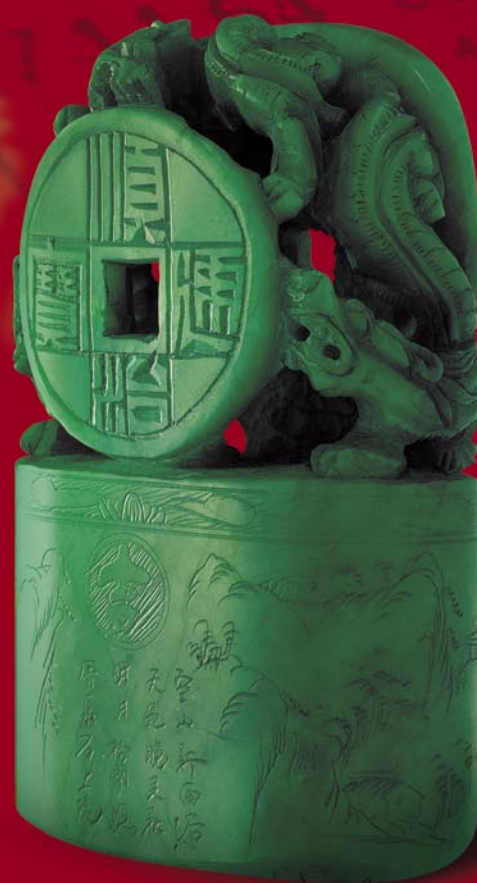




2005 Annual Report





QUALITY MARKET:

Everything has a price but, according to a Chinese saying, jade is priceless. Even though prices are determined every day on our markets, at HKEx we believe there is something as priceless as jade - effectively building a quality market. It defines what we do. Fairness and integrity are integral to Hong Kong's success as a premier capital market for China and pre-eminent international financial centre. That success, we believe, is priceless.

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Financial Highlights

(Financial figures are expressed in Hong Kong Dollar)

	2005	2004	Change
KEY MARKET STATISTICS			
Average daily turnover value on the Stock Exchange	\$18.3 billion	\$16.0 billion	14%
Average daily number of derivatives contracts traded on the Futures Exchange	68,157	56,752	20%
Average daily number of stock options contracts traded on the Stock Exchange	35,385	22,720	56%
	\$'000	\$'000	
RESULTS			
Income	2,694,057	2,393,937	13%
Operating expenses	1,145,482	1,156,296	(1%)
Operating profit	1,548,575	1,237,641	25%
Share of profits less losses of associates	18,433	12,884	43%
Profit before taxation	1,567,008	1,250,525	25%
Taxation	(227,460)	(193,641)	17%
Profit attributable to shareholders	1,339,548	1,056,884	27%
Earnings per share	\$1.26	\$1.00	26%
Interim dividend per share	\$0.49	\$0.43	14%
Final dividend per share	\$0.64	\$0.47	36%
	\$1.13	\$0.90	26%
Dividend payout ratio	90%	90%	N/A
	\$'000	As restated \$'000	
KEY BALANCE SHEET ITEMS			
Shareholders' funds	4,367,489	4,032,234 ^o	8%
Total assets*	22,960,933	21,443,404	7%
Net assets per share [#]	\$4.11	\$3.82 ^o	8%

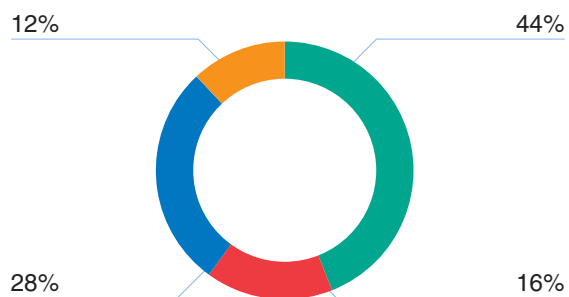
^o Audited and restated (shareholders' funds down by \$20 million and net assets per share down by \$0.01) as at 31 December 2004 due to the adoption of new HKFRSs

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

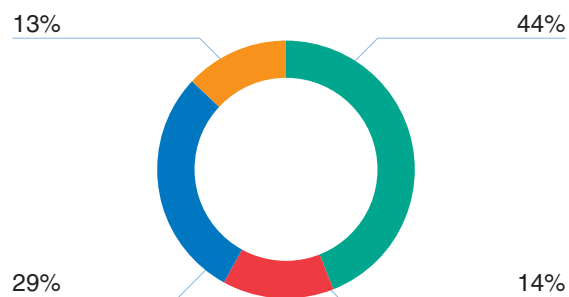
[#] Based on 1,062,754,846 shares issued and fully paid as at 31 December 2005 (2004: 1,056,638,846 shares)

BY BUSINESS SEGMENT*

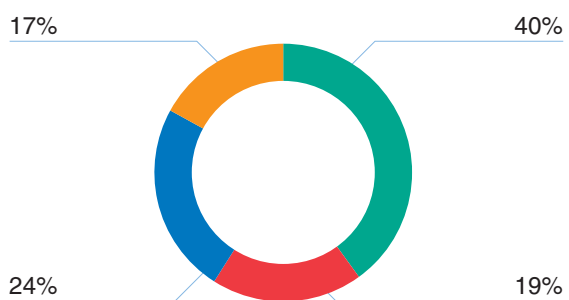
2005 Income



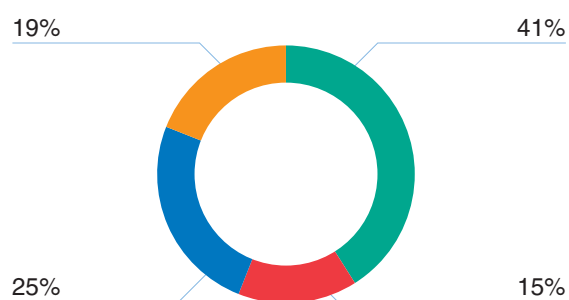
2004 Income



2005 Segment results



2004 Segment results



● Cash Market

● Derivatives Market

● Clearing Business

● Information Services

* Details are set out in note 4 to the consolidated accounts on pages 142 to 144.

Highlights of the Year

Strengthening Regulatory Framework

1 January

Implemented the Listing Rules governing the regulation of sponsors and IFAs.

Implemented the amendments to the Listing Rules relating to the CG Code and rules on the CG Report.

7 February

Published a feedback statement on continuing listing criteria and related issues.

18 February

Published a consultation paper on a new structure for listing decision-making.

24 March

Submitted views on proposals for statutory backing to the Listing Rules.

19 May

Posted responses to consultation paper on the new structure for listing decision-making on the HKEx website.

18 November

Published an exposure paper on the abolition of the requirement for Main Board issuers to publish paid announcements in newspapers and related matters.

Promoting HKEx's Markets and Hong Kong's Position as an International Financial Centre

28 January

Co-organised the Daiwa Securities SMBC/HKEx Conference in Hong Kong for the Japanese business community. **1**

30 March – 1 April

Hosted a workshop for delegates of the China Securities Depository and Clearing Corporation on the structure, operations, risk management, technical infrastructure and strategic development of HKSCC.

2 April

Organised its first investor conference for individual investors on the present and future roles and functions of HKEx. **2**



1-3 June

Co-hosted the World Federation of Exchanges Forum for Developing Markets in Beijing with the Shanghai Stock Exchange and the Shenzhen Stock Exchange. **3**

24 June

Co-organised a listing promotion conference in Shijiazhuang, the provincial capital of Hebei as part of the Hebei-Hong Kong week. **4**

4-5 July

Participated in conferences held in Tokyo and Osaka, highlighting Hong Kong's role as an international capital formation centre. **5**

26 July

Co-organised the Pan Pearl River Delta Capital Market Forum in Chengdu.

9 September

Organised the Asia Forum in Hong Kong in partnership with the London School of Economics and Political Science. **6**

28-29 November

Co-hosted investment seminars in London and Zurich on Hong Kong's role as a gateway to Mainland China. **7**

2 December

Held a listing promotion conference together with the Office of the Government of the Hong Kong Special Administrative Region in Beijing and the Provincial Government of Hubei in the Hubei province. **8**

Enhancing Market Infrastructure**January**

Commenced consolidation of four existing market system networks into the SDNet. **9**

31 January

Upgraded the Clearing Service Call Centre and Interactive Voice Recording System.

**5****6****8****7****9**

April and August

Improved CCASS nominee services by extending the CCASS deadline for participants to submit voting instructions and corporate action instructions.

June

Upgraded the operating systems of the HKATS, DCASS and CCASS/3 to new versions.

4 July

Reduced minimum trading spreads for shares above \$30 and changed the AMS/3 parameters to complement spread reductions.

18 July

Commenced Trading Hall renovation. **10**

8 August

Enhanced CCASS money settlement.

September – November

Upgraded the HKEx website capacity and substantially enhanced disaster recovery arrangements. **11**

October

Harmonised the capital requirements of different categories of clearing participants of the three clearing houses.

31 October

Completed the migration of the HKATS, DCASS and PRS circuits to the SDNet.

21 November

Increased the maximum number of outstanding orders per price queue from 2,000 to 4,000 in the AMS/3.

Introducing New Products and Market Development

1 February

Implemented a series of enhancement measures for stock options such as increasing visibility of market prices, providing more choices in strike prices, and reducing trading tariffs.

10



11



12



23 May

Introduced FTSE/Xinhua China 25 Index Futures and Options. **12**

9 June

Enhanced the market-making obligations associated with ETFs.

10 October

Discussed the derivative warrant market and invited feedback.

25 November

Listing of the first Real Estate Investment Trust in Hong Kong.

7 November

Received the Bronze Prize in the Best Annual Reports Awards presented by the Hong Kong Management Association.

17 November

Received the Directors of the Year Awards 2005 from The Hong Kong Institute of Directors (Listed Companies: Main Board – Constituents of Hang Seng Indices). **14**

29 November

Received the Best Corporate Governance Disclosure Awards (Diamond Award) presented by the HKICPA. **15**

Awards Received

19 October

Received the Application Category Gold Award in the Hong Kong Computer Society's 7th Information Technology Excellence Awards for the CCASS/3. **13**

**13****15****14**

Chairman's Statement

2005 was a remarkable year for the Hong Kong Cash and Derivatives Markets. Several historic records were set and HKEx benefited from vibrant market activity.

For HKEx, 2005 was an outstanding year. Our markets set many new records and HKEx posted the highest-ever income and earnings per share since its listing in 2000. Supported by a recovering economy, strong results were achieved due to increased activity in our core business areas, including listing, trading, clearing and information services.

Hong Kong's business environment improved markedly in 2005 with a broad-based recovery in many key sectors that led to falling unemployment rates and rising confidence. Hong Kong was one of the fastest-growing economies in Asia last year with a GDP growth of 7.3 per cent.



The Mainland registered strong economic growth of 9.9 per cent. The buoyant economy created a favourable environment for numerous listings of major Mainland enterprises, and Hong Kong remained their preferred listing venue in large part due to its high market liquidity, attributable to global investors' interest in the growth potential of Mainland companies and in acquiring Renminbi-denominated assets in anticipation of the currency revaluation. Since 1993, half of the total equity funds raised in the Hong Kong market have been by Mainland enterprises. Last year, Mainland enterprises accounted for the majority of the IPO funds raised and contributed to a larger and more diverse portfolio of listed companies. As a result of this vibrant fund raising activity, Mainland enterprises now account for over 40 per cent of Hong Kong's total market capitalisation.



In 2005, we continued to focus much of our effort on establishing new, and reinforcing existing, relationships with Mainland partners while further developing our market infrastructure and strengthening investor protection. We were able to rationalise costs by consolidating and streamlining operations to increase efficiency. These factors combined to advance Hong Kong to become the eighth largest market in the world in terms of market capitalisation, up from ninth in 2004, as well as yield high returns for the year.

Financial Results

For 2005, HKEx achieved record income, net profit and market capitalisation levels.

Income for the year was \$2,694 million, a rise of 13 per cent as compared to 2004. Profit attributable to Shareholders was \$1,340 million, 27 per cent higher than that in the previous year. HKEx's market capitalisation increased to \$34.2 billion by the year end, a growth of 55 per cent from 12 months earlier, and a fourfold rise from \$8.6 billion at the close of the first day of trading on 27 June 2000.

The rise in income for the year is principally attributable to strong listing and trading activities in the Cash and Derivatives Markets, which boosted transaction and clearing fees and income from sale of information. The relatively higher interest rates during the year also raised the Group's net interest income. On the expense side, rigorous consolidation also contributed to the strong net profit recorded.

Earnings per share were \$1.26 and the Board recommended payment of a final dividend of \$0.64 per share. Combined with the interim dividend of \$0.49 per share, the total dividend for the year amounted to \$1.13 per share, in compliance with the Company's dividend policy of a 90 per cent payout ratio.

New Records in the Securities Market 2005

	2005 (Up to year-end)	Pre-2005 Record
Market Capitalisation	\$8,260.3 bil (21 Dec 2005)	\$6,695.9 bil (31 Dec 2004)

	2005 (Up to year-end)	Pre-2005 Record
Total Market Turnover	\$4,520.4 bil	\$3,974.1 bil (Year 2004)

Securities Achieved Highest Turnover Record

Trading Turnover of H-shares	\$953.3 bil	\$941.1 bil (Year 2004)
Trading Turnover of Derivative Warrants	\$856.6 bil	\$524.5 bil (Year 2004)
Number of Newly Listed Derivative Warrants	1,682	1,259 (Year 2004)

New Funds Raised Records by IPOs

IPO equity funds raised by H-shares	\$137.4 bil	\$52.4 bil (Year 2000)
IPO equity funds raised (including the three REITs)	\$191.5 bil	\$132.1 bil (Year 2000)
Largest single IPO by a listed company	\$71.6 bil	\$43.6 bil (Year 2000)

New Records in the Derivatives Market 2005

	Volume	
	Number of Contracts in 2005 (Up to year-end)	Previous All-time high Contracts (All in 2004)
Total Futures and Options	25,523,007	19,629,692
Total Futures	13,433,386	11,884,152
Total Options	12,089,621	7,745,540
Hang Seng Index Futures	9,910,565	8,601,559
Stock Options	8,722,393	5,611,832

A Record-setting Year

Both the Cash and Derivatives Markets set a number of new records in 2005.

Total market capitalisation of our Main Board and GEM, excluding REITs and government bonds, stood at \$8,179.9 billion at the end of December 2005, up 22 per cent from the end of 2004.

Total market turnover reached \$4,520.4 billion from the previous record of \$3,974.1 billion in 2004. Also surpassing the records set in 2004 were the trading turnover of H-shares (\$953.3 billion, up from \$941.1 billion in the previous year) and the trading turnover of derivative warrants (\$856.6 billion, up from \$524.5 billion in 2004).

Hong Kong continued to be a leading global capital formation centre in 2005. We introduced 65 new listings, which raised \$165.7 billion – up 70 per cent from 2004 and up 25 per cent from the previous high in 2000, of which \$137.4 billion was raised through H-share offerings. For the first time in the past two decades, IPO equity capital raised exceeded post-IPO capital raised, reflecting the strong new business potential for HKEx.

The Link REIT, Hong Kong's first exchange-listed REIT, raised approximately \$21.6 billion and is the world's largest ever REIT IPO. Subsequently, GZI REIT and Prosperity REIT also debuted on the market. In total, the three REIT listings raised \$25.8 billion. For 2005, the total funds raised (equities and the three REITs) amounted to \$327.1 billion, comprising \$191.5 billion and \$135.6 billion from IPO and post-IPO respectively.

A record of 1,682 newly listed derivative warrants was also achieved in 2005, up from 1,259 in 2004.

The Derivatives Market broke all records set in 2004 for futures and options contracts traded. During the year, there were a total of 25.5 million contracts traded, comprising 13.4 million futures contracts traded, of which 9.9 million were for Hang Seng Index Futures, and 12.1 million options traded, of which 8.7 million were stock options. In terms of notional turnover, Hong Kong's Derivatives Market was the seventh largest in the world in 2005.

Premier Capital Formation Market for China

Hong Kong has strengthened its pre-eminent position as the preferred market choice for Mainland issuers. Our market's capital-raising strength, its liquidity, and the opportunity it offers companies to improve their corporate governance through exposure to international standards and practices have continued to attract Mainland enterprises to seek listing in Hong Kong.

Over the past 12 years, Mainland enterprises that listed in Hong Kong, including H-shares, red chips and non-H-share Mainland private enterprises, have raised over \$1 trillion. In the history of our stock market, the top 10 IPOs have all been by Mainland enterprises.

Of those companies newly listed in 2005, 55 per cent, or 37 were Mainland enterprises and the \$150.8 billion raised by them accounted for 91 per cent of all IPO equity funds raised. Also, eight of the top 10 IPOs last year were by Mainland enterprises, including the China Construction Bank IPO, the largest in Hong Kong's history and the largest in the world since 2001. China Construction Bank chose to list exclusively in Hong Kong and its share offering raised more than \$71 billion, which further reinforced our market's position as the premier venue for listing of Mainland enterprises.

Quality Recognition

The Board and our executive team recognise that investor confidence is vital to the continued success of HKEx's markets. In order to strengthen investor confidence, efforts have been made to continuously raise market quality by enhancing our structure, policies and operations.

All companies listed on the Exchange, including Mainland enterprises, are governed by the same regulatory regime and subject to the same accounting and corporate governance standards, many of which were enhanced during the year.

I am glad to report international recognition of our efforts. In the "Doing Business in 2006" survey cosponsored by the World Bank and International Finance Corporation, Hong Kong ranked fourth among 155 economies with a score of 8.7 out of 10 in terms of investor protection, achieving high marks in the transparency of transactions, director liability and shareholders' ability to sue over misconduct.

Performance of Mainland Enterprises

As at 31 December 2005	Cash Market	Mainland Enterprises	(%)
Number of listed companies	1,135	335	30
Number of newly listed companies	67 [^]	37	55
Market capitalisation – equities	\$8,179.9 bil	\$3,192.1 bil	39
Average daily turnover – Cash Market (equities, warrants and other securities)	\$18.3 bil	\$6.7 bil	37
Average daily turnover – equities	\$14.6 bil	\$6.7 bil	46
Equity funds raised by IPOs (excluding the three REITs)	\$165.7 bil	\$150.8 bil	91
Funds raised by the three REITs	\$25.8 bil	N/A	N/A
Equity funds raised in secondary market	\$135.6 bil	\$47.0 bil	35
Total funds raised (equities and the three REITs)	\$327.1 bil	\$197.8 bil	60

[^] The figure includes two companies which switched their listings from the GEM to the Main Board

At HKEx, we have been setting the benchmarks for integrity and market quality. In 2005, we were honoured to receive a number of awards for good corporate governance, including receiving our third consecutive Diamond Award (top honour) from the HKICPA and the Directors of the Year Awards 2005 from the Hong Kong Institute of Directors.

Outlook

We remain optimistic about the long-term prospects of our business and the markets. However, uncertainties on the external front over global oil prices, interest rates and valuation of the Renminbi could affect trading activity and hence our profitability.

With increasing globalisation and greater availability of products in other markets, we also foresee intensified competition among exchanges in the region and beyond for investor funds and issuers' listings both in the Cash and Derivatives Markets.

HKEx welcomes the Government's decision to abolish estate duties and exempt profits tax for offshore funds. These measures should help attract further inflow of funds to Hong Kong and support the city's development as a major fund management centre, complementing our role as the premier capital-formation market for Mainland China.

Our renovated Trading Hall opened earlier this year after extensive refurbishment while the adjacent Exchange Exhibition Hall will open in April 2006. Together they offer a variety of functions and the materials to be displayed will facilitate a better understanding of the extraordinary evolution of Hong Kong financial market by the public.

It is my firm belief that our markets' evolution, sustained by an emphasis on quality – through continuous improvements in regulation, education and infrastructure – will help distinguish Hong Kong as a pre-eminent international financial hub. Combined with the right business conditions, the ongoing success of our growth strategies and cost-saving programmes should keep us on track to continue to provide good returns to Shareholders.

At HKEx, the Board and executives will be preparing the next three-year plan, as the Strategic Plan of 2004-2006 approaches completion. The focus is expected to remain on pursuing organic growth opportunities, including building on our unique partnership with the Mainland, and providing a better platform to meet the growing fund-raising needs of potential issuers seeking listing in Hong Kong.

On a personal note, my term expires in April 2006, and this is my last statement to you as Chairman. I have greatly enjoyed working with my fellow Board members for the past six years and I am truly heartened to see that during that period our markets have grown and become more robust. Total market capitalisation has risen 73 per cent from \$4,734.8 billion at the end of 1999, with turnover in the Cash Market increasing more than twofold and volume in the Derivatives Market expanding almost threefold.

Achieving the growth of your Company over the years and at the same time upholding the public interest have been the steadfast goals of the Board as well as all the executives and staff at HKEx. I am honoured to have worked with my colleagues and shared their endeavours. I would like to acknowledge the exemplary hard work carried out with commitment and passion at every level within HKEx. This work ethic and spirit bode well for HKEx's long-term prospects.

LEE Yeh Kwong, Charles

Chairman

Hong Kong, 8 March 2006

Chief Executive's Review

In late 2003, HKEx embarked on a Three-year Strategic Plan to pursue its mission to provide a world-class marketplace for Hong Kong and Mainland China securities and derivatives products. The three key strategic objectives – Building a Quality Market, Becoming a Mainland Partner and Consolidation have remained the key focuses of HKEx ever since.

HKEx — THE THREE-PRONGED STRATEGY



HKEx's Vision

A world-class marketplace for Hong Kong and Mainland China securities and derivative products

Building a Quality Market

Improving and maintaining market quality is the most important prerequisite for HKEx to uphold and reinforce its roles as an international financial centre and a premier capital market for Mainland enterprises.

