profit making objectives. Further information regarding the salient features of the structure are set out in the sections of this document headed "Business — business operation structure" and "Business — board composition";

- *status as the sole operator of the exchange-based stock and futures markets in Hong Kong* — the fees imposed by HKEx in its capacity as controller of the Exchanges and Clearing Houses, and the fees imposed by the Exchanges and Clearing Houses in their respective capacities as exchanges and clearing houses, are required under the Merger Ordinance to be set out in their rules and approved by the SFC. The making of, and changes to, the rules of HKEx, the Exchanges and the Clearing Houses require the approval of the SFC. In deciding whether or not to approve a fee or changes to a fee, the SFC is required by the Merger Ordinance to have regard to:

  — the level of competition, if any, in Hong Kong for the matter for which the fee is to be imposed; and

  — the level of fee, if any, imposed by similar bodies inside or outside Hong Kong for the same or a similar matter.

  It was stated in the Position Paper that it is intended that the SFC will develop non-statutory guidelines setting out the factors to be taken into account in considering the level of fees and charges proposed by the Group. The detailed guidelines have still to be published. It was further stated in the Position Paper that it is the Government's view that as a matter of general principle the level of control exerted over the fees and charges of the Group should be inversely proportional to the degree of competition available in the local market in respect of the particular service. It was stated in the Position Paper, accordingly, that for services which are already subject to adequate market competition, no SFC supervision is anticipated.

  This provides a reasonable safeguard against abuse and at the same time allows sufficient flexibility in implementation which is essential given the diversified business and product base of HKEx;

- *risk management* — a Risk Management Committee has been established, chaired by the Chairman of HKEx, whose role is to formulate policies on risk management matters relating to the activities of HKEx, the Exchanges and the Clearing Houses and to submit such policies to the Board for its consideration. Further information regarding the Risk Management Committee is set out in the section of this document headed "Business — business of the Group";

- *restrictions on control of the Group* — pursuant to the Merger Ordinance, no person is permitted to become or continue to be the controller of either of the Exchanges or any of the Clearing Houses unless that person has been *(i)* recognised as such a controller by the SFC with the consent of the Financial Secretary or *(ii)* exempted from such prohibition by the Financial Secretary. The SFC may only recognise someone as an exchange controller where it is satisfied that it is appropriate to do so in the interest of the investing public or in the public interest, or for the proper regulation of markets in securities or futures contracts. HKEx is the only person that has been recognised as a controller of the Exchanges and Clearing Houses. Other relevant members of the Group, namely, the Stock Exchange, the Futures Exchange, HKEC Nominees Limited and The Stock Exchange Nominee Limited have been exempted by the Financial Secretary from the prohibition on their controlling other relevant members of the Group;

- *shareholding limit* — a prohibition on the holding of 5 per cent. or more of the voting power at any general meeting of HKEx has been prescribed in section 6 of the Merger Ordinance, and incorporated into the articles of association of HKEx, to prevent control of HKEx by any person, either alone or with any associate or associates. However, the SFC, in consultation with the Financial Secretary, may give approval to a person holding 5 per cent. or more of the voting power at any general meeting of HKEx where it can be demonstrated that it is in the interest of the investing public or in the public interest; and

- *HKEx as a listed company* — as set out in the section of this document headed "Business — business of the Group" HKEx, as a listed company on its own stock market, will be regulated by the SFC to avoid any conflict of interest and to ensure a level playing field between HKEx and other listed companies which are subject to the Listing Rules. Regulation by the SFC will be imposed through two sets of provisions. First, the Listing Rules have been amended to incorporate a new chapter (Chapter 38) relating specifically to the listing of HKEx and which sets out the requirements that must be satisfied for the securities of HKEx to be listed on the Stock Exchange. Secondly, a Memorandum of Understanding, dated 19th June, 2000, has been entered into between the SFC, HKEx and the Stock Exchange which sets out the way the parties to it will relate to each other in relation to:

  — HKEx's and other applicants and issuers' compliance with the Listing Rules;

  — the Stock Exchange's enforcement of its rules in relation to HKEx's securities and those of other applicants and issuers;

  — the SFC's supervision and regulation of HKEx as a listed issuer and, where a conflict of interest arises, other applicants and issuers;

  — conflicts of interest which may arise between the interests of HKEx as a listed company and companies of which it is the controller, and the interests of the proper performance of regulatory functions by such companies; and

  — market integrity.