Strengthening the regulatory regime

In line with our continuous efforts to improve the corporate governance standards, amendments to the Listing Rules embracing the CG Code took effect from 1 January 2005. As strengthening the regulatory framework is an ongoing process, HKEx reviews its rules on a regular basis to ensure that they are in line with the best market practices and international standards. While the majority of companies and market participants have fully complied with the rules and regulations, as in all markets, there may still be a small number of companies and market participants that do not abide by the rules. It is HKEx's belief that, for the benefit of the market, non-compliance cases should be dealt with through stricter enforcement. To this end, HKEx supports the Government's and the SFC's proposals for giving statutory backing to the more important Listing Rules requirements.



The Exchange had also reviewed the composition and structure of the Listing Committees, and the relevant rule amendments will come into effect in May 2006. The measures were aimed at increasing the Exchange's transparency in the discharge of its responsibilities for listing regulation and improving the operation of the Listing Committees.

Also for the purpose of improving transparency, the Listing Committees published the second annual report since July 2004 to set out the work done during the service term of their members. In addition, starting from this year, a Listing Committee Report is prepared to record the work done during the financial year of HKEx, which is despatched to the Shareholders together with the Annual Report.



Almost six years after the launch of the GEM, HKEx considers that it is now the right time to conduct a comprehensive review of the GEM, and issued in January 2006 a discussion paper to facilitate public discussion for the purpose of enhancing the further development of the GEM.

In respect of the increased interest in our derivative warrants market, HKEx conducted a review of the market and published an article on derivative warrants in October 2005 to invite public comments thereon.

Fostering corporate governance culture

Good corporate governance in the market translates into better internal control and risk management practices and higher market integrity, resulting in stronger investor confidence. Hence, a well-established compliance culture is equally important to a regulatory regime for maintaining an open, secure, fair, orderly, efficient and transparent marketplace.

As the exchange controller as well as a listed company, HKEx has focused intently upon observing the best corporate governance standards and practices, and setting a good example in leading the Hong Kong market in the area of corporate governance. HKEx strongly believes that the awareness of good corporate governance among issuers could be raised by sharing with them the best practices that we have observed. Over the years, HKEx has received several awards in recognition of our achievements in corporate governance from both local and overseas organisations. In 2005, we were particularly delighted that HKEx has been recognised as a member of the FTSE4Good Index Series, a group of real-time indices designed to reflect the performance of companies in social responsibility aspect, and identified as a corporate governance star in the CG Watch 2005 conducted by the CLSA Asia-Pacific Markets and the Asian Corporate Governance Association. A summary of the public recognitions is set out on page 87 of this Annual Report.

HKEx will continue to strive to engender trust and confidence by pursuing ongoing enhancements to its internal governance and upholding the highest standards of transparency. The Corporate Governance Report on page 72 will provide more details.



Meeting customers' demands

In response to market needs and with the aim of improving market liquidity and efficiency, HKEx reduced the monthly user fees for all AMS/3 trading devices, and completed its review on clearing fees in 2005. In fact, investors and market participants have been enjoying substantial cost savings as a result of a series of fee reductions implemented since 2004. Details of the fee reductions implemented in the past two years and in the coming year can be found on page 51 under the Business Review of this Annual Report.

To add value to our business, HKEx has been reviewing the existing products and services and exploring new ones in collaboration with the market. To name a few, FTSE/Xinhua China 25 Index Futures and Options and three ETFs were newly introduced and six additional classes for stock options and futures were launched during the year. Various measures were taken to give market participants more choices and to ensure sustained long-term growth in the stock options market. In addition, HKEx plans to introduce CBBCs in June/July 2006 subject to the readiness of the market. On information services, HKEx has also introduced new service for redistribution of historical data products and extended special offer of real-time market data for Mainland users.

In the interests of the investing public, HKEx has increased its efforts to promote investor education by offering ongoing training and seminars to our participants and investors to familiarise them with our products and services.

Improving the market infrastructure

A quality market can only be built upon a stable, reliable and efficient market infrastructure. We leverage the competency, teamwork and quality culture of our staff to deliver cost-effective IT solutions to support further growth and development of our markets. In 2005, apart from upgrading the operating systems of the HKATS, DCASS and CCASS/3, a total of about \$25 million was spent on upgrading the capacity of the AMS/3. HKEx's securities market trading and clearing systems are highly recognised in the IT industry. Following the awards received in 2004 for the AMS/3, a Gold Award (top honour) of the Application Category of the 7th IT Excellence Awards was conferred on HKEx in respect of its CCASS/3 by the Hong Kong Computer Society in October 2005.

As part of HKEx's commitment to enhance the market infrastructure and ensure the highest standard of system performance, HKEx, in October 2005, completed the construction and implementation of the SDNet, a new Optical Ethernet network, and successfully migrated its participants' links to the HKATS, DCASS and PRS onto the SDNet, which constituted the first phase of the network consolidation project. The migration of the CCASS/3 and AMS/3

participants' circuits to the SDNet is expected to be completed in mid-2006 and 2007 respectively. This initiative has improved the quality of the market by offering significant technological improvements and greater operational efficiency and cost effectiveness to both HKEx and participants.

Other enhancements to the market infrastructure included improvements in money settlement services and nominee services, harmonisation of the capital requirements of different categories of clearing participants of the three clearing houses, reduction in trading spreads (Phase 1), revamp of HKEx website, improvement of HKEx disaster recovery website and refurbishment of the Trading Hall.

After reviewing the trading and market data for the first six months following Phase 1 spreads reduction, on 15 February 2006 the Board decided to implement the Phase 2 proposal for securities trading between \$0.25 and \$20 in July 2006 subject to the SFC's approval.

Becoming a Mainland Partner

HKEx is well-placed to capitalise on the steady economic growth in the Mainland and will continue to offer an effective and prestigious listing venue for potential Mainland enterprises to raise capital and enhance their profile to enable them to further develop their businesses.

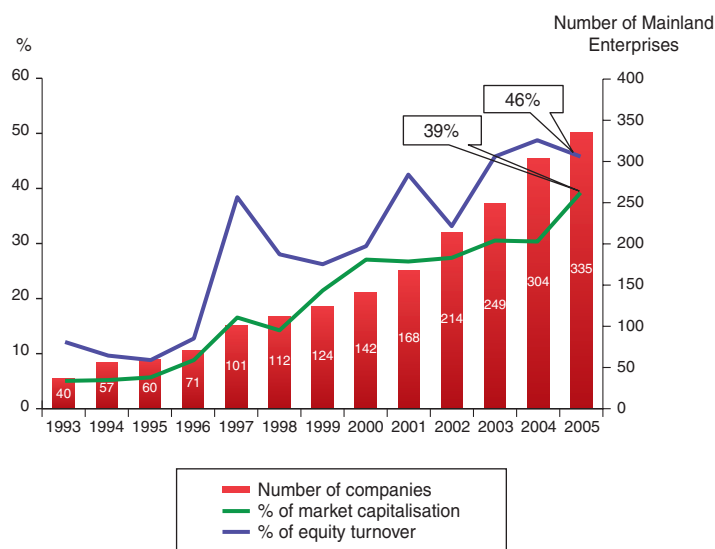
Encouraging listings of Mainland enterprises

The listing of Mainland enterprises has contributed significantly to the growth of the Hong Kong Cash and Derivatives Markets. In 2005, out of the 10 largest companies by turnover, six of them were Mainland enterprises. At the end of December 2005, the 335 Mainland enterprises accounted for 30 per cent of the total number of 1,135 issuers on the Exchange, 39 per cent of the total year-end market capitalisation of \$8,179.9 billion and 46 per cent of the equity market's total turnover. The trading turnover of H-shares, reached a record high last year, rising to \$953.3 billion, signifies strong investor interest in Mainland enterprises.

Raising the awareness of good corporate governance

In addition to the access to capital denominated in a freely convertible currency, Mainland enterprises, through becoming listed companies on the Exchange, are subject to market discipline and compliance requirements which help bring their standards of corporate governance, accounting, disclosure and management on a par with international best practices. The vitality of the equity market depends fundamentally on the quality of listed companies. Education programmes are frequently organised, in particular, in the Mainland for newly listed companies and potential issuers so as to properly equip them with better knowledge of the regulatory framework in Hong Kong and to promote the awareness of post-listing compliance.

Mainland Enterprises Contributed Significantly To The Hong Kong Market



Strengthening cooperation with the Mainland regulators

In the light of the challenges on cross-border enforcement of local rules and regulations on Mainland issuers, HKEx has been co-operating closely with the SFC, the CSRC, the Shanghai Stock Exchange and the Shenzhen Stock Exchange to promote good corporate governance practices to Mainland listed and potential issuers. In the way forward, in addition to the Memorandum of Regulatory Cooperation meeting, more frequent meetings and liaison will be conducted with the Mainland regulators to share experience and information and discuss regulatory issues and market development.

Consolidation

HKEx will be able to offer greater value to its stakeholders by effectively implementing its policies and developments and improving its operations as a streamlined, dedicated and efficient business entity.

In the past two years, HKEx has focused on prudent cost controls, a streamlined project portfolio, corporate reorganisation, staff development and training, integration of business operations and policies, and strengthening of risk management. All these have contributed positively to the remarkable performance of HKEx in 2005.

HKEx posted the best results since listing in 2000

- Income increased by 13 per cent to \$2,694 million (2004: \$2,394 million)
- Reduction in the IT and computer maintenance expenses of 9 per cent
- Net profit increased by 27 per cent to \$1,340 million (2004: \$1,057 million)

As part of the succession plan, the corporate structure was revised in August 2005 to provide senior executives with the opportunities to further enrich their exposures and management experience. The Cash Clearing Systems Development and Support Department and the Derivatives Clearing Systems Development and Support Department have been consolidated into the Clearing Systems Development and Support Department and the Investor Services has been transferred to the Corporate Communications Department, resulting in a more efficient organisation structure.

To implement the initiatives to develop a comprehensive electronic listing management system and the establishment of a China Affairs Team, the Listing Division was also reorganised in February 2006.

HKEx's objective is to establish a robust corporate culture in order to deliver an enhanced performance in the long term and to help deliver HKEx's wider strategic aims. To this end, we will continue to emphasise our corporate goal that life-long learning is important to all staff and provide academic sponsorship and job-related trainings to employees at all levels. Driven by the need to better serve our customers, HKEx will also focus on improving its customer services by understanding better and responding faster to their needs. In addition, HKEx will strengthen the capability of its management by providing a more effective MIS, reviewing the remuneration structure and policies, and implementing the succession plan. Promotion of corporate citizenship is another goal. Since 2000, over \$130 million had been donated to the Hong Kong Community Chest via the Stock Code Balloting for Charity Scheme. HKEx will continue to actively participate in various community and charitable activities. The Corporate and Social Responsibility Report on page 103 will give further information about HKEx's commitments towards the community.

2006 MAJOR INITIATIVES

Consolidation of operations through mainly the organisational restructuring, cost rationalisation, and prioritisation of projects in 2004 and 2005 has underpinned our strength and helped better allocate our available resources to meet future challenges in completing the Three-year Strategic Plan. The executives are now working on the next three-year plan for the period 2007 – 2009. In 2006, we have a wide range of initiatives on our agenda, some are new and others are ongoing. The Key Achievements and Priorities on page 55 provides a summary of HKEx's achievements in 2005 and the key initiatives planned for 2006.

APPRECIATION

The overview of the work by various divisions and departments in the past year is given in more detail under the Business Review of this Annual Report. I wish to thank everyone within HKEx for their valuable contributions to a remarkable 2005, which would not have been made possible without their hard work and dedication. I am also deeply grateful for the unswerving confidence of our loyal Shareholders and the notable support of our business partners and customers. I would also like to take this opportunity to thank my fellow Board members for their support, guidance and advice throughout the year.

While we can all be proud of the progress achieved to date, I and on behalf of all the Board members and employees of HKEx, want to express our sincere gratitude to our Chairman, Mr Charles Lee, who will be retiring at the conclusion of the 2006 AGM. The Chairman's commitment and tireless efforts over the past six years have been instrumental in steering HKEx to develop into an internationally respected exchange for liquidity, opportunity, accessibility and reliability. HKEx has now become one of the most successful international publicly-owned exchange operators.

The Chairman has also played a pivotal role in reinforcing Hong Kong's position as the pre-eminent international financial centre over the past two decades. Of his many contributions, the introduction of the listing of H-shares in Hong Kong in 1993 paved the way for the listing of Mainland enterprises in Hong Kong, which has created tremendous business opportunities for the Cash and Derivatives Markets. Under his steadfast leadership, the successful demutualisation of the exchanges and clearing houses and listing of HKEx in 2000 opened a new chapter for the history of the Hong Kong financial industry. His noteworthy achievements underpin the high respect and great support accorded to him in the global financial arena.

It has been a distinct honour and privilege to have had the opportunity to work with the Chairman. I would like to record my personal thanks and sincere appreciation to him for his invaluable advice and continuous encouragement extended to me in fulfilling the duties of the Chief Executive of HKEx in the past three years. I look forward to receiving his continued support for the further growth of HKEx.

Chow Man Yiu, Paul
Director and Chief Executive
 Hong Kong, 8 March 2006

Corporate Information

BOARD OF DIRECTORS

Independent Non-executive Chairman

1. LEE Yeh Kwong, Charles* GBS, JP

Executive Director, Chief Executive

2. CHOW Man Yiu, Paul SBS, JP

Independent Non-executive Directors

3. CHEUNG Kin Tung, Marvin* SBS, JP
(appointment effective 12 April 2005)
4. FAN Hung Ling, Henry* SBS, JP
(re-appointment effective 12 April 2005)
5. FONG Hup*
(re-appointment effective 12 April 2005)
6. FRESHWATER, Timothy George*
7. KWOK Chi Piu, Bill
(re-elected on 12 April 2005)
8. LEE Jor Hung, Dannis BBS
9. LEE Kwan Ho, Vincent Marshall
(re-elected on 12 April 2005)
- LEONG Ka Chai*, SBS, JP
(retired on 12 April 2005)
10. LO Ka Shui* GBS, JP
11. STRICKLAND, John Estmond GBS, JP
12. WEBB, David Michael
13. WONG Sai Hung, Oscar

* Government Appointed Directors

COMMITTEES

Audit Committee

STRICKLAND, John Estmond (*Chairman*)

FONG Hup (*Deputy Chairman*)
(re-appointment effective 13 April 2005)

CHEUNG Kin Tung, Marvin
(appointment effective 13 April 2005)

FAN Hung Ling, Henry
(re-appointment effective 13 April 2005)

LEE Kwan Ho, Vincent Marshall
(re-appointment effective 13 April 2005)

WEBB, David Michael
(resigned on 13 April 2005)

Executive Committee

LEE Yeh Kwong, Charles (*Chairman*)

CHOW Man Yiu, Paul

CONROY, Patrick Kevin

KWOK Chi Piu, Bill
(appointment effective 13 April 2005)

LEE Jor Hung, Dannis

LEONG Ka Chai
(retired on 12 April 2005)

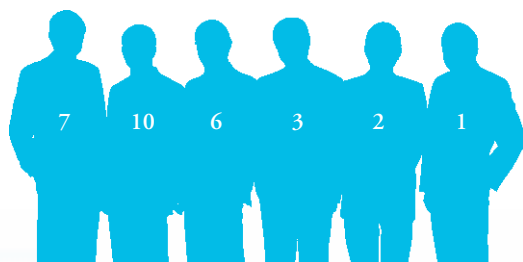
Investment Advisory Committee

FRESHWATER, Timothy George (*Chairman*)

WONG Sai Hung, Oscar (*Deputy Chairman*)

SUN, David

WEBB, David Michael



Nomination Committee

LEE Yeh Kwong, Charles (*Chairman*)
 FONG Hup
(appointment effective 20 April 2005)
 KWOK Chi Piu, Bill
(retired on 12 April 2005)
 LEE Kwan Ho, Vincent Marshall
(appointment effective 13 April 2005)
 WEBB, David Michael
(appointment effective 20 April 2005)
 WONG Sai Hung, Oscar

Remuneration Committee

LO Ka Shui (*Chairman*)
 CHEUNG Kin Tung, Marvin
(appointment effective 13 April 2005)
 LEE Jor Hung, Dannis
 LEE Kwan Ho, Vincent Marshall
(retired on 12 April 2005)

Risk Management Committee

(established under Section 65 of the SFO)

LEE Yeh Kwong, Charles (*Chairman*)
 CHAN Ka-lok**
(appointment effective 1 July 2005)
 DICKENS, Mark**
(retired on 31 March 2005)
 FAN Hung Ling, Henry
(re-appointment effective 13 April 2005)
 FONG Hup**
(appointment effective 1 July 2005)
 HE Guangbei**
(appointment effective 20 January 2006)
 KWOK Chi Piu, Bill
(re-appointment effective 13 April 2005)
 LAM Kin**
(retired on 30 June 2005)

LEONG Ka Chai**
(retired on 30 June 2005)
 OR Ching Fai, Raymond**
(retired on 31 March 2005)
 WHEATLEY, Martin**
(appointment effective 1 July 2005)
 WONG Tung-shun, Peter**
(retired on 19 January 2006)
 YUE Wai Man, Eddie**
(re-appointment effective 1 July 2005)

** Appointed by the Financial Secretary

COMPANY SECRETARY

MAU Kam Shing, Joseph

AUTHORISED REPRESENTATIVES

CHOW Man Yiu, Paul
 MAU Kam Shing, Joseph

AUDITORS

PricewaterhouseCoopers

LEGAL ADVISERS

Allen & Overy



Board of Directors and Senior Management

BOARD OF DIRECTORS



Lee Yeh Kwong, Charles
GBS, JP

Independent Non-executive Chairman
Aged 69

Director since 6 March 2000
Term of office: 1 April 2004
(re-appointed) to 2006 AGM

Memberships in HKEx's committees:
Chairman of **Executive Committee**,
Nomination Committee and
Risk Management Committee

Other major office

Mandatory Provident Fund Schemes Authority – chairman

Past offices

SEHK – council member (1988-1994) and chairman (1992-1994)

Government appointments

Executive Council of the HKSAR – member (current and 1997-2002)
Governor's Business Council – member (1992-1997)
Hong Kong Affairs Adviser – member (1993-1997)
Selection Committee for the First Government of the HKSAR – member (1996)
Companies Law Revision Committee – secretary (1968-1973)

Community appointments and others

Council of The Open University of Hong Kong – chairman
Executive Committee of Hong Kong Arts Festival Society Limited – chairman
Court of The Hong Kong University of Science and Technology – honorary member
The Community Chest of Hong Kong – director and vice-patron
Equal Opportunities Commission of Hong Kong – member (1996-2003)
Court of The Hong Kong Polytechnic University – member (1995-2002)

Professional qualification and experience

Solicitor (Hong Kong and England & Wales)
Qualified accountant and **chartered secretary**

Mr Lee is one of the founders of Woo, Kwan, Lee & Lo, and has over 30 years of experience in the securities industry.



CHOW Man Yiu, Paul
SBS, JP

Executive Director, Chief Executive
Aged 59

Director since 1 May 2003
Ex-officio member of the Board

Membership in HKEx's committee:
Member of **Executive Committee**

Other major offices

World Federation of Exchanges – director
SEHK, HKFE, HKSCC, SEOCH and HKCC – chairman

Past offices

HSBC Asset Management (Hong Kong) Limited – chief executive, Asia Pacific ex-Japan Region (1997-2003)
SEHK – chief executive (1991-1997)
HKSCC – director (1990-1997) and chief executive (1990-1991)

Government appointments

Hong Kong Cyberport Management Company Limited – director
Digital 21 Strategy Advisory Committee – member
Advisory Committee of SFC – member
Standing Committee on Company Law Reform – member

Community appointments and others

Council of HKICPA – appointed member
Council and Court of The University of Hong Kong – member
The Community Chest of Hong Kong – director
Hong Kong Investment Fund Association – chairman (2000-2001)

Professional qualification and experience

Distinguished fellow (Hong Kong Computer Society)
Bachelor of Science in Mechanical Engineering, Diploma in Management Studies and MBA (The University of Hong Kong)
Diploma in Finance (Distinction) (The Chinese University of Hong Kong)

Mr Chow has over 30 years of business and management experience in a wide range of industries from information technology, securities, banking to fund management.

Mr Chow also acts as director of various subsidiaries of HKEx.

**CHEUNG Kin Tung, Marvin**

SBS, JP

INED

Aged 58

Director since 12 April 2005
Term of office: 12 April 2005 to
2007 AGM

Memberships in HKEx's committees:
Member of **Audit Committee** and
Remuneration Committee

**Other major
offices**

Hang Seng Bank Limited – non-executive director
HKR International Limited – non-executive director
Supervisory Committee of Tracker Fund of Hong Kong – chairman

Past offices

Shui On Construction and Materials Limited – non-executive director (2004-2005)
SEHK – chairman of the Listing Committee (2003-2005) and
the GEM Listing Committee (2003-2005)
KPMG Hong Kong (1969-2003: partner (1974-2003), chairman and
chief executive officer (1996-2003))

**Government
appointments**

Executive Council of the HKSAR – member
Exchange Fund Advisory Committee – member
Airport Authority Hong Kong – board member
Barristers Disciplinary Tribunal Panel – member
Greater Pearl River Delta Business Council – member
Operations Review Committee of ICAC – member
Legislative Council – appointed member (1991-1995)
Urban Council – appointed member (1985-1995)

**Community
appointments
and others**

Witness Protection Review Board – member
International Accounting Standards Committee Foundation – trustee
Council of The Hong Kong University of Science and Technology – vice-chairman
Council of The Open University of Hong Kong – member
HKICPA – president (1990)

**Professional
qualification
and experience**

Fellow (HKICPA and Institute of Chartered Accountants in England & Wales)
Honorary Doctorate in Business Administration (Hong Kong Baptist University)

**FAN Hung Ling, Henry**

SBS, JP

INED

Aged 57

Director since 15 November 2003
Term of office: 12 April 2005
(re-appointed) to 2007 AGM

Memberships in HKEx's committees:
Member of **Audit Committee** and
Risk Management Committee

**Other major
offices**

CITIC Pacific Limited – managing director
Cathay Pacific Airways Limited – deputy chairman
Hong Kong Dragon Airlines Limited – director

**Government
appointments**

Executive Council of the HKSAR – member
Takeovers and Mergers Panel of SFC – deputy chairman
Takeovers Appeal Committee of SFC – member
Exchange Fund Advisory Committee – member
Health and Medical Development Advisory Committee – member
**Advisory Committee on Post-office Employment for Principal Officials under
the Accountability System** – member
Standing Committee on Judicial Salaries and Conditions of Service – member
Standing Committee on Directorate Salaries and Conditions of Service – member

**Community
appointments
and others**

The University of Hong Kong – treasurer and chairman of Finance Committee
Council of The Hong Kong Management Association – member
Hong Kong-United States Business Council – member
**Zhejiang Province Committee of the Chinese People's Political Consultative
Conference** – member

**Professional
qualification
and experience**

Barrister-at-Law (Hong Kong and England & Wales)
Attorney and counsellor at Law (California, USA)
Honours degree in Economics and Business Management
(The University of Hong Kong)
Bachelor of Laws (University of Beijing, China)

**FONG Hup**

INED
Aged 61

Director since 16 April 2003
Term of office: 12 April 2005
(re-appointed) to 2007 AGM

Memberships in HKEx's committees:
Deputy chairman of **Audit Committee**, member of **Nomination Committee** and **Risk Management Committee**

Other major offices

Deloitte Touche Tohmatsu – senior adviser
Supervisory Committee of Tracker Fund of Hong Kong – member

Past offices

Deloitte Touche Tohmatsu – senior assurance and advisory partner (1997-2002)
Kwan Wong Tan & Fong – senior partner (1976-1997)
SEHK – member of the Council (1997-2000) and the Listing Committee (1993-1996 and 2000-2003)
HKSCC – director (1997-2000)
SEOCH – director (1997-2000)

Government appointments

Process Review Panel for SFC – member
Securities and Futures Appeals Tribunal – member

Professional qualification and experience

Fellow (HKICPA and Institute of Chartered Accountants in England & Wales)
Bachelor of Business Administration (Boston University, USA)

Mr Fong has over 30 years of experience in the accounting profession and in the securities industry.

**FRESHWATER, Timothy George**

INED
Aged 61

Director since 3 April 2000
Term of office: 1 April 2004
(re-appointed) to 2006 AGM

Membership in HKEx's committee:
Chairman of **Investment Advisory Committee**

Other major offices

Goldman Sachs (Asia) L.L.C. – vice-chairman
Liu Chong Hing Bank Limited – non-executive director
Pacific Century Insurance Holdings Limited – non-executive director
COSCO Pacific Limited – non-executive director

Past offices

Jardine Fleming (1996-2000: chairman (1999))
Slaughter and May (1967-1996: partner (1975-1996) and head of worldwide corporate practice (1993-1996))

Government appointments

Securities and Futures Appeals Panel – member (1999-2004)
Takeovers and Mergers Panel of SFC – member (1997-1999)

Community appointments and others

The Community Chest of Hong Kong – director
The Law Society of Hong Kong – council member (1981-1985) and president (1984-1985)

Professional qualification and experience

Solicitor (Hong Kong and England & Wales)
Bachelor of Laws and **Master of Arts** (University of Cambridge, UK)

Mr Freshwater has over 35 years of experience in the securities industry.

**KWOK Chi Piu, Bill**

INED

Aged 53

Director since 3 April 2000
Term of office: 12 April 2005
(re-elected) to 2008 AGM

Memberships in HKEx's committees:

Member of **Executive Committee**
and **Risk Management Committee**

Other major offices

Wocom Holdings Limited – managing director
Wing On International Holdings Limited – executive director
Wing On Company International Limited – non-executive director

Past offices

HKFE – director (1991-2000) and vice-chairman (1997-2000)

Government appointments

Investor Compensation Company Limited – director
Takeovers and Mergers Panel of SFC – member
Takeovers Appeal Committee of SFC – member
Investor Education Advisory Committee of SFC – member
Securities and Futures Appeals Tribunal – member

Community appointments and others

Hong Kong Securities Institute – director (current and 1997-2003) and chairman (1999-2001)
Executive Committee of Asian Securities Analysts Federation Inc – chairman
Investigation Panel A of HKICPA – member
Council of China Mergers & Acquisitions Association – member

Professional qualification and experience

Bachelor of Science (Chemistry) and **Bachelor of Arts (Economics)**
(Stanford University, USA)
Doctor of Philosophy (Biochemistry) (University of Chicago, USA)

Dr Kwok has over 20 years of experience in the securities and futures industry.

**LEE Jor Hung, Dannis**
BBS

INED

Aged 51

Director since 3 April 2000
Term of office: 15 April 2003
(re-elected) to 2006 AGM

Memberships in HKEx's committees:

Member of **Executive Committee**
and **Remuneration Committee**

Other major offices

DL Brokerage Limited – chairman
CIG Yangtze Ports PLC – non-executive director

Past offices

Stockmartnet Holdings Limited – non-executive director (2000-2005)
SEHK – council member (1991-1997) and vice-chairman (1994-1995)
HKSCC – director (1992-1997) and vice-chairman (1995-1997)

Government appointments

Barristers Disciplinary Tribunal Panel – member
Securities and Futures Appeals Panel – member
Advisory Committee of SFC – member (1999-2001)

Community appointments and others

Hong Kong Securities Institute – director
Disciplinary Panel A of HKICPA – member
Hong Kong Stockbrokers Association Limited
– permanent honorable president, and chairman (1997-1999)

Professional qualification and experience

Bachelor of Business Administration and Commerce (University of Alberta, Canada)
Master of Business Administration (University of East Asia, Macau)
Fellow (The Hong Kong Institute of Directors)

Mr Lee has over 20 years of experience in the securities industry.



LEE Kwan Ho, Vincent Marshall

INED

Aged 50

Director since 3 April 2000
Term of office: 12 April 2005
(re-elected) to 2008 AGM

Memberships in HKEx's committees:
Member of **Audit Committee** and
Nomination Committee

**Other major
offices**

Tung Tai Group of Companies – managing director
Ocean Grand Holdings Limited – non-executive director

Past offices

HSBC group, Hong Kong & Vancouver – senior banker (1981-1990)
Coopers and Lybrand, Los Angeles & Boston – Certified Public Accountant
(1978-1981)

**Government
appointments**

Securities and Futures Appeals Tribunal – member
Correctional Services Children's Education Trust Investment Advisory Board
– member
Academic and Accreditation Advisory Committee of SFC – member (2002-2006)

**Community
appointments
and others**

The Institute of Securities Dealers Limited – chairman
Canadian International School of Hong Kong Limited – founding member
and chairman

**Professional
qualification
and experience**

Fellow (HKICPA)
Graduated Magna Cum Laude in Accounting and International Finance
(University of Southern California, USA)
Master of Economics (London School of Economics and Political Science, UK)
Certified Public Accountant (State of California, USA)
Fellow (The Hong Kong Institute of Directors)

Mr Lee has over 20 years of experience in the securities and futures industry and has extensive experience in banking, corporate finance and investment.



LO Ka Shui
GBS, JP

INED

Aged 59

Director since 3 April 2000
Term of office: 1 April 2004
(re-appointed) to 2006 AGM

Membership in HKEx's committee:
Chairman of **Remuneration
Committee**

**Other major
offices**

Great Eagle Holdings Limited – deputy chairman and managing director
The Hongkong and Shanghai Banking Corporation Limited – non-executive director
Shanghai Industrial Holdings Limited – non-executive director
Phoenix Satellite Television Holdings Limited – non-executive director
China Mobile (Hong Kong) Limited – non-executive director
City e-Solutions Limited – non-executive director
Melco International Development Limited – non-executive director
Tom Online Inc – non-executive director
Winsor Properties Holdings Limited – non-executive director

Past offices

SEHK – chairman of the GEM Listing Committee (1999-2003) and
chairman of the Listing Committee (1992-1996)

**Government
appointments**

Airport Authority Hong Kong – board member
Hospital Authority – chairman (2000-2002)

**Community
appointments
and others**

The Real Estate Developers Association of Hong Kong – vice-president
Hong Kong Centre for Economic Research – trustee

**Professional
qualification
and experience**

Bachelor of Science in Biophysics (McGill University, Canada)
M.D. – Cardiology (Cornell University, USA)

Dr Lo has over 25 years of experience in the property, hotel and financial industries.



STRICKLAND, John Estmond
GBS, JP

INED
Aged 66

Director since 3 April 2000
Term of office: 31 March 2004
(elected) to 2007 AGM

Membership in HKEx's committee:
Chairman of **Audit Committee**

Other major offices

Esquel Holdings Inc – non-executive director
Integrated Distribution Services Group Limited – non-executive director
Yoma Strategic Investments Limited – non-executive director

Past offices

The Hongkong and Shanghai Banking Corporation Limited – chairman (1996-1998)
HSBC, Hong Kong (1971-1995)

Government appointments

Hong Kong Cyberport Management Company Limited – chairman
Operations Review Committee of ICAC – member

Community appointments and others

Council of The University of Hong Kong – member
The Outward Bound Trust of Hong Kong Limited – president
The Community Chest of Hong Kong – director
Committee of The Boys' and Girls' Clubs Association of Hong Kong – member
Committee of Hong Kong Youth Hostels Association – member
Salvation Army Advisory Board – member
Council of Hong Kong Adventure Corps – member
International Council of Asia Society – member

Professional qualification and experience

Degree in Physics (Jesus College, University of Cambridge, UK)
Honorary Doctorate in Business Administration (City University of Hong Kong)
Honorary Doctorate in Technology (The Hong Kong Polytechnic University)
Honorary fellow (Hong Kong Computer Society, The Hong Kong Institute of Bankers, The Hong Kong Management Association and The University of Hong Kong)



WEBB, David Michael

INED
Aged 40

Director since 15 April 2003
Term of office: 15 April 2003 to
2006 AGM

Memberships in HKEx's committees:
Member of **Investment Advisory Committee** and **Nomination Committee**

Other major office

Webb-site.com – editor

Past offices

Wheelock Capital Limited – director (1994-1998)
BZW Asia Limited – director (1993-1994)

Government appointments

Takeovers and Mergers Panel of SFC – member
Takeovers Appeal Committee of SFC – member
Public Shareholders Group of SFC – member

Community appointment and others

Hong Kong Mensa – chairman (1998-2000)

Professional qualification and experience

Honours degree in Mathematics (University of Oxford, UK)
Full member (Hong Kong Securities Institute)
Established and funded "Project Poll" which successfully required blue chip companies to count their votes on a poll and stop using the show-of-hands system (2003)
Established "Project Vampire" (Vote Against Mandate for Placings, Issues by Rights Excepted) (2003)
Named as "Star of Asia" in the "Opinion Shapers" category (Business Week magazine, 2000)
Named as "Global Leader for Tomorrow" (World Economic Forum, 2001)
Named as one of the "Global 100" who shape finance (CFO Magazine, 2002)
Named as a member of the "Young Global Leaders" (World Economic Forum, 2005)

From 1986 to 1991, Mr Webb was a corporate financier in London. Prior to 1986, he was a best-selling author of games and books for the first generation of home computers. He has published wide-ranging articles on the regulatory framework of Hong Kong's securities markets.



WONG Sai Hung, Oscar

INED

Aged 50

Director since 15 April 2003

Term of office: 31 March 2004

(re-elected) to 2007 AGM

Memberships in HKEx's committees:

Deputy chairman of **Investment Advisory Committee** and member of **Nomination Committee**

Other major offices

One Asset Management Limited (Thailand) – executive director
ARN Asian Enterprise Fund Limited (a company listed on Irish Stock Exchange) – non-executive director
China Enterprise Fund Management Limited – executive director

Past offices

BOCI-Prudential Asset Management Limited – chief executive officer (2001-2005)
Prudential Portfolio Managers Asia – regional managing director (1999-2000)
INVESCO Asia Limited – deputy chief executive (1998)
LGT Asset Management Limited (1977-1998), including LGT, Hong Kong (1977-1986), involved in managing equity portfolios with investments in the Japanese and other Asia Pacific markets; seconded to run an investment management joint venture in Taipei and assisted in starting other similar investment management joint ventures of LGT in Thailand, Indonesia and the Mainland China (1987-1990); deputy managing director of LGT (1990-1994); responsible for LGT's mutual fund marketing operations in Canada, a business which he helped to establish in 1994 (1994-1997); head of LGT's Asian operations (1998)

Government appointment

Committee on Unit Trusts of SFC – member

Community appointment

Investigation Panel A of HKICPA – member

Professional qualification and experience

Higher Diploma in Business Studies (Marketing)
 (The Hong Kong Polytechnic University)

Mr Wong has over 25 years of experience in the fund management industry.

Other memberships held by Directors in various board committees and consultative panels of the Group are available on HKEx's corporate website.

SENIOR MANAGEMENT

**CONROY, Patrick Kevin**

Chief Operating Officer
Aged 53

Joined in August 2003

Membership in HKEx's committee:
Member of **Executive Committee**

Other major
office

SEHK – chief executive

Past offices

The International Bank for Reconstruction and Development (World Bank)
– director of the financial sector development and global partnership departments (1998-2003)
Australian Stock Exchange – adviser for special projects (1997-1998)
SFC – senior director of the supervision of markets division and other executive positions in market supervision, research and policy (1991-1997)
Chicago Stock Exchange – chief legal officer, corporate business ventures (1982-1991)

Professional
qualification
and experience

Bachelor of Arts in English Literature (DePaul University, USA)
Juris Doctor (The John Marshall School of Law, USA)

**GREINER, Gerald Dale**

Deputy Chief Operating Officer and
Head of Exchange
Aged 49

Joined in May 2004

Other major
office

HKFE – chief executive

Past offices

SFC – senior director of the supervision of markets division (1989-2004)
US Securities and Exchange Commission – various senior executive positions (1984-1989)

Professional
qualification
and experience

Bachelor of Science in Economics (Allegheny College, USA)
Juris Doctor (University of Toledo College of Law, USA)

**FOK Kwong Man, Lawrence**

Head of Business Development
Aged 56

Joined in February 1992

Past offices

SEHK – senior executive director of regulatory affairs group of the listing division (1998); executive director of the listing division (1997); assistant director of the listing division (1992-1997)
SFC – assistant director of corporate finance (1989-1992)

Professional
qualification
and experience

Bachelor of Science in Engineering (The University of Hong Kong)
Master of Business Administration (Columbia University, USA)
Master of Arts (Economics) and **Master of Science (Statistics)** (Stanford University, USA)

Mr Fok has over 20 years of experience in financial services and securities regulatory work. Before joining SEHK and SFC, he also worked for the Office of the Commissioner for Securities and Commodities Trading of the Government (1983-1985) and other private organisations in areas of corporate finance advisory work, securities dealing, venture capital investment, Mainland China trade and investment management.



KAO May Loy, Mary

Chief Counsel and
Head of Legal Services
Aged 56

Joined in July 1990

Past offices

International Bank of Asia Limited – general counsel, head of the legal affairs group (1985-1990)
Sun Hung Kai Group – general counsel, head of the legal and secretarial department (1981-1985)
American International Assurance Company, Limited – assistant general counsel, assistant vice president and secretary (1978-1981)
In private practice as a barrister (1975-1978)

Professional qualification and experience

Bachelor of Laws (The University of Hong Kong)
Bachelor of Civil Law (University of Oxford, UK)
Diploma in Chinese Law (University of East Asia, Macau)
Barrister-at-Law (Hong Kong and England & Wales)
Barrister and solicitor (the Australian Capital Territory)

Ms Kao has about 30 years' legal experience in the financial services industry and significant experience in corporate regulatory matters.



LAW Man Wai, Henry

Head of Corporate Communications
Aged 51

Joined in January 1988

Past offices

Ogilvy and Mather Public Relations (Hong Kong) Limited – senior consultant and group head of the public relations section for financial institutions and listed companies (1982-1988)
Michael Stevenson Limited – advertising and public relations executive (1974-1982)

Professional qualification and experience

Mr Law worked in advertising, marketing and corporate communications profession for over 30 years and has extensive experience in communications in financial institutions and utilities.



SHING Shin Cheung, Stewart

Head of Clearing
Aged 58

Joined in December 2003

Other major office

HKSCC – chief executive

Past offices

South China Brokerage Company Limited – executive director and chief executive (2001-2003)
HKEx – first head of clearing business unit (2000)
HKSCC – chief executive (1996-2000); director of planning and development and deputy chief executive (1991-1996)

Community appointments and others

Examinations Committee of Hong Kong Securities Institute – member
Professional Education Committee of Hong Kong Securities Institute – member (2005)
The Hong Kong Association of Online Brokers representing the South China Brokerage Company Limited – chairman (2002-2003)
The International Securities Services Association – board member (1999)
Asia-Pacific Central Securities Depository Group – founding member (1997)

Professional qualification and experience

Fellow (HKICPA)
Master of Business Administration (University of New South Wales, Australia)

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.

Mr Shing has served as a member of working groups for various regulatory bodies and stockbroking associations in Hong Kong.

**TSIM Tak Chee, Archie**

Chief Financial Officer and
Head of Finance
Aged 47

Joined in October 2004

Past offices

The Hongkong and Shanghai Banking Corporation Limited –
managing director for corporate finance and advisory, Asia-Pacific (1997-2004)
SEHK – deputy head of corporate finance in the listing division (1992-1997)

Professional qualification and experience

Fellow (HKICPA and Association of Chartered Certified Accountants)
Bachelor of Science in Management Sciences (University of Manchester, UK)

Mr Tsim has more than 15 years' experience in corporate finance.

**WILLIAMS, Richard George**

Head of Listing
Aged 43

Joined in October 2002

Past offices

Financial Services Authority, UK – head of listing policy and compliance (2000-2002)
London Stock Exchange ("LSE") – head of listing policy (1999-2000)

Professional qualification and experience

Fellow (Institute of Chartered Accountants in England & Wales)
Bachelor of Arts in Economics and Economic History (University of Warwick, UK)

Before moving to the LSE, Mr Williams was with PricewaterhouseCoopers.

**WONG Kwok Kuen, Alfred**

Chief Technology Officer and
Head of Information Technology
Aged 49

Joined in November 1992

Past offices

Australia's Westpac Banking Corp – consultant application engineer (1988-1992)
Australian Stock Exchange – project leader (1987-1988)
SEHK – computer development manager (1985-1987)

Professional qualification and experience

Full member (Hong Kong Computer Society and Hong Kong Securities Institute)
Bachelor of Science in Computer Science and Chemistry (The University of Hong Kong)
Graduate Management Qualification (University of New South Wales, Australia)
Executive Master of Business Administration (The Chinese University of Hong Kong)

COMPANY SECRETARY**MAU Kam Shing, Joseph**

Company Secretary and
Head of Secretarial Services
Aged 47

Joined in June 2000

Past office

Hysan Development Company Limited – Company Secretary (1988-2000)

Community appointments and others

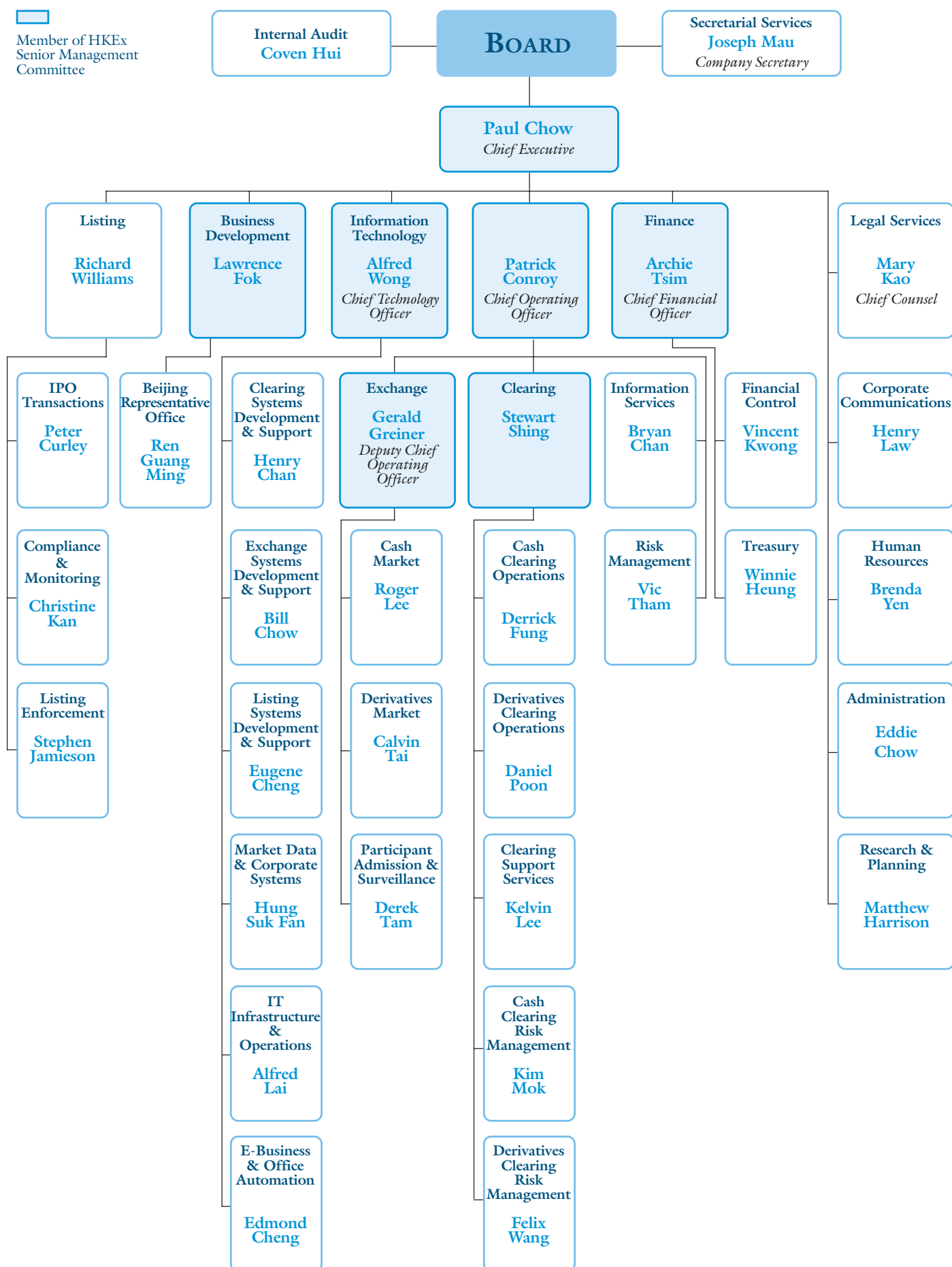
Companies Secretaries Panel of The Hong Kong Institute of Chartered Secretaries ("HKICS") – member
Professional Development Committee of HKICS – member
Divisional Appeal Tribunal of HKICS – member

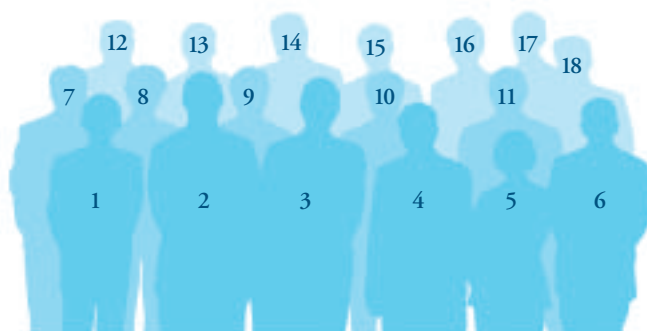
Professional qualification and experience

Fellow (HKICS, The Institute of Chartered Secretaries and Administrators, and Association of Chartered Certified Accountants)
Associate (HKICPA)
Master of Science (Business Administration) (University of Bath, UK)

Messrs Patrick K Conroy, Gerald D Greiner, Lawrence K M Fok and Stewart S C Shing, and Ms Mary M L Kao also hold position as a director in one or more of the Group's subsidiaries.

Organisation Chart





- | | |
|---------------------|----------------------|
| 1. Stewart Shing | 10. Ren Guang Ming |
| 2. Richard Williams | 11. Vic Tham |
| 3. Paul Chow | 12. Patrick Conroy |
| 4. Lawrence Fok | 13. Eddie Chow |
| 5. Mary Kao | 14. Gerald Greiner |
| 6. Archie Tsim | 15. Bryan Chan |
| 7. Henry Law | 16. Joseph Mau |
| 8. Brenda Yen | 17. Matthew Harrison |
| 9. Alfred Wong | 18. Coven Hui |

Business Review

LISTING

Publication of a Feedback Statement on the Consultations on Continuing Listing Criteria and Related Issues

In February 2005, HKEx published a feedback statement on its consultations on continuing listing criteria and related issues which includes a summary of the responses and a commentary on developments over 2004. The latter served to improve transparency.

Consultations on Enhancing Listing Regulation

In March 2005, HKEx submitted its views on each of the Government's and the SFC's consultation documents on proposals aimed at giving statutory backing to major listing requirements. Since then, HKEx has been working closely with the FSTB and the SFC on further developing the initiative that would give "teeth" to major listing requirements with minimal disruptions to the market.

Publication of Listing Committee Annual Report

To continue its commitment to enhance the transparency of the regulatory functions discharged by the Listing Committees and the Exchange, the second Annual Report of the Listing Committee was published in July 2005 and posted on the HKEx website. The Report was an account of the work of the Listing Committees in contributing to the success of the Hong Kong listing regime during the service term of their members from 1 May 2004 to 13 May 2005.

Proposed New Structure for Listing Decision-Making

In February 2005, HKEx issued a consultation paper on the New Structure for Listing Decision-Making to solicit public views on the overall listing decision-making structure together with the proposed amendments to the Listing Rules for implementing such a structure. The consultation closed in April 2005 and the responses were published on the HKEx website in May 2005.

In November 2005, the Listing Committee resolved to address the consultation proposals in two phases. The decision was taken in the light of the forthcoming decision of the Court of Final Appeal in the judicial review of the New World Development Company Limited ("New World") and others, which may have an impact on the future model of hearings and procedures to be adopted by the Exchange, together with the continuing consideration regarding which of the current obligations set out in the Listing Rules will be given statutory backing.

The first phase involved a number of rule amendments in relation to the size, composition and the maximum term for the Committee members, which were approved by the SFC and the Board of the Exchange in December 2005. The second phase will commence once the legislation of part of the Listing Rules has been resolved.

Pursuant to the amendments to the Listing Rules that changed the composition of the Listing Nominating Committee ("LNC") such that the HKEx representatives on the LNC are three non-executive members of the Board rather than two members of the Board and the chief executive of the SEHK, Mr David Webb was appointed by the Board as the third member of HKEx representatives on the LNC on 15 February 2006.

Revision of the Mechanisms for Disseminating Regulatory Information by Main Board Issuers

HKEx published an exposure paper in November 2005 on abolition of the requirement for Main Board issuers to publish paid announcements in newspapers. The purpose of the exposure paper is to invite market comments on certain aspects of the proposed transitional arrangements, including the form and content of the proposed notification announcement. The requirement of publishing notification announcements will be implemented subject to HKEx's system and operational readiness and the approval of the relevant rule amendments by the SFC.

Review of the GEM

HKEx has established an internal working group to co-ordinate studies and develop proposals for the comprehensive review of the GEM. A discussion paper was published on 20 January 2006 to facilitate public discussion of the GEM for the purpose of enhancing its further development and ensuring that its objectives and functions appropriately align with the expectations and needs of various market stakeholders.

Implementation of a Detailed Case Database for the Listing Division

In 2005, the Listing Division established a centralised electronic database, which serves to capture all its precedent and know-how materials. The objective is to facilitate information sharing and distribution within the Division, thus improving the effectiveness and efficiency of work.

IPO Processing

During 2005, the IPO Transactions Department vetted a total of 162 listing applications of which 111 new applications were accepted for vetting in 2005 and 51 applications were brought forward from 2004. A total of 105 first comment letters were issued to new listing applicants. The average time between receipt of an application and the issuance of the first comment letter and the median both were 22 calendar days, and 95 per cent of the listing applicants received the first comment letter within 30 calendar days.

75 cases were reviewed in 2005, including all of the 67 newly listed companies and a selected sample of 8 listing applications which lapsed during the year and were not subsequently listed or refiled. 75 per cent of the listing applicants received 5 rounds of comments or less before the application was reviewed by the Listing Committees, and 72 per cent of the listing applicants received a total of 7 rounds of comments or less before and after the hearing of the respective Listing Committees.

In 2005, a total of 92 applications were brought to the Listing Committees (or their delegates) for decisions, of which 55 cases (or 60 per cent) were reviewed by the respective Listing Committees within 120 calendar days, whilst 17 cases (or 18 per cent) were reviewed in more than 180 calendar days.

The content of the regular month end IPO status statement, currently published on the HKEx website, will be further enriched to include additional performance-related material to improve transparency.

IPO Transactions

	2001	2002	2003	2004	2005
Number of new listing applications accepted	153	205	101	130	111
Number of applicants listed on the Main Board	31	60	46	49	57
Number of applicants listed on the GEM	57	57	27	21	10
Number of new listing applications rejected	1	1	7	15	6
Number of applications in process at year-end	55	121	51	44	31
Number of applicants with approval granted but not yet listed at year-end	14	9	8	7	6

Number of Listed Companies (as at year-end)

	2001	2002	2003	2004	2005
Main Board	756	812	852	892	934
GEM	111	166	185	204	201
Total	867	978	1,037	1,096	1,135

Main Board – Number of Listed Companies by classification (as at year-end)

	2001	2002	2003	2004	2005
Finance	59	71	75	79	80
Utilities	11	13	14	15	18
Properties	97	98	98	100	102
Consolidated Enterprises	240	257	269	293	300
Industrials	327	354	378	388	416
Hotels	14	14	13	12	12
Miscellaneous	8	5	5	5	6
Total	756	812	852	892	934

Compliance and Monitoring

The Compliance and Monitoring Department (“CMD”) continues to target its monitoring resources in those areas that it perceives to pose the biggest risks to the maintenance of a fair, orderly and informed market. In particular, it pays attention to companies’ compliance with the rules governing the disclosure of price sensitive information and corporate governance standards.

Compliance and Monitoring Actions (as at year-end)

	2001*	2002*	2003	2004	2005
Number of announcements of listed companies vetted	6,300	8,200	8,938	9,092	11,092
Number of circulars of listed companies vetted	1,300	1,600	1,773	1,919	2,409
Number of share price and trading volume monitoring actions undertaken	7,300	5,800	8,305	6,116	6,200
Number of clarification announcements published by listed companies in response to share price and/or trading volume movements in their securities	2,500	1,600	3,801	3,383	3,172
Number of complaints handled	150	320	170	213	262
Number of cases (including complaint cases) referred to the Listing Enforcement Department for investigation	N/A	64	21	57	88

* Figures for 2001 and 2002 were rounded

During 2005, we have taken further steps to make progress on shifting the balance of our review work from pre-vetting of disclosure materials of listed companies towards post-vetting monitoring and enforcement. We have limited the types of announcements that are subject to pre-vetting and reduced the extent of comments given. In the past year, out of the 11,092 announcements vetted, 3,437 announcements (31 per cent) were shifted from pre-vetting to post-vetting. In addition, there were 1,097 announcements which were published without being subject to any vetting. The Division will seek further guidance from the Listing Committees on how to pursue this initiative further.

A robust approach has been adopted to handling companies in long suspension and in the delisting process, which has resulted in the cancellation of listings of eight Main Board and seven GEM long-suspended companies. Five Main Board long-suspended companies had entered the third stage of the delisting process and a notice of the Exchange's intention to cancel their listings had been served on four GEM long-suspended companies.

As part of its regular functions, the CMD undertook 6,200 share price and trading volume monitoring actions and reviewed over 41,989 press articles on listed companies in 2005, which resulted in enquiries and publication of clarification announcements by listed companies, as appropriate. Moreover, 292 enquiries were handled and 122 sponsor-related matters were processed.

Listing Enforcement

The decision of the Court of Appeal in the judicial review brought by New World has had, and continues to have, an impact on the work of the Listing Enforcement Department ("LED"). Notwithstanding the implications of that decision on the operation of the disciplinary process, the LED completed a number of investigations and had successfully taken disciplinary actions, including three cases which were settled by agreement, resulting in the imposition of public and private sanctions by the Listing Committees.

The sanctions imposed in 2005 included issue of public censure, public statements involving criticisms and private reprimands. Further, as part of disciplinary action, the LED had also successfully made recommendations to the Listing Committees directed towards correcting ongoing breaches and improving corporate governance. On one occasion, the Listing Committee required remedial action to be taken by an investment company to correct a spread of investments held in breach of the Listing Rules. Further examples included the direction of a review of compliance procedures of two listed companies and the requirement for the management of a listed company to undergo training in order to improve their understanding of corporate governance matters.

Disciplinary Actions (as at year-end)

	2001	2002	2003	2004	2005
Number of investigations	140	161	178	201	232*
Public censure	8	6	4	5	10
Public statements/criticisms	8	1	8	14	8
Private reprimands	5	7	3	3	3
Warning/caution letters	117	147	134	161	109

* This includes cases investigated and concluded in 2005 and those continuing at year-end which were initiated during 2005.

During 2005, 15 cases were referred to the LED by the CMD originating from a complaint, which might give rise, after investigation, to disciplinary proceedings. Of those cases investigated, 33 investigations were discontinued with no further action taken.

The LED was also involved in a number of contested sponsor review cases. In one concluded review case in 2005, two members of the senior management of the sponsor were required to resign from their positions.

From the process standpoint, the LED is engaged in an ongoing project to develop the revised operating procedures, taking into account the decision of the Court of Final Appeal in the judicial review of New World when known, with a view to improving consistency and productivity.

The LED will continue its effort to pursue suspected breaches of the Listing Rules and initiate disciplinary actions where appropriate.

CASH MARKET

Market Performance

The Hang Seng Index closed at 14,876 at the end of 2005, up 5 per cent from the 14,230 at the end of 2004. During the year, the Hang Seng Index peaked at 15,466 on 15 August 2005 and was at its lowest of 13,355 on 18 April 2005. For 2005, the total turnover of the Cash Market was \$4,520 billion up from \$3,974 billion and the average daily turnover was \$18.3 billion up from \$16.0 billion in the previous year, both recorded a 14 per cent increase against those of last year.

Closing Indices (as at year-end)

	2005	2004	Change (%)
S&P/HKEx LargeCap Index	17025.45	15740.43	8
Hang Seng Index	14876.43	14230.14	5
Hang Seng Composite Index	1947.72	1831.99	6
Hang Seng China Enterprises Index	5330.34	4741.32	12
Hang Seng China-affiliated Corporation Index	1934.89	1556.88	24
S&P/HKEx GEM Index	1007.28	988.60	2

In 2005, there were 67 newly listed companies, 57 on the Main Board and 10 on the GEM. As a result, the total number of listed companies on the Exchange increased to 1,135.

Hang Seng Index 01/2002 – 12/2005



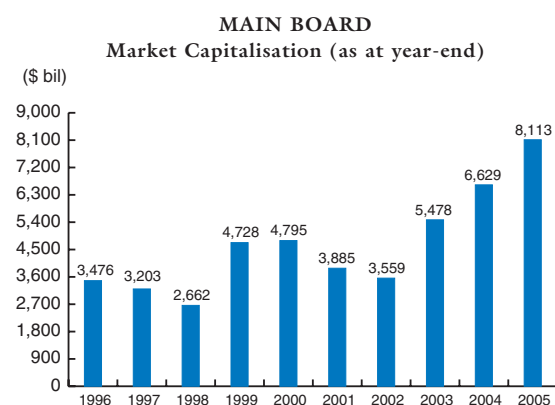
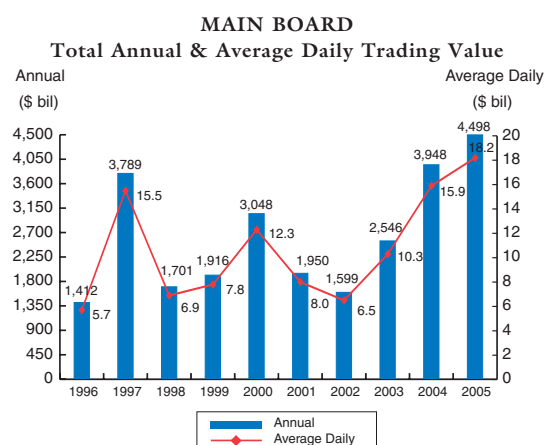
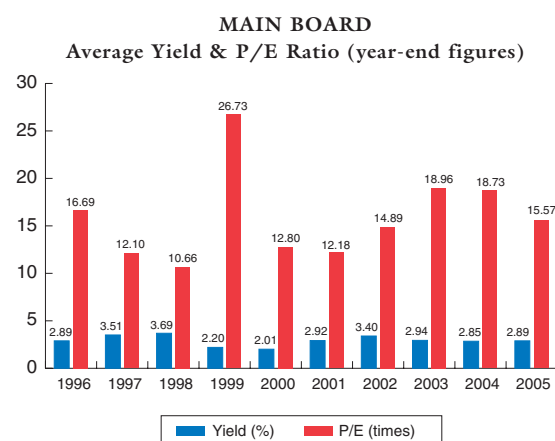
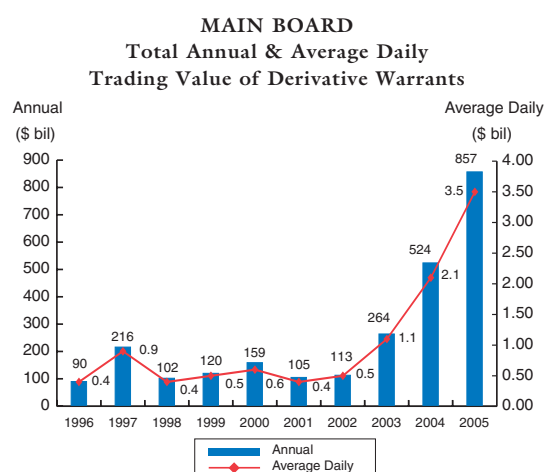
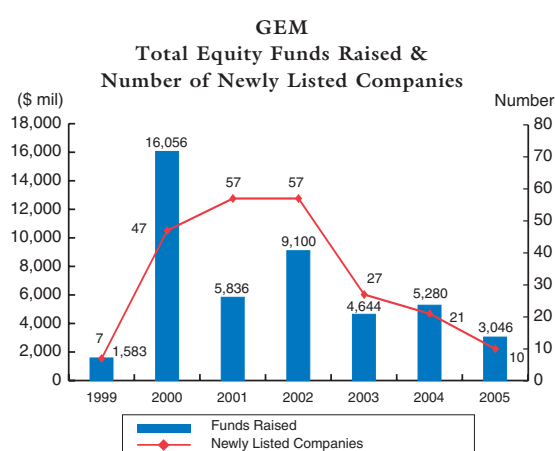
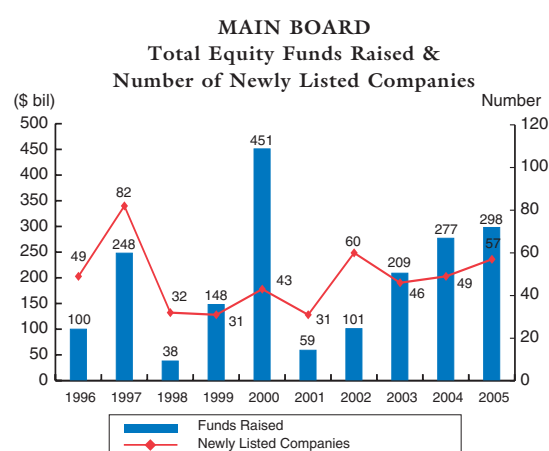
S&P/HKEx GEM Index 01/2002 – 12/2005



Market Performance of the Main Board and the GEM (as at year-end)

	Main Board			GEM		
	2005	2004	Change	2005	2004	Change
IPO fund raised for the year (\$bil)	165	94	76%	1	3	-67%
Market capitalisation (\$bil)	8,113	6,629	22%	67	67	0%
Number of listed companies	934	892	5%	201	204	-1%
Number of listed securities	2,448	1,971	24%	201	205	-2%
Total turnover for year (\$bil)	4,498	3,948	14%	22	26	-15%
Average daily turnover (\$mil)	18,211	15,857	15%	90	103	-13%

Note: Figures have been rounded



Performance of the GEM (as at year-end)

	1999	2000	2001	2002	2003	2004	2005
Newly Listed Companies	7	47	57	57	27	21	10
Total Funds Raised (\$bil)	2	16	6	9	5	5	3
Market Capitalisation as at year-end (\$bil)	7	67	61	52	70	67	67
Trading Value (\$bil)	4	84	39	44	38	26	22

Main Board – New Listings

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Newly Listed Companies	49	82	32	31	43	31	60	46	49	57
New Warrants										
Equity Warrants	80	101	31	51	46	31	27	10	14	12
Derivative Warrants	201	351	157	162	279	181	644	678	1,259	1,682
Total New Warrants	281	452	188	213	325	212	671	688	1,273	1,694
New Equity Linked Instrument	—	—	—	—	—	—	25	16	46	0
New Debt Securities	84	61	21	87	20	21	18	20	49	32
New Unit Trusts and Mutual Funds	1	0	0	1	0	1	1	1	2	6

Note: Equity Linked Instrument commenced trading on 5 August 2002

Renovation of the Trading Hall

The renovation of the trading area of the Trading Hall was completed and re-opened for use on 16 January 2006. There are a total of 294 dealing desks including 4 for backup use and 4 for EPs as Internet access workstation in the renovated trading area. As at the opening day, 281 dealing desks were subscribed by 220 EPs at a monthly user fee of \$2,800 per desk for a minimum of 3 years.

Further renovations of the non-trading area, including the Exchange Exhibition Hall, are in progress and are expected to be completed in April 2006.

Exchange Participants and Trading Rights Holders Status (as at year-end)

	Stock Exchange	Futures Exchange
Exchange Participants [#]	468	137
Trading	429	137
Non-trading	39	N/A
Trading Rights Holders [□]	51	56
Corporate	2	47
Individual	49	9
Average no. of trading rights held by Exchange Participants and Trading Rights Holders*	1.78	1.17

[#] The Stock Exchange and Futures Exchange require any person who registers as a participant of the relevant exchange to hold a trading right of the respective exchange.

[□] Stock Exchange Trading Rights Holders refer to (i) those non-trading members of the Stock Exchange as of 6 March 2000 when the exchange merger completed; and (ii) former individual participants of the Stock Exchange who ceased to be a participant effective 1 April 2005 following the amendments to the Rules of the Exchange and are now solely holding a Trading Right of the Stock Exchange.

Futures Exchange Trading Rights Holders refer to former members/participants of the Futures Exchange who resigned as a participant and are now solely holding a trading right of the Futures Exchange.

* Average number of trading rights held by EPs and Trading Rights Holders = total number of trading rights held/total number of EPs and Trading Rights Holders. There were 922 Stock Exchange trading rights and 225 Futures Exchange trading rights as of 31 December 2005.

Product Developments

The ETF market grew steadily in 2005. With the listing of three new ETFs, namely Hang Seng FTSE-Xinhua 25 Index ETF, ABF Hong Kong Bond Index Fund and ABF Pan Asia Bond Index Fund, there were a total of eight ETFs listed on the Exchange as at the end of 2005.

The listing of the two bond ETFs would further increase the diversity of the underlying assets of the market and the listing of ABF Pan Asia Bond Index Fund consisting of bonds denominated in some major regional currencies is a new achievement for Hong Kong.

In addition, HKEx has successfully obtained the SFC regulatory approval for the introduction of CBBC and targets to launch the product in mid-2006.

Market Infrastructure Improvements

Cost savings of 20 per cent for EPs in respect of the monthly user fees effective 1 January 2005 are among the benefits of the network consolidation project. In response to the market development, the Phase 1 spread reduction for shares priced above \$30 including changes of related trading parameters was launched on 4 July 2005. Phase 2 spread reduction for shares priced between \$0.25 and \$20 is expected to be implemented in July 2006 subject to the approval of the necessary rule changes by the SFC. The proposal to exempt placing or fund raising activities by EPs from the current prohibition of dealings in suspended securities under the Rules of the Exchange was implemented on 8 September 2005. To facilitate EPs' order input process, HKEx increased the maximum number of outstanding orders per price queue from 2,000 to 4,000 orders in the AMS/3 on 21 November 2005. The closing price calculation under special situations was enhanced to allow the availability of reasonable closing prices at all times.

Trading System Enhancements

On 28 December 2005, HKEx upgraded the capacity of the AMS/3 to provide higher order throughput and improve the order execution, the update of prices and the response time for order input, particularly at market opening. Moreover, at the end of 2005, the ORS was successfully transferred to the AMS/3 platform, which would deliver savings in annual operating costs. With the newly introduced solutions developed by the Proprietary Network System ("PNS") vendors, the services offered by the PNS under the HKEx's ORS include a wide range of front-end trading services from online order input functions to comprehensive order management tools such as risk checking, order tracking and programme trading. Utilisation of the services offered by the PNS grew by about nine times in 2005.

DERIVATIVES MARKET

Market Performance

2005 was another fruitful year for HKEx's Derivatives Market, marked by the record high daily volume and/or open interest for some of the products. The details are shown in the following table.

Record High Daily Volume and Open Interest Achieved in 2005

	Record High Daily Volume		Record High Open Interest	
	Date	Number of Contracts	Date	Number of Contracts
Hang Seng Index Options	22 June 2005	26,412	28 November 2005	312,101
Mini Hang Seng Index Futures	–	–	28 October 2005	6,016
H-shares Index Futures	28 December 2005	33,591	28 December 2005	47,272
H-shares Index Options	22 July 2005	4,280	29 August 2005	65,249
Stock Options	–	–	28 September 2005	1,655,274

For 2005, the total yearly volume for all futures and options markets had increased 30 per cent to 25,523,007 contracts (2004: 19,629,692 contracts). Apart from improvement in Hong Kong's economy, HKEx's continued efforts in product and market infrastructure enhancement, trading system upgrade, education and marketing have contributed to the improved market growth.

Product Developments

To meet market demand, stock options and stock futures on six underlying stocks were introduced in 2005 as follows:

Underlying Stocks	Type	Trading Commencement Dates
Esprit Holdings Ltd	Blue Chip	11 Jul 2005
Denway Motors Ltd	Red Chip	11 Jul 2005
China Netcom Group Corporation (Hong Kong) Ltd	Red Chip	7 Nov 2005
Ping An Insurance (Group) Co of China Ltd	H-share	7 Nov 2005
Bank of Communications Co Ltd	H-share	7 Nov 2005
China Construction Bank Corporation	H-share	19 Dec 2005

The total number of contracts traded in 2005 in these six additional stock options and stock futures reached 108,353. HKEx endeavours to meet the evolving demand for Mainland China-related derivative products. HKEx introduced FTSE/Xinhua China 25 Index Futures and Options on 23 May 2005 to provide an additional trading and hedging tool for investors in Mainland equities-related derivatives. The total number of contracts traded in 2005 in these new contracts reached 10,268.

To further facilitate the trading of stock options, the position limit and reporting level for stock options have been revised with effect from February 2006.

Market Infrastructure Enhancements

In February 2005, a series of enhancements was made to improve the stock options market which included (1) the provision of continuous quotations to eight active option classes to improve the availability of option market prices; (2) the reduction of stock options strike intervals in 7 option classes to offer more choices of strike levels; and (3) the reduction of the trading tariffs of Tier 1 option classes from \$5 to \$3 to enhance market competitiveness. In 2005, the average daily volume of stock options market was 35,385 contracts, an increase of 56 per cent (2004: 22,720 contracts). The year-end open interest had also grown by 49 per cent to 1,021,913 (2004: 684,052 contracts).

In 2005, there were 12 and six new HKFE participants and Options Trading EPs respectively. Three additional EPs were registered as market makers for stock options.

Trading System Improvements

In February 2005, mass quotation facility was offered to stock options continuous quote market makers to increase their power to provide liquidity to the Stock Options market. All Click workstations were upgraded from Microsoft Windows NT platform to Microsoft Windows XP platform in June 2005. Since the rollout of Phase I of SDNet, the EPs in the Derivatives Market have enjoyed a doubled bandwidth at a reduced cost.

Education and Marketing

In 2005, a total of 121 Derivatives Market training courses and seminars were conducted, attracting about 12,000 attendees, including mainly the staff of EPs and public investors. In the first half of 2005, a promotion project on Stock Options was launched, under which nine Options Trading EPs were sponsored on hosting seminars on product promotions to the public and their clients. In the second quarter of 2005, a large-scale investment event for promoting H-shares and Red-chips investment products and FTSE/Xinhua China 25 Index Futures and Options was conducted and attracted more than 1,700 people. In addition, overseas promotion activities on introducing HKEx's Derivatives Market were also organised.

Derivatives Market Statistics (as at year-end)

	2005		2004	
	Volume (Contracts)	Year-end Open Interest (Contracts)	Volume (Contracts)	Year-end Open Interest (Contracts)
Futures				
Hang Seng Index Futures	9,910,565	98,211	8,601,559	125,860
Mini Hang Seng Index Futures	1,501,342	3,081	1,457,681	2,044
H-shares Index Futures	1,978,673	35,125	1,743,700	22,418
FTSE/Xinhua China 25 Index Futures ⁽¹⁾	2,882	48	N/A	N/A
Dow Jones Industrial Average Futures ⁽²⁾	424	–	2,673	96
Stock Futures	13,069	1,750	17,274	1,821
3-Month HIBOR Futures	24,935	1,472	58,307	6,570
1-Month HIBOR Futures	246	5	733	30
3-Year Exchange Fund Note Futures	1,250	–	2,225	–
Options				
Hang Seng Index Options	3,071,822	192,069	2,029,068	76,444
Mini Hang Seng Index Options	30,595	555	26,882	613
H-shares Index Options ⁽³⁾	257,425	32,599	77,758	9,265
FTSE/Xinhua China 25 Index Options ⁽⁴⁾	7,386	431	N/A	N/A
Stock Options	8,722,393	1,021,913	5,611,832	684,052
Total Futures and Options	25,523,007	1,387,259	19,629,692	929,213

(1) Trading in FTSE/Xinhua China 25 Index Futures commenced on 23 May 2005

(2) Trading in Dow Jones Industrial Average Futures suspended with effect from 21 Mar 2005

(3) Trading in H-shares Index Options commenced on 14 Jun 2004

(4) Trading in FTSE/Xinhua China 25 Index Options commenced on 23 May 2005

CLEARING

DCASS Upgrade

Upon the review of the DCASS capacity, the software was fine-tuned to improve the DCASS throughput rate, and thus enhancing the operation efficiency of the participants. To meet future development of the Derivatives Market, a project team was formed for the further upgrade of the current version of the HKATS and DCASS.

DCASS Fee Review

In response to the concerns of the participants' clients on the transaction-based give up fees, the DCASS standard instruction input/processing fee of \$1.5 per transaction per side charged to participants of HKCC and SEOCH for performing external trade transfer on the DCASS had been abolished since 1 March 2005.

With effect from 1 June 2005, the interest retention rates of 1.2 per cent per annum and 2 per cent per annum imposed by HKCC and SEOCH respectively on cash margin deposits provided by participants were abolished, and interest is being rebated to participants at the prevailing bank savings deposit rates on their cash margin deposits. Moreover, the accommodation charges levied by HKCC and SEOCH have been reduced from 1.2 per cent per annum and 2 per cent per annum respectively to a harmonised rate of 0.5 per cent per annum on non-cash collateral utilised for margin coverage.

CCASS Fee Review

HKEx announced CCASS fee proposals in March 2005 which included a new fee structure for the CCASS to be implemented in two phases. HKSCC waived the monthly stock custody fee of \$0.012 per board lot for delisted securities and securities in prolonged suspension effective 1 February 2005. HKSCC had also extended the fee waiver on Short Message Service for IP accounts up to the end of June 2006 and abolished the \$1,000 initial deposit upon account opening with effect from 1 July 2005. Moreover, the scrip fee assessed on deemed book close dates was eliminated effective 1 January 2006.

CCASS Nominee Services Improvements

HKSCC improved its nominee services by extending the CCASS deadline for submitting voting instructions to the business day before the relevant meeting date with effect from 4 April 2005. The CCASS deadline for submitting corporate action instructions had also been extended to the last acceptance day of the issuers starting from 8 August 2005. Further improvements including the provision of corporate action data download function, allowing the cancellation and re-input of authorised instructions, crediting scrip entitlement to participants' stocks accounts on a real-time basis, and extending the service hours of various nominee functions took effect from 3 January 2006.

Other CCASS Services Enhancements

Early in 2005, the hotline for CCASS IPs was revamped to streamline the call flow and make it more user-friendly. The input and enquiry functions of the Interactive Voice Recording System are now available 24 hours a day, seven days a week.

From 8 August 2005 onwards, participants remitting cash prepayments, intra-day marks and subscription monies to HKSCC are able to execute their transactions through the Real Time Gross Settlement ("RTGS") system operated by Hong Kong Interbank Clearing Limited, and they are no longer required to pay the service fee of \$100 per transaction when using the RTGS for cash prepayment.

Expanding Admission of Investor Participants

After taking the legal advice on identified jurisdictions regarding the possibility of expanding admission of IPs to residents and corporations outside Hong Kong, decision was made to first admit Macau residents and corporations.

Third Party Clearing for Cash Market

In response to a formal proposal submitted by a potential Third Party Clearing ("TPC") provider, HKSCC is now assessing the current demand in the Cash Market for the development of the TPC.

T+2 Finality of Payment

Based on the feasibility study conducted, it has been concluded that there is no need for the CCASS to implement the T+2 Finality at the moment because the move to the model will bring limited benefits to the market. However, HKSCC will continue to keep abreast of the developments in other markets and consider the initiative again under appropriate market conditions.

Scripless Project

We are working closely with the Federation of Share Registrars on the project which is subject to the enactment of the applicable legislation.

Risk Management Measures

No default event had occurred throughout 2005.

Intra-day marks collection mechanism has been automated to reduce workload of both broker participants and HKSCC and it paves way for further reduction of market risks by means of reducing the time required for making payment, increasing the frequency of collections and/or reducing the tolerance limit so that more marks can be collected.

Additional insurance cover for the HKCC Reserve Fund has been secured effective 1 July 2005. In 2005, we reviewed the risk management policies and arrangements to further improve risk management functions of the clearing houses and better serve the markets. Upon the review, the capital requirements of different categories of clearing participants were harmonised, and further studies will be conducted on the collateral policy, capital based position limit and daily settlement price methodology. The assessment of other risk management policies such as the liquidity requirements in the event of settlement bank default, the frequency of margin calls, the price movement assumptions for stress testing and the cross margining for the derivatives clearing houses is in progress and will be completed in the first quarter of 2006.

Status of Clearing Participants

CCASS	As at year-end	
	2005	2004
Broker Participants	435	440
Clearing Agency Participants	1	1
Custodian Participants	37	39
Stock Pledgee Participants	7	7

CCASS Statistics

	Up to year-end	
	2005	2004
Average Daily Exchange Trades Handled by CCASS		
– Number of Trades	149,618	149,572
– Value of Trades	\$18.3 billion	\$16.0 billion
– Share Quantity Involved	23.4 billion	16.2 billion
Average Daily Settlement Instructions (SIs)		
Settled by CCASS		
– Number of SIs	25,354	23,778
– Value of SIs	\$46.2 billion	\$38.0 billion
– Share Quantity Involved	14.1 billion	11.8 billion
Average Daily Investor Settlement Instructions (ISIs)		
Settled by CCASS		
– Number of ISIs	349	413
– Value of ISIs	\$100.0 million	\$119.0 million
– Share Quantity Involved	70.7 million	82.2 million
Average Daily Settlement Efficiency of CNS Stock		
Positions on Due Day (T+2)	99.78%	99.70%
Average Daily Settlement Efficiency of CNS Stock		
Positions on the Day following the Due Day (T+3)	99.98%	99.98%
Average Daily Buy-ins Executed on T+3		
– Number of Brokers Involved	8	9
– Number of Buy-ins	8	10
– Value of Buy-ins	\$2.7 million	\$3.7 million
Shares Deposited in the CCASS Depository		
– Number of Shares	1,309.9 billion	1,217.7 billion
– Percentage of Total Issued Share Capital of the Admitted Securities	55.55%	60.71%
– Value of Shares	\$3,026.9 billion	\$2,465.0 billion
– Percentage of the Total Market Capitalisation of the Admitted Securities	34.60%	34.46%

BUSINESS DEVELOPMENT

Promotional Activities to Attract Potential Issuers

In 2005, HKEx continued to focus on organising conferences and seminars for Mainland prospective issuers with the aim of promoting Hong Kong as their preferred listing venue. With the support of our Beijing Representative Office and the special representatives in Shanghai and Guangzhou, we co-organised a total of 14 conferences in the Mainland, covering the Pan Pearl River Delta Region, Yangtze River Delta Region and the Northeast. The one held in collaboration with the Pan Pearl River Delta Region's governments and the Shanghai and Shenzhen stock exchanges in Chengdu in July last year was particularly successful, attracting more than 300 business executives and government officials from the Mainland.

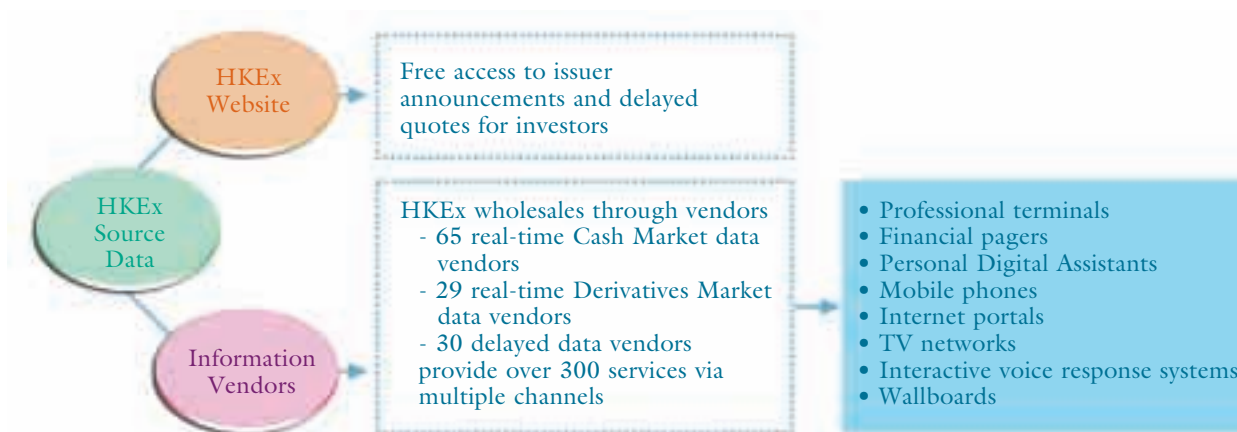
HKEx has expanded its marketing effort beyond the Mainland to attract quality potential issuers from other markets in Asia. We participated as speakers in several conferences held in Osaka, Taipei and Tokyo to introduce the benefits of listing in Hong Kong. HKEx has seen an increase in the new listings of companies from the region.

Training Programmes for Issuers

To ensure a quality market, HKEx is committed to educating the issuers about their continuing listing obligations and the latest developments in the area of corporate governance. In 2005, more than 160 Mainland executives took part in the six training programmes in Hong Kong and Beijing co-organised by HKEx and the Research Centre of the Hong Kong and Macao Affairs Office of the State Council, The Hong Kong Institute of Chartered Secretaries and The Hong Kong Polytechnic University China Business Centre respectively.

HKEx's commitment to attract more quality issuers and increase their awareness of good corporate governance practices is unequivocal. We will raise our marketing effort in the Mainland and Asia Pacific Region to arouse the interests of more enterprises to list on the Exchange and organise more training programmes to help improve the corporate governance standards.

INFORMATION SERVICES



Information Business

There was a five per cent or \$15 million growth in the information income in 2005 to \$323 million, and a steady increase in the use of Internet and usage-based services, e.g. per quote services. As at the end of 2005, there were 65 real-time information vendors for the Cash Market data (2004: 66) and 29 for the Derivatives Market data (2004: 34). They together offered a total of 339 real-time market data services to the market.

In 2005, two more vendors joined the Mainland Discount Programme for real-time market data, bringing the total number of vendors under this programme to 20. The programme, which has been extended to the end of 2006, allows investors in the Mainland to subscribe for HKEx market data at a discounted fee.

A new service for the redistribution of historical data products was introduced in 2005. The first Historical Data Product Vendor Agreement was signed in September.

In order to assist vendors' marketing activities, a free trial unit policy was introduced in April 2005. Under the new policy, information vendors with our prior approval are allowed to provide limited number of trial devices to potential customers free of charge.

Taking the advantage of the migration of the PRS onto the SDNet in the fourth quarter of 2005, we have doubled the data throttle for the PRS from 128Kbps to 256Kbps in support of the market development.

Internal Data Management

To provide better data support to internal departments and external parties, enhancements to internal data systems, namely Stock Market Database (“SMD”) and On-line Data Subscription System, were implemented. In 2005, we also completed a review of the internal processing of historical securities data, with a view to further strengthening the SMD as the central database for securities market statistics and historical trade data. As a result, we have streamlined the internal operation, removed data duplication and enhanced operation efficiency. Going forward, we will continue the review of HKEx’s existing Derivatives Market data products to see if there is a need to restructure the data products and delayed data products to make it more commercially-friendly and attractive to the market. To support the implementation of the proposal to abolish the requirement for Main Board issuers to publish announcements on newspapers, we will make corresponding system enhancements for receiving and publishing issuer announcements.

Mainland Co-operation

In view of the steady economic growth in the Mainland, we have worked closely with our information vendors to develop the Mainland market for our information products. In October 2005, we engaged the third vendor under the Shenzhen Market Data Agency Agreement.

To better facilitate the accessibility of market information of Hong Kong, Shanghai and Shenzhen stock markets via a single platform, the China Stock Markets Web on the HKEx website was enhanced in October 2005 to provide a faster way for its viewers to find out which H-share companies also have A-shares listed on the Shanghai Stock Exchange or the Shenzhen Stock Exchange.

Moreover, to promote the visibility of the Hong Kong Cash Market in the Mainland, starting from July 2005, Hong Kong stock market summaries and delayed market data have been broadcasted in the financial TV Programme “Trading Day”, which is owned and managed by Shenzhen Securities Information Company Limited, a subsidiary of the Shenzhen Stock Exchange.

INFORMATION TECHNOLOGY

Production Systems Stability and Reliability

The overall stability and reliability of all major trading, clearing and settlement, and market data dissemination systems for the Cash and Derivatives Markets continued to be performing excellently throughout 2005, despite a delay for Derivatives Market opening on 11 November 2005 caused by a software deficiency from the HKATS software supplier. HKEx will continue its effort to uphold this high standard of system reliability and stability and pursue continuous and further system improvements.

Capacity Planning and Upgrade

During 2005, HKEx completed the capacity upgrade of the AMS/3 to cater for the continuous growth of market activities and development. In addition, HKEx also upgraded the capacity and substantially enhanced the disaster recovery arrangement for the HKEx website to ensure its highest performance and availability during site disastrous situation. Capacity upgrade for the HKATS, DCASS and PRS will also be implemented in early 2006.

Obsolescent Technology Replacement and System Migration

In June 2005, HKEx upgraded the operating systems of the HKATS, DCASS and CCASS/3 to secure continued and quality system vendor support.

Due to hardware and system software obsolescence, HKEx completed the replacement of more than 400 AMS/3 off-floor terminals installed since 1998, together with an upgraded AMS/3 security solution. To support the Trading Hall renovation programme, the Trading Hall LAN cabling infrastructure as well as all the on-floor terminals and facilities had been upgraded. In December 2005, the migration of the existing AMS/3 ORS to an integrated platform was completed to reduce technology complexity and achieve operational cost savings.

In 2006, HKEx will commence the replacement of obsolete hardware and/or system software for the AMS/3 Open Gateway and Multi-workstation as well as the HKATS network gateway to uphold the high system standard and reliability.

System Consolidation and Operation Efficiency

The consolidation of the existing market system networks into SDNet to ensure a cost effective and high performance network infrastructure for the Cash and Derivatives Markets started in 2005. The migration of participants' circuits of the HKATS, DCASS and PRS onto the SDNet was successfully completed in October 2005. The plan is to complete the migration of the CCASS/3 and AMS/3 participants' circuits to the SDNet in mid-2006 and 2007 respectively.

Consolidation of the AMS/3 satellite systems and the redevelopment of Derivatives Market surveillance system to streamline the overall support and operational efficiency were completed in December 2005. Redevelopment of the Derivatives Market's risk management systems to further improve operational efficiency and effectiveness is in progress.

Fee Reductions in 2004, 2005 and 2006

2004

- One-off waiver for the on-behalf-of processing fee of \$50 per transaction during the stabilisation period of the launch of the DCASS from 6 to 21 April 2004.

2005

- Reduction in monthly user fees for all AMS/3 trading devices by 20 per cent effective 1 January 2005.
- Reduction in the tariffs for Tier 1 stock options classes from \$5 to \$3 effective 1 February 2005.
- Waiver of the monthly stock custody fee of \$0.012 per board lot for delisted securities and securities in prolonged trading suspension held in the CCASS effective 1 February 2005.
- Abolition of the standard instruction input/processing fee of HKCC and SEOCH of \$1.5 per transaction per side effective 1 March 2005.
- Waiver of exchange fee of \$5.00 per contract per side for a period of three months upon the commencement of trading of FTSE/Xinhua China 25 Index Futures Contract effective 23 May 2005.
- Abolition of the interest retention rates of 1.2 per cent for HKCC and that of 2 per cent for SEOCH for cash margin collateral deposited with HKCC and SEOCH effective 1 June 2005.
- Reduction in the accommodation charges for non-cash collateral deposited with HKCC and SEOCH from 1.2 per cent and 2 per cent respectively to 0.5 per cent effective 1 June 2005.
- Interest rebates to participants on their cash margin deposits at the prevailing bank savings deposit rate effective 1 June 2005.
- Abolition of the initial deposit requirement of \$1,000 for opening a CCASS IP Account effective 1 July 2005.
- Reduction in handling charges for scrip fee concessions from 10 per cent of concession granted (with a minimum of \$10,000) to a flat fee of \$1,000 per application effective 8 August 2005.
- Abolition of the service fee of \$100 per transaction for cash prepayment instruction executed via the RTGS system effective 8 August 2005.
- Reduction in the rentals of participant circuits for the HKATS/DCASS/PRS by 20 per cent upon migration to the SDNet effective November 2005.

2006

- Elimination of scrip fee on deemed book close dates effective 1 January 2006.
- Extension of waiver of Short Message Service fees for IP Account Holders who opt for the service until 30 June 2006.
- Extension of discounted monthly fee of \$80 per device (regular monthly fee being \$200) for Mainland users of HKEx's real-time securities trading information until 31 December 2006.
- Waiver of the regular monthly subscription fee for the futures data package of \$25 per device for the users who subscribe to securities market data until 31 December 2006.

TREASURY

The Group's funds available for investment comprise Corporate Funds, Margin Funds and Clearing House Funds, totalling \$17.6 billion on average in 2005 (2004 average: \$14.4 billion).

As compared with 2004, the overall size of funds available for investment as at 31 December 2005 increased by 18 per cent or \$2.9 billion to \$19.2 billion (31 December 2004: \$16.3 billion). Details of the asset allocation of the investments as at 31 December 2005 against those as at 31 December 2004 are set out below.

	Investment Fund Size \$ billion		Bonds		Cash or Bank Deposits		Global Equities	
	2005	2004	2005	2004	2005	2004	2005	2004
Corporate Funds	4.2	3.9	56%	64%	37%	30%	7%	6%
Margin Funds	13.6	10.5	28%	34%	72%	66%	0%	0%
Clearing House Funds	1.4	1.9	17%	7%	83%	93%	0%	0%
Total	19.2	16.3	33%	38%	65%	60%	2%	2%

Investments are kept sufficiently liquid to meet the Group's operating needs and possible liquidity requirements of the Clearing House Funds and Margin Funds. Excluding equities held under the Corporate Funds (\$0.3 billion as at 31 December 2005 and 31 December 2004), which have no maturity date, the maturity profiles of the remaining investments as at 31 December 2005 (\$18.9 billion) and 31 December 2004 (\$16.0 billion) were as follows:

	Investment Fund Size \$ billion		Overnight		>Overnight to 1 month		>1 month to 1 year		>1 year to 3 years		> 3 years	
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
Corporate Funds	3.9	3.6	14%	15%	23%	16%	23%	21%	24%	31%	16%	17%
Margin Funds	13.6	10.5	56%	40%	19%	26%	17%	14%	8%	20%	0%	0%
Clearing House Funds	1.4	1.9	77%	83%	7%	3%	9%	6%	7%	8%	0%	0%
Total	18.9	16.0	49%	39%	19%	21%	18%	15%	11%	21%	3%	4%

Credit exposure is well diversified. The bond portfolio held is of investment grade and, as at 31 December 2005, had a weighted average credit rating of Aa2 (31 December 2004: Aa2) and a weighted average maturity of 1.3 years (31 December 2004: 1.5 years). Deposits are placed only with the note-issuing banks in Hong Kong, investment grade licensed banks and restricted licence banks approved by the Board from time to time.

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 the Group) at a given confidence level (95 per cent confidence interval is adopted by the Group) based on historical data (one year is used by the Group). The overall risk, as measured by the VaR methodology, during 2005 and 2004 was as follows:

	Average VaR \$ million		Highest VaR \$ million		Lowest VaR \$ million	
	2005	2004	2005	2004	2005	2004
Corporate Funds	13.5	15.8	16.1	18.3	11.2	13.2
Margin Funds	14.4	15.3	17.9	17.4	9.8	10.3
Clearing House Funds	1.0	1.1	1.5	1.2	0.6	0.8

Details of the Group’s investment income are set out in the Income section under the Financial Review and note 7 to the consolidated accounts of this Annual Report.

INVESTMENTS IN ASSOCIATES

Computershare Hong Kong Investor Services Limited (“CHIS”)

In May 2005, the Group acquired a further six per cent interest in CHIS for \$25 million and raised its interest to 30 per cent. As at 31 December 2005, the cost of the investment in CHIS was \$52 million (2004: \$27 million) and the book value of the investment was \$63 million (2004: \$37 million).

ADP Wilco Processing Services Limited (In Liquidation) (“AWPS”)

The Group acquired a 30 per cent interest in AWPS in May 2002 at a cost of \$1.8 million. The book value of the investment as at 31 December 2005 was \$1.3 million (2004: \$1.3 million). AWPS is in the process of a voluntary dissolution. The liquidation proceeds of AWPS are expected to approximate its book value.

INITIATIVES, ACHIEVEMENTS & PRIORITIES UNDER THE 3-YEAR STRATEGIC PLAN

Major Functions	
Listing	<p>Responsible for supervising the listing process and the ongoing compliance by listed companies with the Listing Rules. It includes –</p> <ul style="list-style-type: none"> • IPO Transactions Department which is responsible for reviewing new listing applications for both the Main Board and the GEM as well as handling pre-IPO enquiries; • Compliance and Monitoring Department which is responsible for ongoing monitoring of listed companies in respect of compliance with the Listing Rules, processing listing applications, dealing with sponsorship and applications, and handling complaints and enquiries relating to the Listing Rules; and • Listing Enforcement Department which is responsible for investigating possible breaches of the Listing Rules, and where appropriate, initiating disciplinary actions.
Cash Trading	<p>Responsible for (i) managing the operations of and the trading in the Cash Market; (ii) coordinating the development and enhancement of market infrastructure for the issuance, trading, information dissemination, clearing and settlement of cash products, and the secondary market trading including rules, policies, systems and related facilities; and (iii) maintaining good relations with market practitioners and providing relevant education to them.</p>
Derivatives Trading	<p>Responsible for (i) managing the operations of and the trading of derivative products (futures and options) on the Futures Exchange; (ii) ensuring the stability and efficiency of the trading system; (iii) improving the market infrastructure for market development; (iv) broadening the product distribution channels by recruiting new EPs; and (v) maintaining good relations with market practitioners and providing relevant market education.</p>
Clearing	<p>Responsible for clearing, settlement, and related risk management of the securities and derivatives markets. It comprises –</p> <ul style="list-style-type: none"> • Cash Clearing Operations Department which is responsible for handling clearing, settlement, depository and nominee activities of securities traded in the Cash Market; • Cash Clearing Risk Management Department which is responsible for developing and implementing risk management strategies for all cash clearing services; • Clearing Support Services Department which is responsible for handling IP Accounts services, clearing product development and project management of the division; • Derivatives Clearing Operations Department which is responsible for handling clearing and settlement of products traded in the Derivatives Market; and • Derivatives Clearing Risk Management Department which is responsible for developing and implementing risk management strategies for all derivatives clearing services.
Business Development	<p>Responsible for (i) identifying prospective issuers and promoting new listings in Hong Kong; (ii) liaising and establishing relationship with Mainland government and regulatory authorities through the Beijing Representative Office and Special Representatives stationed in Guangzhou and Shanghai; and (iii) providing training for Hong Kong-listed Mainland companies and potential listing applicants.</p>
Information Services	<p>Responsible for (i) selling market data and issuer information to licensed information vendors for redistribution to selling intermediaries, institutional and retail investors and other market users; (ii) preparing and selling historical data products to the investing public; (iii) maintaining and managing market databases to provide information support for internal and external parties; and (iv) receiving issuer announcements and disclosures of interests and posting them on the HKEx website for public viewing.</p>
Information Technology	<p>Responsible for the development and operations of secure, reliable and quality systems to support the securities and derivatives markets in Hong Kong. It comprises –</p> <ul style="list-style-type: none"> • IT System Development and Support which is responsible for the development, implementation, maintenance and support of all HKEx systems, including <ul style="list-style-type: none"> (i) trading, clearing and settlement market data dissemination systems to support the securities and derivatives market operations; (ii) market surveillance, risk management, issuers and other related management information systems; and (iii) other corporate systems to support HKEx internal operations; and • IT Infrastructure & Operations which is responsible for the management and prudent operations of all HKEx systems and infrastructure, including (i) data centre operations; (ii) network and engineering services and support; (iii) technical system services and support; (iv) change management and system security administration; and (v) system vendor and network service provider management and control.

Building a
Quality
Market

Building a
Mainland
Partner

Consolidation

Key Achievements in 2005

- Enhanced regulation of sponsors and IFAs
 - Revised Corporate Governance Best Practices
 - Solicited public views on new structure for listing decision-making
 - Provided support for the establishment of statutory listing requirements
 - Published second Listing Committee Annual Report
 - Set out future model for dissemination of regulatory information by Main Board issuers
 - First phase of Listing Committee structure rule amendments approved by the Exchange
 - Prepared for a major review of the GEM
 - Implemented case database for the Listing Division
- Completed the renovation of the trading area of the Trading Hall
 - Reduced minimum trading spreads (phase 1) and changed the related trading parameters
 - Exempted placing or fund-raising activities by EPs from current prohibition of dealings in suspended securities under trading rules
 - Increased maximum number of outstanding orders per price queue from 2,000 to 4,000 orders in the AMS/3
 - Increased EPs' Open Gateway trading capacity via sale of 271 standard throttles
 - Obtained the SFC's approval for the launch of CBBC
 - Reviewed the derivative warrant market
 - Introduced REITs and 3 new ETFs
 - Provided continuous education and training for 7,200 employees of EPs
- Implemented enhanced measures for stock options
 - Offered mass quotation facility to stock options market makers
 - Launched the FTSE/Xinhua China 25 Index Futures and Options and six additional classes for stock options and futures
 - Obtained SFC's approval on position limits increase for stock options
 - Recruited 12 new HKFE participants and 6 Options Trading EPs
- Upgraded Clearing Service Call Centre and Interactive Voice Recording System
 - Waived monthly stock custody fee for delisted securities and securities in prolonged suspension
 - Abolished the DCASS standard instruction input/processing fee for performing external trade transfer
 - Extended the CCASS deadline for participants to submit voting instructions and corporate action instructions
 - Implemented Derivatives Market Clearing Houses fee changes on interest retention rate and accommodation charge
 - Introduced further fee concessions for IPs Account Services in the CCASS
 - Enhanced the CCASS money settlement
 - Harmonised capital requirements of different categories of clearing participants of the three clearing houses
 - Announced elimination of scrip fee on deemed book close dates
- Organised and co-organised more than 16 conferences and seminars in the Mainland and Hong Kong to promote listings in Hong Kong
 - Co-organised 6 training programmes in Hong Kong and the Mainland for Hong Kong – listed Mainland enterprises
 - Conducted around 100 presentations in Hong Kong and the Mainland respectively
 - Identified more than 560 prospective issuers
- Introduced new service for redistribution of historical data products and signed the first Historical Data Product Vendor Agreement
 - Streamlined processes relating to historical securities data
 - Extended the Mainland Discount Programme for real-time market data
- Upgraded the operating systems of the HKATS, DCASS and CCASS/3
 - Commenced consolidation of the four existing market system networks into the SDNet and completed phase 1 migration of the HKATS, DCASS and PRS network
 - Upgraded the HKEx website capacity and enhanced disaster recovery arrangements
 - Migrated the AMS/3 ORS to an integrated technology platform
 - Upgraded system capacity of the AMS/3
 - Replaced all the AMS/3 off-floor terminals since 1998 and upgraded the corresponding security solution
 - Upgraded the Trading Hall LAN cabling infrastructure and all the on-floor trading terminals and facilities for the renovated Trading Hall
 - Consolidated the AMS/3 satellite system

Priorities in 2006

- Implement the first phase of abolition of paid announcements and enhance issuer information content on the HKEx website
 - Continue work towards the establishment of statutory listing requirements
 - Revamp listing decision-making structure (Phase 2)
 - Study the introduction of a comprehensive electronic management system for the Listing Division
 - Further refine the IPO vetting progress
 - Continue review of the GEM
 - Further enhance corporate governance
 - Support establishment of Financial Reporting Council
 - Establish China Affairs Team
- Complete the Trading Hall renovation
 - Launch and develop the CBBC
 - Strengthen the derivative warrant market education, including developing a web-based resource centre
 - Study further spread reduction for shares with prices below \$30 (Phase 2)
- Establish more favourable position limit regime
 - Review market maker model for the Derivatives Market
 - Review possible introduction of tailor-made combination order functionality
- Implement improvements to CCASS nominee services
 - Further enhance CCASS nominee services in respect of electronic voting
 - Harmonise collateral policies of the three clearing houses
 - Study expanding admission of IPs to the CCASS
 - Explore Third Party Clearing
- Organise listing promotional events in Hong Kong and the Mainland to attract potential issuers to list in Hong Kong
 - Participate in listing promotional events in Taiwan, Japan and other Asia Pacific region to promote Hong Kong as the preferred listing venue
 - Arrange regular training programmes in Hong Kong and the Mainland for Hong Kong-listed Mainland enterprises
- Review the existing derivatives market data products
 - Review policy on delayed data product and indirect vendorship
 - Further develop the Mainland market for HKEx's information products
 - Support the implementation of the proposal to abolish the requirement for Main Board issuers to publish paid announcements on newspapers
 - Further improve the efficiency of historical data management and issuer information processing
- Upgrade the capacity of the HKATS, DCASS and PRS
 - Upgrade the software of the HKATS Network Gateways
 - Implement phase 2 of the network consolidation with migration of the CCASS/3 network to the SDNet
 - Replace the hardware and software of the AMS/3 Open Gateway and Mutli-Workstation
 - Study and prepare for the migration of the AMS/3 for a higher version of server technology

Financial Review

HKEx GROUP – OVERVIEW OF 2005 RESULTS AND FINANCIAL POSITION

Key Market Statistics and Business Drivers – Cash Market	
Average daily turnover value on the Stock Exchange	\$18.3 billion *
Number of newly listed derivative warrants	1,682 *
Number of newly listed companies on the Main Board	57
Number of newly listed companies on the GEM	10
Number of Main Board companies at 31 December 2005	934
Number of GEM companies at 31 December 2005	201
Total equity funds raised on the Main Board	\$298.2 billion
Total equity funds raised on the GEM	\$3.1 billion
* New record high in 2005	

2004 Consolidated Balance Sheet

		As restated \$'000
Assets		
Fixed assets, land and properties	6	432,818
Investments in associates	7	38,731
Funds	8	12,428,630
Investments and time deposits		2,801,874
Cash and cash equivalents		1,035,045
Other assets	10	4,706,306
		<u>21,443,404</u>
Liabilities		
Participants' contributions to Funds	11	11,828,444
Participants' admission fees received		87,700
Other liabilities	12	5,495,026
		<u>17,411,170</u>
Net assets		<u>4,032,234</u>
Capital and reserves		
Share capital, share premium and reserves		1,877,559
Retained earnings		1,658,055
Proposed/declared dividend		496,620
		<u>2,154,675</u>
		<u>4,032,234</u>

Segment Profit for the Year

	Cash Market \$'000	Derivatives Market \$'000	Clearing Business \$'000	Information Services \$'000	Group \$'000
Income	1,172,850	441,755	753,695	325,757	2,694,057
Operating expenses	544,956	147,961	384,910	67,655	1,145,482
	1	2	3	4	
Segment results	627,894	293,794	368,785	258,102	1,548,575
Share of profits less losses of associates	(3)	–	18,436	–	18,433
					5
Segment profits before taxation	627,891	293,794	387,221	258,102	1,567,008
Taxation					(227,460)
Profit attributable to shareholders					<u>1,339,548</u>

Cash Flows for the Year

		\$'000
Net cash inflow from operating activities	13	1,399,898
Acquisition of interest in an associate	7	(24,876)
Capital expenditures		(62,080)
Dividends paid		(1,018,784)
Other net cash inflow		29,910
Net increase in cash and cash equivalents		324,068
Cash and cash equivalents at 1 January 2005		1,035,045
Cash and cash equivalents at 31 December 2005		<u>1,359,113</u>

Key Market Statistics and Business Drivers – Derivatives Market

Average daily number of derivatives contracts traded on the Futures Exchange	68,157 *
Average daily number of stock options contracts traded on the Stock Exchange	35,385 *
* New record high in 2005	

2005 Consolidated Balance Sheet

		\$'000
Assets		
Fixed assets, land and properties	6	370,246
Investments in associates	7	64,581
Funds	8	15,027,401
Contributions to HKEEx Employee Share Trust	9	30,037
Investments and time deposits		2,799,178
Cash and cash equivalents		1,359,113
Other assets	10	3,310,377
		<u>22,960,933</u>
Liabilities		
Participants' contributions to Funds	11	14,400,332
Participants' admission fees received		82,700
Other liabilities	12	4,110,412
		<u>18,593,444</u>
Net assets		<u>4,367,489</u>
Capital and reserves		
Share capital, share premium and reserves		1,911,695
Retained earnings		1,775,631
Proposed/declared dividend		680,163
		<u>4,367,489</u>

Notes

Due to the continued economic recovery, influx of foreign funds and upbeat market sentiment, activity on the Stock Exchange and the Futures Exchange increased substantially. Coupled with rising interest rates and increased Margin Fund size, the Group achieved record profit for the second consecutive year in 2005. The performance of the Group by business segment during 2005 was as follows:

- 1 Results of the Cash Market increased by \$114 million mainly due to the higher turnover of the Cash Market and the rise in Stock Exchange listing fees attributable to the higher number of listed securities and newly listed derivative warrants during the year.
- 2 Results of the Derivatives Market increased by \$111 million mainly as a result of the increase in investment income from the Margin Funds and the increase in the level of activity on the Derivatives Market.
- 3 Results of the Clearing Business rose by \$60 million mainly attributable to the increase in clearing and settlement fees generated from Cash Market transactions.
- 4 Results of the Information Services Business increased by \$26 million as demand for information increased in tandem with the activities of the Cash and Derivatives Markets.
- 5 Share of profits less losses of associates increased due to the higher profitability of one of the associates and the acquisition of a further six per cent interest in that associate during the year.
- 6 Fixed assets, land and properties decreased by \$63 million mainly attributable to depreciation during the year.
- 7 Investments in associates rose by \$26 million as the Group acquired a further six per cent interest in an associate during the year for a consideration of \$25 million.
- 8 Funds comprised Margin Funds of \$13,649 million (2004: \$10,530 million), Clearing House Funds of \$1,340 million (2004: \$1,862 million) and Compensation Fund Reserve Account of \$38 million (2004: \$37 million). The increase in Margin Funds was as a result of increased open interest in futures and options contracts. The decrease in Clearing House Funds reflected the decrease in additional contributions from Participants in response to market fluctuations and changes in risk exposure.
- 9 The HKEx Employees' Share Award Scheme ("HKEx Employee Share Trust") was set up in December 2005 under which \$30 million of HKEx shares were acquired from the market and held by the Trust on behalf of eligible employees until the shares become vested.
- 10 Other assets mainly represented obligations receivable under the Continuous Net Settlement system of \$2,890 million (2004: \$4,261 million) and other receivables.
- 11 Participants' contributions to funds represented Margin deposits from Participants of \$13,649 million (2004: \$10,530 million) and Participants' contributions to Clearing House Funds of \$752 million (2004: \$1,299 million). The reasons for the movements in the contributions were similar to the movements in the funds as explained in note 8.
- 12 Other liabilities mainly represented obligations payable under the Continuous Net Settlement system of \$2,890 million (2004: \$4,261 million).
- 13 Net cash inflow from operating activities decreased by \$416 million mainly due to more financial assets were converted into cash in 2004 for funding the special dividend.

Retained Earnings for the Year

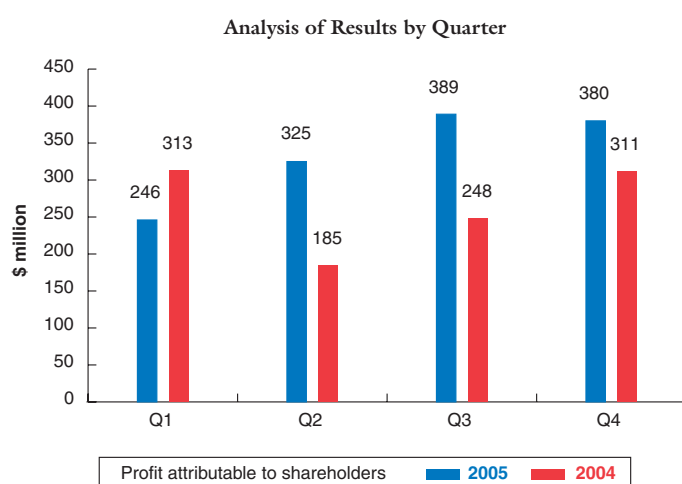
	\$'000
Profit attributable to shareholders	1,339,548
Dividends paid during the year	(1,018,784)
Transfer to reserves	(19,645)
Net increase in retained earnings	301,119
Retained earnings at 1 January 2005, as restated	2,154,675
Retained earnings at 31 December 2005	2,455,794
Representing:	
Retained earnings	1,775,631
Proposed/declared dividend	680,163
	2,455,794

OVERALL PERFORMANCE

The financial performance of the Group is summarised below:

Analysis of results by quarter

	Q1 2005 \$'000	Q2 2005 \$'000	Q3 2005 \$'000	Q4 2005 \$'000	Total 2005 \$'000
Income	574,252	664,213	732,835	722,757	2,694,057
Operating expenses	282,675	287,843	282,394	292,570	1,145,482
Operating profit	291,577	376,370	450,441	430,187	1,548,575
Share of profits less losses of associates	2,617	6,018	4,357	5,441	18,433
Profit before taxation	294,194	382,388	454,798	435,628	1,567,008
Taxation	(48,773)	(57,013)	(65,678)	(55,996)	(227,460)
Profit attributable to shareholders	245,421	325,375	389,120	379,632	1,339,548
	Q1 2004 \$'000	Q2 2004 \$'000	Q3 2004 \$'000	Q4 2004 \$'000	Total 2004 \$'000
Profit attributable to shareholders	312,896	184,529	248,610	310,849	1,056,884



With the exception of the first quarter, profit attributable to shareholders for each quarter of 2005 has shown a significant growth over 2004. The highest profit was recorded in the third quarter of 2005 when the average daily turnover value on the Stock Exchange for the quarter reached the peak at \$20.6 billion during the year.

The Group achieved record high profit for the second consecutive year in 2005. Profit attributable to shareholders increased by 27 per cent to \$1,340 million for the year ended 31 December 2005, compared with \$1,057 million for 2004.

Due to the continued economic recovery, influx of foreign funds and upbeat market sentiment, activity on the Stock Exchange and the Futures Exchange increased substantially. Several new records were achieved in the Cash and the Derivatives Markets in 2005, including the highest equity capital raised by IPO, record annual turnover of the Cash Market and the highest number of contracts traded on the Derivatives Market. As a result, turnover-related income rose significantly.

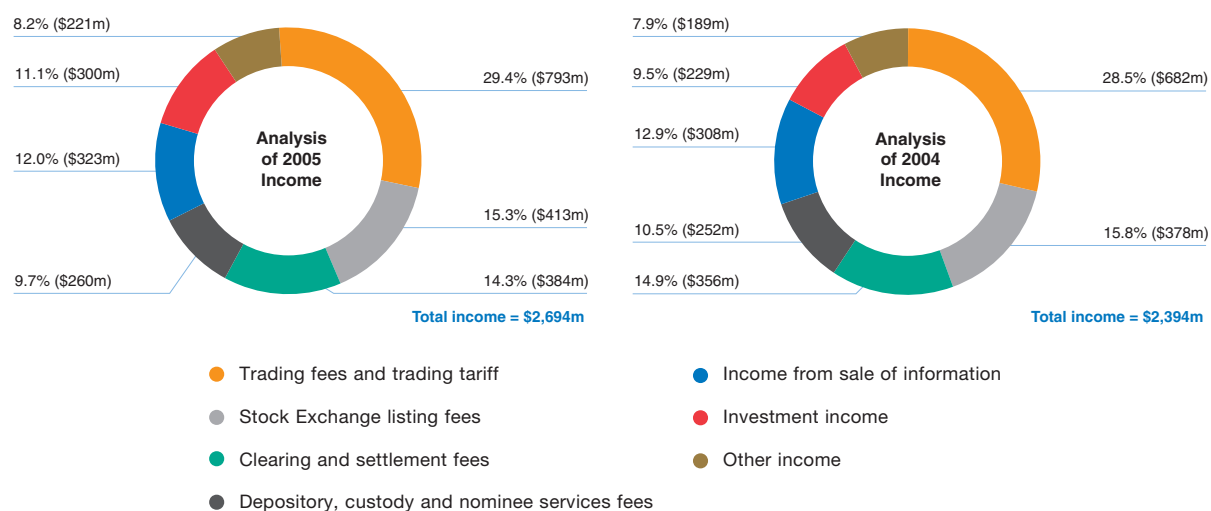
Investment income increased as interest income of the Margin Funds rose on the back of increased fund size and rising interest rates in 2005.

Stock Exchange listing fees also recorded considerable growth due to the higher number of listed securities and newly listed derivative warrants during the year.

Total level of operating expenses remained similar to that of last year despite an increase in staff costs.

The accounts have been prepared in accordance with HKFRSs issued by the HKICPA, which have been aligned with the requirements of International Financial Reporting Standards in all material respects as at 31 December 2005.

Income



(A) Income affected by market turnover

	2005 \$'000	2004 \$'000	Change
Trading fees and trading tariff	793,247	682,293	16%
Clearing and settlement fees	384,019	356,274	8%
Depository, custody and nominee services fees	259,952	251,722	3%
Total	1,437,218	1,290,289	11%

The increase in trading fees and trading tariff was mainly due to the higher turnover of the Cash and Derivatives Markets in 2005 against that of last year.

Clearing and settlement fees are derived predominantly from Cash Market transactions. Despite being mostly ad valorem fees, clearing and settlement fees are subject to a minimum and a maximum fee per transaction. Clearing and settlement fees did not increase linearly with the Cash Market turnover in 2005 as there was a higher proportion of transactions with value subject to the maximum fee.

Depository, custody and nominee services fees increased due to higher scrip fee income, corporate action fees and dividend collection fees but partly offset by lower stock withdrawal fees in 2005. The fees were influenced by the level of Cash Market activities but did not move proportionately with changes in the Cash Market turnover as they varied mostly with the board lots rather than the value of the securities concerned and many were subject to a maximum fee. Moreover, scrip fee was only chargeable on the net increase in individual Participants' aggregate holdings of the securities. Effective 1 January 2006, deemed book close scrip fee (2005: \$41 million; 2004: \$46 million) was abolished.

Key market indicators

	2005	2004	Change
Average daily turnover value on the Stock Exchange	\$18.3 billion	\$16.0 billion	14%
Average daily number of derivatives contracts traded on the Futures Exchange	68,157	56,752	20%
Average daily number of stock options contracts traded on the Stock Exchange	35,385	22,720	56%

(B) Stock Exchange listing fees

	2005 \$'000	2004 \$'000	Change
Annual listing fees	263,945	252,358	5%
Initial and subsequent issue listing fees	142,075	119,468	19%
Others	6,980	6,601	6%
Total	413,000	378,427	9%

The increase in annual listing fees was attributable to the higher number of listed securities. The rise in initial and subsequent issue listing fees was due to the increase in the number of newly listed derivative warrants and newly listed companies on the Main Board, including notably the biggest IPO in Hong Kong, the China Construction Bank Corporation, and the Link REIT during 2005.

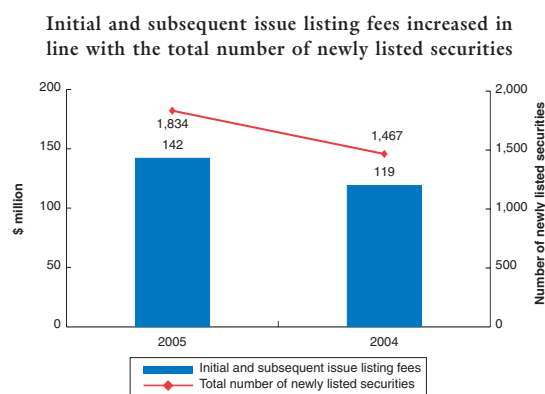
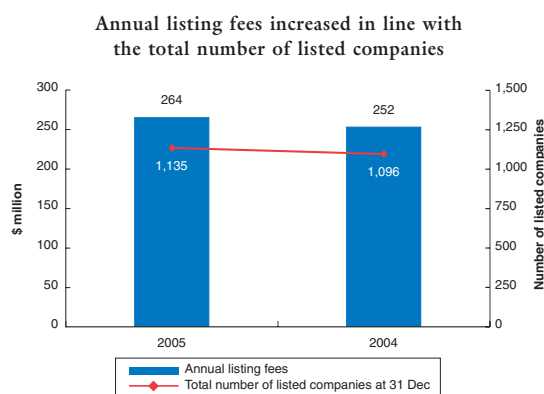
Key drivers for annual listing fees

	As at 31 Dec 2005	As at 31 Dec 2004	Change
Number of companies listed on the Main Board	934	892	5%
Number of companies listed on the GEM	201	204	(1%)
Total	1,135	1,096	4%

Key drivers for initial and subsequent issue listing fees

	2005	2004	Change
Number of newly listed derivative warrants	1,682	1,259	34%
Number of newly listed companies on the Main Board	57	49	16%
Number of newly listed companies on the GEM	10	21	(52%)
Number of other newly listed securities on the Main Board and the GEM	85	138	(38%)
Total	1,834	1,467	25%

	2005 \$ billion	2004 \$ billion	Change
Total equity funds raised on the Main Board	298.2	276.5	8%
Total equity funds raised on the GEM	3.1	5.3	(42%)
Total	301.3	281.8	7%



(C) Income from sale of information

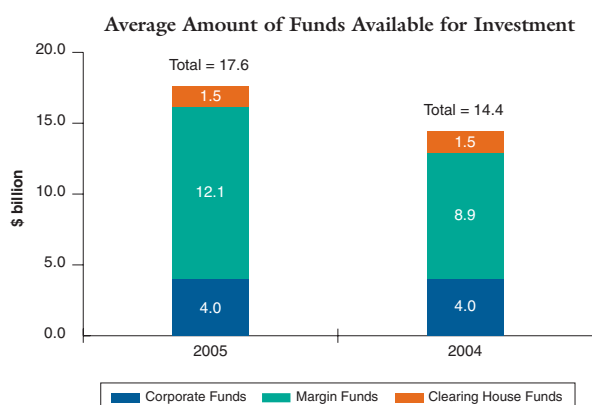
	2005 \$'000	2004 \$'000	Change
Income from sale of information	322,713	307,633	5%

Income from sale of information rose as demand for information increased in tandem with the activity on the Cash and Derivatives Markets.

(D) Investment income

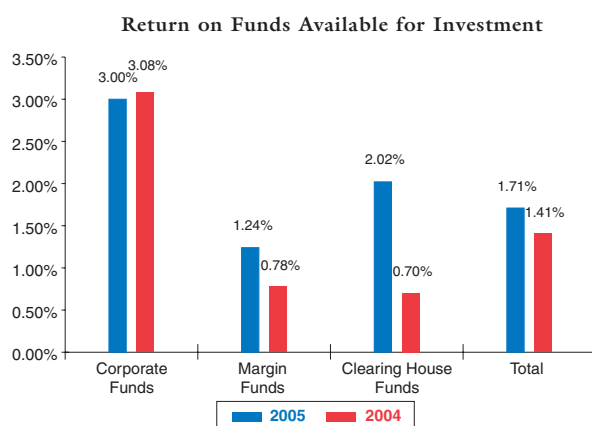
	2005 \$'000	2004 \$'000	Change
Income from:			
Funds available for investment	300,109	202,955	48%
Investment in Singapore Exchange Limited	–	25,632	(100%)
Total	300,109	228,587	31%

The average amount of funds available for investment was as follows:



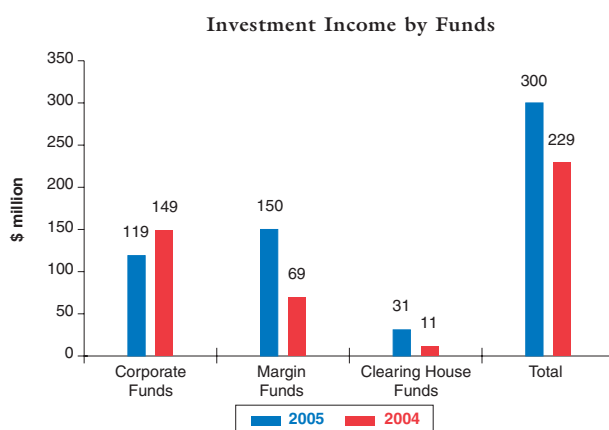
The increase in average amount of Margin Funds during the year was primarily due to increased open interest in futures and options contracts.

The performance of funds available for investment was as set out below:



The return on Margin Funds and Clearing House Funds increased mainly as a result of rising interest rates in 2005. The return on Margin Funds in 2005 was lower than that of the Clearing House Funds as there was a significant increase in margin deposits denominated in Japanese Yen, and Participants were paid interest on all of their margin deposits whereas only certain part of the clearing house contributions was eligible for interest. The return on Corporate Funds declined mainly due to the drop in fair value gains of financial assets held for trading, reflecting market movements due to rising interest rates and a stronger USD.

The movements in total investment income by Funds (including investment in Singapore Exchange Limited) were as follows:



Investment income from Margin Funds increased due to an increase in fund size and rising interest rates in 2005. Investment income from Clearing House Funds increased due to rising interest rates in 2005. The decrease in investment income from Corporate Funds was mainly due to the one-off gain on disposal of the investment in Singapore Exchange Limited of \$24.8 million in 2004 and the drop in fair value gains of financial assets held for trading in 2005.

More details of the investment portfolio are set out in the Treasury section under the Business Review.

(E) Other income

	2005 \$'000	2004 \$'000	Change
Network, terminal user, dataline and software sub-license fees	129,733	120,261	8%
Participants' subscription and application fees	34,351	34,341	0%
Brokerage on direct IPO applications	34,123	17,586	94%
Fair value gain of an investment property	4,400	3,300	33%
Accommodation income	2,154	5,133	(58%)
Miscellaneous income	16,256	8,380	94%
Total	221,017	189,001	17%

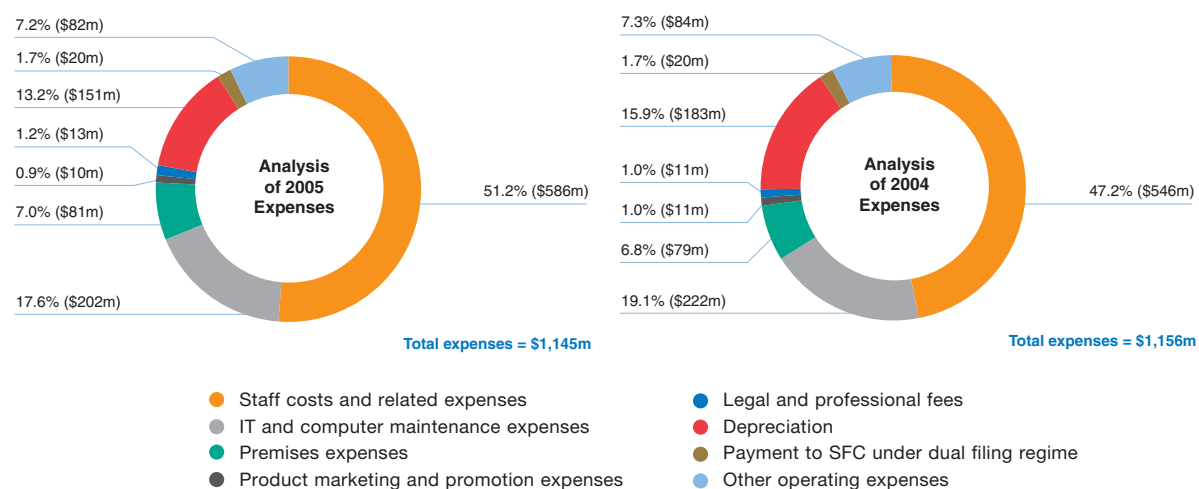
Despite the 20 per cent reduction in AMS/3 user fees that took effect on 1 January 2005, network, terminal user, dataline and software sub-license fees rose due to the increase in sales of additional throttle.

Brokerage on direct IPO applications increased in line with the funds raised by IPOs and unit trusts, in particular the Link REIT.

Accommodation income (i.e. retention interest charged on cash margin deposits in non-contract settlement currencies and securities deposited by Participants as alternatives to cash deposits of the Margin Funds) decreased mainly due to less cash margin deposits denominated in non-contract settlement currencies received in the first half of 2005. In addition, from 1 June 2005 onwards, accommodation charges on cash margin deposits were abolished and accommodation fee on utilised non-cash collateral charged by HKCC and SEOCH was reduced from 1.2 per cent and 2 per cent respectively to 0.5 per cent.

Miscellaneous income increased mainly due to an increase in other income from Participants, exchange gains on accounts payable denominated in foreign currencies due to the strengthening HKD and interest on late payment levied on information vendors.

Operating Expenses



	2005 \$'000	2004 \$'000	Change
Staff costs and related expenses	586,033	545,654	7%
Information technology and computer maintenance expenses	201,725	221,624	(9%)
Premises expenses	80,679	78,833	2%
Product marketing and promotion expenses	10,065	11,263	(11%)
Legal and professional fees	13,641	11,083	23%
Depreciation	150,995	183,400	(18%)
Payment to SFC under dual filing regime	20,000	20,000	0%
Other operating expenses	82,344	84,439	(2%)
Total	1,145,482	1,156,296	(1%)

Staff costs and related expenses increased by \$40 million, primarily due to the increase in salary costs and contribution to provident funds of \$21 million as a result of the increase in headcount and salary adjustment, and a \$10 million increase in performance bonus as a result of the improved performance of the Group in 2005. Employee share-based compensation costs also rose by \$9 million due to the costs of share options and shares granted under the Employees' Share Award Scheme ("Awarded Shares") arising from the amortisation of the fair value of the new grants of share options in March 2004, May 2004 and January 2005 and of Awarded Shares in December 2005.

Information technology and computer maintenance expenses of the Group, after excluding goods and services directly consumed by the Participants of \$55 million (2004: \$61 million), were \$147 million (2004: \$161 million). The decrease was mainly due to lower system maintenance costs and reduced network line rental charges.

Depreciation decreased as certain fixed assets became fully depreciated.

Other operating expenses decreased mainly as a result of the reduction in bank charges following the expiry of certain banking facilities that were no longer necessary.

Share of Profits less Losses of Associates

	2005 \$'000	2004 \$'000	Change
Share of profits less losses of associates	18,433	12,884	43%

Share of profits less losses of associates increased due to the higher profitability of one of the associates, CHIS, and the acquisition of a further six per cent interest in CHIS in May 2005.

Taxation

	2005 \$'000	2004 \$'000	Change
Taxation	227,460	193,641	17%

Taxation increased mainly attributable to an increase in operating profit, but partly offset by an increase in non-taxable investment income.

Key Changes to Financial Position

Key changes in the Group's financial position during the year were as follows:

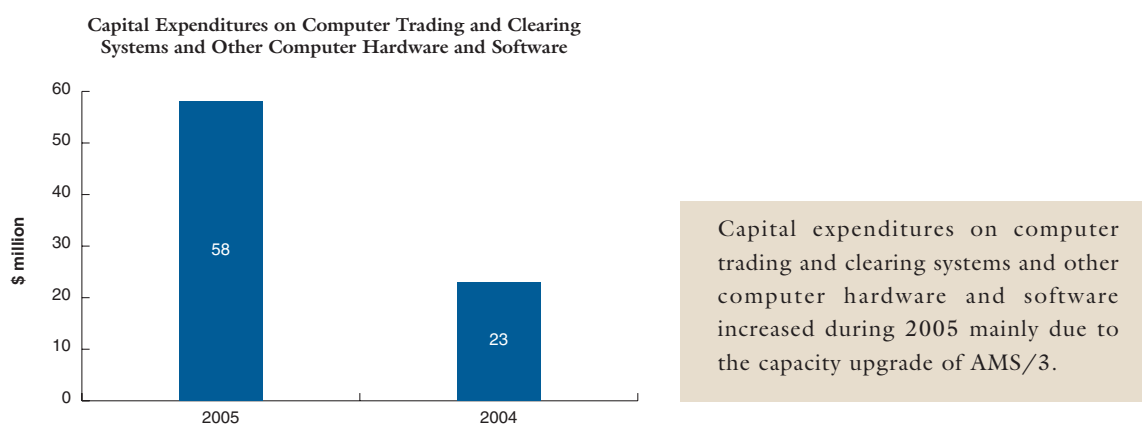
(A) Fixed assets and capital commitments

The Group's fixed assets consisted of leasehold buildings, computer trading and clearing systems, other computer hardware and software and miscellaneous assets such as leasehold improvements.

The Group is heavily reliant on the capability and reliability of its computer systems for its business operations, including those required for its electronic trading platforms and for post-trading clearing and settlement services.

As at 31 December 2005, the net book value of fixed assets dropped by \$66 million compared with 31 December 2004 mainly due to \$151 million of depreciation, but partly offset by \$86 million of additions during the year. Computer trading and clearing systems and other computer hardware and software decreased by \$76 million to \$212 million (2004: \$288 million), again mainly attributable to depreciation of \$134 million, but partly offset by additions of \$58 million during the year.

The total additions to computer trading and clearing systems and other computer hardware and software during the years 2005 and 2004 were as follows:



The Group's capital expenditure commitments as at 31 December 2005, mainly related to the refurbishment of the Trading Hall and the development and purchases of computer systems, amounted to \$137 million (2004: \$78 million). The Group has adequate internal resources to fund its commitments on capital expenditures.

(B) Funds

	2005 \$'000	2004 \$'000	Change
Clearing House Funds	1,340,410	1,861,487	(28%)
Margin Funds	13,648,581	10,529,692	30%
Corporate Funds	4,196,701	3,874,370	8%
Total	19,185,692	16,265,549	18%

The decrease in Clearing House Funds during the year reflected the decrease in additional contributions from Participants in response to market fluctuations and changes in risk exposure.

The increase in Margin Funds was due to higher open interest in futures and options contracts.

The increase in Corporate Funds in 2005 was mainly due to the profit net of dividends paid during the year.

(C) Significant investments held and material acquisitions and disposals of investments and subsidiaries

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

(D) Accounts receivable, prepayments and deposits and accounts payable, accruals and other liabilities

	2005 \$'000	2004 \$'000	Change
CNS money obligations receivable	2,889,804	4,261,202	(32%)
Other accounts receivable, prepayments and deposits	397,031	430,644	(8%)
Total accounts receivable, prepayments and deposits	3,286,835	4,691,846	(30%)
CNS money obligations payable	2,889,524	4,261,382	(32%)
Other accounts payable, accruals and other liabilities	751,546	640,968	17%
Total accounts payable, accruals and other liabilities	3,641,070	4,902,350	(26%)

The Group's accounts receivable, prepayments and deposits and accounts payable, accruals and other liabilities mainly comprised CNS money obligations receivable and payable.

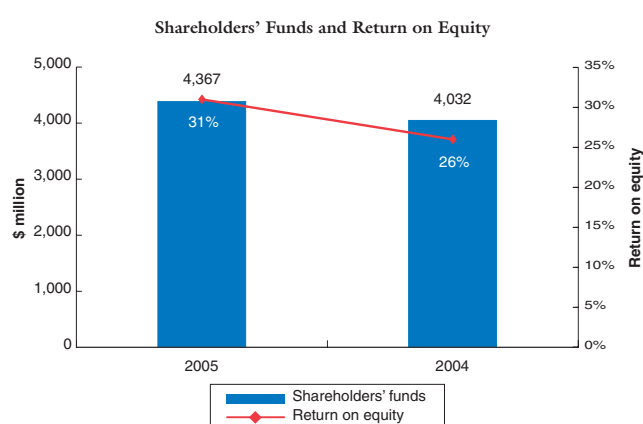
CNS money obligations receivable and payable are recognised when final acceptance of Stock Exchange trades is confirmed on T+1. Settlement will take place on T+2 unless it is not a settlement day in which case settlement will be effected on T+3.

CNS money obligations receivable and payable in 2005 were lower than 2004 as the last trading day in 2004 was not a settlement day when the Stock Exchange was only opened for trading for half a day. Accordingly, the amounts outstanding as at 31 December 2005 represented unsettled transactions for one trading day whereas the amounts as at 31 December 2004 comprised two days of unsettled trades.

(E) Shareholders' funds and return on equity

Shareholders' funds as at 31 December 2005 increased by \$335 million to \$4,367 million (2004: \$4,032 million). The increase was mainly attributable to a \$321 million increase in retained profits before transfers to/from designated reserves. Share capital, share premium and employee share-based compensation reserve in aggregate rose by \$70 million due to share options exercised and employee share-based compensation benefits recognised during 2005. Investment revaluation reserve, on the contrary, fell by \$56 million mainly due to a drop in the fair values of available-for-sale financial assets caused by higher interest rates.

Return on equity rose from 26 per cent in 2004 to 31 per cent in 2005 as profit attributable to shareholders increased.



Shareholders' funds and return on equity were boosted by the record high profit of the Group in 2005.

Liquidity, Financial Resources and Gearing

Working capital rose by \$292 million or 10 per cent to \$3,357 million as at 31 December 2005 (2004: \$3,065 million). The increase was primarily due to the profit generated during the year of \$1,340 million, which was partly offset by payment of the 2004 final dividend of \$498 million and 2005 interim dividend of \$521 million, the payment to the Employees' Share Award Scheme of \$30 million and the increase in other net current assets of \$1 million.

Although the Group has consistently maintained a very liquid position, banking facilities have nevertheless been put in place for contingency purposes. As at 31 December 2005, the Group's total available banking facilities amounted to \$1,608 million (2004: \$1,608 million), of which \$1,500 million (2004: \$1,500 million) represented repurchase facilities to augment the liquidity of the Margin Funds.

Borrowings of the Group have been rare and are mostly event driven, with little seasonality. As at 31 December 2005 and 31 December 2004, the Group had no bank borrowings, and therefore had zero gearing.

As at 31 December 2005, 99 per cent (2004: 99 per cent) of the Group's cash and cash equivalents (comprising cash on hand, bank balances and time deposits within three months of maturity when acquired) were denominated in HKD or USD.

Charges on Assets

None of the Group's assets was pledged as at 31 December 2005 and 31 December 2004.

Exposure to Fluctuations in Exchange Rates and Related Hedges

Details of the Group's exposure to fluctuations in exchange rates and related hedges are included in note 46(a)(i) – Foreign exchange risk to the consolidated accounts of this Annual Report.

Contingent Liabilities

In May 2005, the Court of Appeal issued its judgement in the New World and others judicial review appeal case. The Court allowed the appeal and quashed the direction of the Chairman of the Listing (Disciplinary) Committee in the New World disciplinary proceedings that legal advisers not be permitted to address the Listing (Disciplinary) Committee. New World was awarded costs which are presently unknown but estimated to be in the region of \$4 million. The Stock Exchange has been granted leave to appeal to the Court of Final Appeal. The appeal is set down to be heard by the Court of Final Appeal on 21 and 22 March 2006. In the opinion of external legal counsel, the Stock Exchange has valid grounds for an appeal, a reasonable prospect of success and consequently it is not probable that the Stock Exchange will be required to bear the costs incurred by New World in the legal proceedings. Accordingly, no provision for such costs has been made in the accounts.

Details of the other contingent liabilities are disclosed in notes 40(a)(i), 40(a)(ii) and 40(b)(i) to the consolidated accounts of this Annual Report.

Financial Statistics since the Year of Merger

	2005	As restated ^Ω 2004	2003	2002	2001	2000
KEY MARKET STATISTICS						
Average daily turnover value on the Stock Exchange <i>in \$ billion</i>	18.3	16.0	10.4	6.7	8.2	12.7
Average daily number of derivatives contracts traded on the Futures Exchange	68,157	56,752	41,889	30,038	27,192	22,118
Average daily number of stock options contracts traded on the Stock Exchange	35,385	22,720	17,122	15,203	16,567	16,958
PROFIT AND LOSS ACCOUNT <i>in \$ million</i>						
Income	2,694	2,394	2,020	1,808	1,998	2,312
Operating expenses	1,145	1,156	1,224	1,165	1,179	1,331
Operating profit	1,549	1,238	796	643	819	981
Share of profits less losses of associates	18	13	9	5	–	–
Profit before taxation	1,567	1,251	805	648	819	981
Taxation	(227)	(194)	(112)	(59)	(85)	(98)
Profit attributable to shareholders	1,340	1,057	693	589	734	883
Dividend per share <i>in \$</i>						
– Interim and final dividends	1.13	0.90	0.60	0.51	0.33	0.33
– Special dividend	–	–	1.68	–	–	–
	1.13	0.90	2.28	0.51	0.33	0.33
Earnings per share <i>in \$</i>	1.26	1.00	0.66	0.56	0.71	0.85
BALANCE SHEET <i>in \$ million</i>						
Non-current assets	1,905	2,423	2,690	1,886	1,803	2,199
Current assets	21,055	19,020	17,118	12,147	11,927	11,948
Current liabilities	(17,698)	(15,955)	(13,048)	(7,939)	(7,888)	(8,672)
Net current assets	3,357	3,065	4,070	4,208	4,039	3,276
Total assets less current liabilities	5,262	5,488	6,760	6,094	5,842	5,475
Non-current liabilities	(895)	(1,456)	(1,146)	(600)	(620)	(620)
Shareholders' funds	4,367	4,032	5,614	5,494	5,222	4,855
Net assets per share <i>in \$</i> [^]	4.11	3.82	5.35	5.26	5.02	4.67
FINANCIAL RATIOS						
Dividend payout ratio [@]	90%	90%	91%	91%	46%	39%
Cost to income ratio [*]	42%	48%	60%	64%	59%	58%
Return on equity [#]	31%	26%	12%	11%	14%	18%
Current ratio	1.2	1.2	1.3	1.5	1.5	1.4

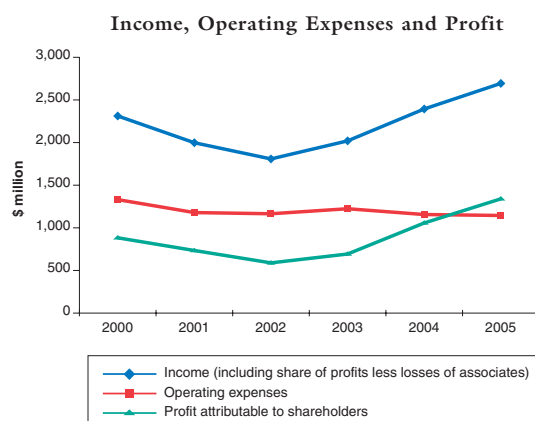
^Ω Following the adoption of HKAS 39 and HKFRS 4 (Amendment), certain 2004 figures previously reported have been restated.

[^] Based on number of shares issued and fully paid as at 31 December

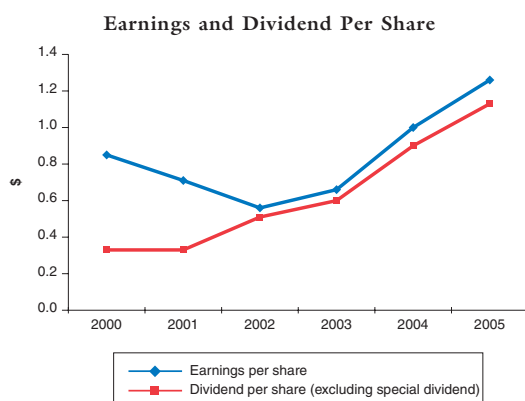
[@] The calculation of dividend payout ratio does not take into account of special dividend.

^{*} For the purpose of computation of cost to income ratio, income includes share of profits less losses of associates.

[#] Based on shareholders' funds as at 31 December

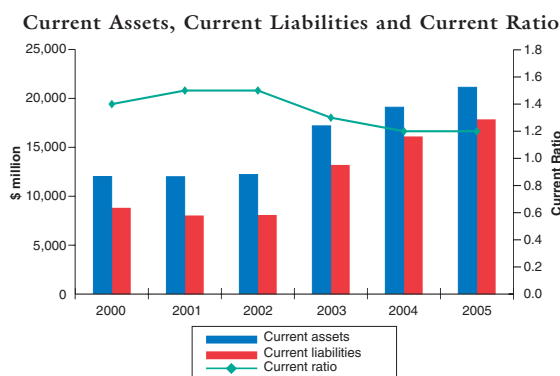


Profit attributable to shareholders declined during 2000 to 2002 as the market sentiment was adversely affected by the weak global economic environment, risk of war against Iraq and accounting scandals in the US. It started to pick up in 2003 following the end of the Severe Acute Respiratory Syndrome threat as there were increasing hopes of a revival in the Hong Kong economy. Thereafter, activity on the Cash and Derivatives Markets continued to gather increasing momentum, culminating in record high income of the Group in 2005. Due to stringent cost controls, operating expenses were kept relatively stable and the lowest operating expenses were achieved in 2005. As a result, profit attributable to shareholders was at record high in 2005.

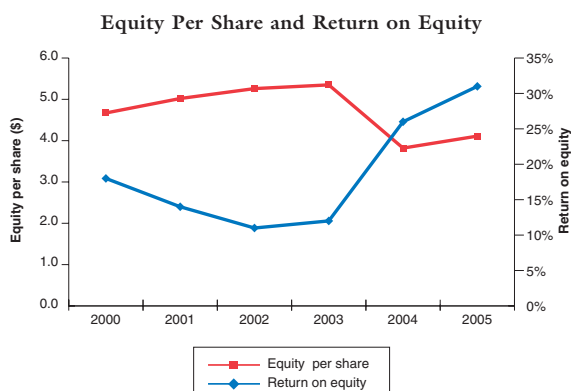


As there were no significant changes in the issued share capital, earnings per share followed the same trend as profit attributable to shareholders and reached a new high in 2005.

Since 2002, the Board has adopted a dividend policy of providing shareholders with regular dividends with a target payout ratio of 90%. Thereafter, dividend per share moved in line with earnings per share.



Current assets and current liabilities of the Group are directly affected by the amount of CNS money obligations receivable and payable under the T+2 settlement cycle and the size of the Margin Funds. Current assets and current liabilities as at 31 December 2005 were the highest compared to previous year ends as the size of the Margin Funds rose as a result of increased open interest in derivative contracts.



Equity per share has been increasing steadily due to profits retained until 2004 when a special dividend of \$1.68 per share was paid in May 2004.

Return on equity moved in line with profit attributable to shareholders. The sharp increase in return on equity in 2004 was also due to the special dividend paid in May 2004.

Corporate Governance Report

CORPORATE GOVERNANCE

As a listed company as well as an exchange controller, HKEx has both public and corporate responsibilities on corporate governance front. The observance of good governance by the market as a whole as well as by an organisation became an important element in the perspective of investors, both local and overseas. We will continue to play a pivotal role in promoting and enhancing corporate governance standards in Hong Kong.

PUBLIC RESPONSIBILITY

Investor confidence is vital to the success of Hong Kong as a leading international financial centre. HKEx acknowledges the importance of raising the corporate governance profile of Hong Kong amid the increasingly competition from other marketplaces, and aims at promoting and enhancing the corporate governance standards on a par with the evolving international standards.

HKEx is the recognised exchange controller, and has the duty under the SFO to ensure the provision of orderly, informed, and fair markets or arrangements for the trading, clearing, and settlement of securities or futures contracts on the Stock Exchange and the Futures Exchange and their related clearing houses in Hong Kong.

Fostering Corporate Governance Culture

To help maintain Hong Kong's pre-eminent position as an international financial centre and develop it as a world-class asset management centre, HKEx has continued to take further steps to raise the corporate governance standard and improve the quality of disclosures in Hong Kong.

Certain of these improvement initiatives include:

- revising the Listing Rules by introducing the CG Code and CG Report which came into effect in January 2005. HKEx also invited HKICPA to issue further guidance to help listed issuers understand and implement the CG Code requirements relating to internal control, which took effect for accounting periods commencing on or after 1 July 2005;
- organising regular corporate governance training seminars and programmes for listed issuers, both in Hong Kong and overseas, including those from the Mainland, for raising their awareness of the good corporate governance and reporting standards;
- working closely with the FSTB and the SFC on further developing the Government proposals for giving statutory backing to major listing requirements to further enhance the regulation of listed companies in Hong Kong; and
- revising the Listing Rules to improve the Stock Exchange's listing decision-making structure. The objective of the proposed new structure is to put in place a simpler administrative framework for listing decision-making whilst retaining the checks and balances for minimising and managing regulatory risk including potential conflicts of interest within the Group.

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 are in conflict with any other interests, the former shall prevail.

The listing of HKEx is governed by the Memorandum of Understanding (“MOU”) entered into between HKEx, the Stock Exchange and the SFC, and by Chapter 38 in the Main Board Listing Rules. Unlike other listed companies in Hong Kong, the SFC is, pursuant to the MOU, 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 respect 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 or their alternates 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 Stock Exchange’s 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.

CORPORATE RESPONSIBILITY

Being a listed company, HKEx is committed to achieving the best corporate governance practices, and is pleased to accept a leadership role in setting and articulating corporate governance standards in Hong Kong.

The Board and the management consider that transparency, fairness and integrity are the cornerstones for good corporate governance and believe that high standard and appropriately rigorous corporate governance practices are essential for HKEx to improve its accountability and transparency, and to achieve a balance of the interests of the public and the interests of its stakeholders, including, inter alia, the Shareholders, EPs, the Government, customers, creditors, and employees.

Ongoing Improvements on Corporate Governance Practices

HKEx regularly reviews its corporate governance practices and aims at standing at the forefront of good governance. During 2005, the following improvement measures have been taken:

Audit and Internal control

- The policy of rotating the engagement partner of the external auditors every five years was adopted, and the first rotation took effect from the audit for 2005.
- A globally recognised framework was adopted for the evaluation of the internal control system of the Group.
- The whistle-blowing policy was formalised, and procedures for reporting malpractices directly to the chairman of the Audit Committee had been laid down.

Remuneration Policy

- The remuneration of the non-executive Directors was revised from \$100,000 to \$240,000 after being approved by the Shareholders at the 2005 AGM. The revision was aimed at remunerating fairly the non-executive Directors for their public accountability and time and effort spent on the Board and various committees and/or panels' meetings.
- Guidelines for recruitment of the Chief Executive and senior management staff were established, as part of the succession policy.
- Performance-based evaluation mechanism was adopted for determining the annual salary adjustment and performance bonus.
- An Employees' Share Award Scheme was adopted to replace the Share Option Scheme for rewarding good performers as well as retaining talented staff for the continual operation and development of the Group.
- The Board has retained an independent consultancy firm to carry out an overall review of the Group's remuneration policy and structure, which is scheduled to be completed in the third quarter of 2006.

Compliance

- Approval from the Shareholders was obtained to revise the Articles of Association for fixing the term of office of the non-executive Directors to not more than approximately three years but retiring non-executive Directors are eligible for re-appointment.

Organisation Structure

- As part of the succession plan, a number of senior executives have been assigned new responsibilities since August 2005 to further enrich their exposures and management experience.
- The corporate structure was fine-tuned in August 2005 by transferring the Investor Services Department (previously under the Business Development and Investor Services Division) to the Corporate Communications Department in order to centralise the public communication functions. (The revised organisation chart is set out on page 32 of this Annual Report.)

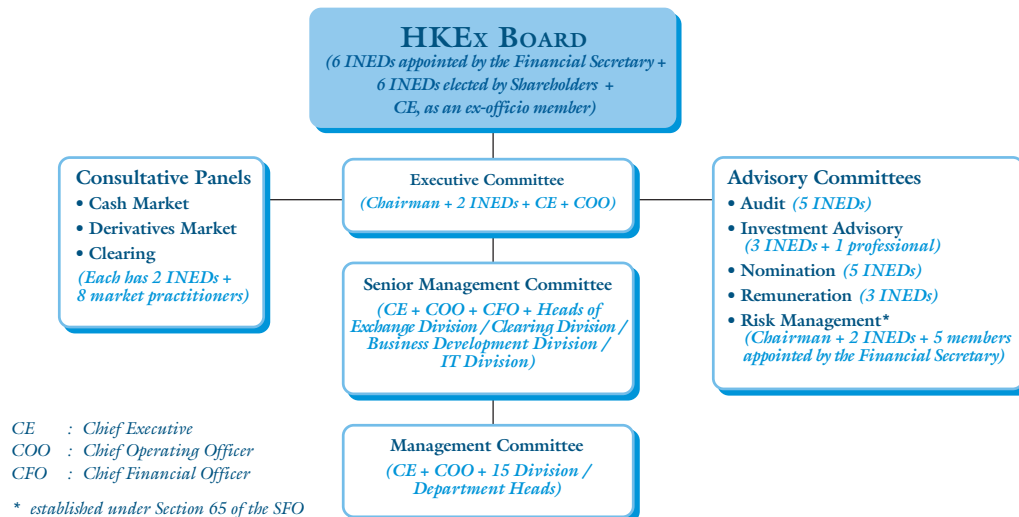
Transparency

- The newly designed quarterly newsletter – "Exchange" was released in October 2005 which demonstrated HKEx's continued effort to strengthen its communication with various stakeholders.
- A Listing Committee report on the work of the Listing Committees during the financial year of HKEx is sent to the Shareholders together with the 2005 Annual Report in order to improve the transparency of the operation of the Listing Committees.

GOVERNANCE STRUCTURE

To balance both commercial and public interests of HKEx, the primary consideration in designing its corporate governance structure is to ensure that these interests are properly balanced.

The overall governance structure of HKEx is set out below:



REPORT ON CORPORATE GOVERNANCE PRACTICES

The Board acknowledges the importance and benefits of fostering a high ethical and responsible culture at all levels within the organisation and its responsibility in ensuring that good corporate governance practices and procedures are laid down.

COMPLIANCE WITH THE CG CODE

HKEx applied the principles and complied with all requirements set out in the CG Code contained in Appendix 14 of the Main Board Listing Rules, throughout the review period with certain deviations from code provisions A.4.1 and A.4.2 in respect of the service term and rotation of Directors, which were duly rectified after amendments to the Articles of Association were approved by the Shareholders in April 2005. Since then, HKEx has fully complied with the CG Code.

The amendments to Articles of Association included: (a) to specify that all Directors, other than the Chief Executive who shall be subject to the term established under his employment contract with HKEx, will have a specific term of no more than approximately three years, but be eligible for re-appointment upon retirement, and (b) to require that any Director appointed by the Board to fill casual vacancy should be subject to election by the Shareholders at the first general meeting of HKEx after such Director's appointment.

KEY CORPORATE GOVERNANCE PRINCIPLES AND HKEx'S PRACTICES

THE BOARD

Roles of Directors

The Board assumes responsibility for leadership and control of HKEx and is collectively responsible for promoting the success of HKEx. The principal roles of the Board are:

- to lay down the Group's objectives, strategies, policies and business plan;
- to monitor and control operating and financial performance through the determination of the annual budget in particular the capital expenditure budget; and
- to set appropriate policies to manage risks in pursuit of the Group's strategic objectives.

The Board has delegated the day-to-day responsibility to the executive management under the instruction/supervision of Chief Executive and various Board committees.

Composition

As at the date of this report, the Board consists of 13 members who are all conversant with the Hong Kong financial market. Four of them are qualified accountants with substantial experience in accounting and financial matters. With the exception of the Chief Executive (an *ex-officio* member of the Board), all Board members are INEDs.

The Chairman (an INED) and the Chief Executive positions are split and each of them plays a distinctive role.

- The **Chairman** is responsible for the leadership and effective running of the Board, and ensuring that all key and appropriate issues are discussed by the Board in a timely and constructive manner.
- The **Chief Executive** is delegated with the authority and is responsible for running the Group's business, and the implementation of the approved strategies in achieving the overall commercial objectives.

The Nomination Committee is mandated to assess annually the independence of all non-executive Directors, and affirms that all non-executive Directors satisfy the criteria of independence, as set out in the Listing Rules. Board members are totally unrelated in every aspect including financial, business, or family.

The Board structure is defined in the SFO to ensure a balance of the public and commercial interests.

Biographies of the Directors, and their respective roles in the Board and committees are set out on page 22 of this Annual Report. The information is also available on HKEx's corporate website.

Appointment and Re-election of Directors

Other than the rules governing the appointment, re-election and removal of Directors laid down in the Articles of Association, details of the procedures for nominating candidates to stand for election at the 2006 AGM are set out in the circular to the Shareholders sent together with this Annual Report.

Elected Directors

The Nomination Committee, comprising all INEDs, is mandated to formulate the nomination policy and be responsible for identifying and nominating suitable candidates for the Board's consideration and recommendation to the Shareholders for election at annual general meetings, or where necessary, nominating candidates to fill casual vacancy of Elected Director.

In the selection process, the Nomination Committee makes reference to criteria including, inter alia, reputation for integrity, accomplishment and experience in the financial service industry, in particular, in the Cash and Derivatives Markets, professional and educational background, and commitment in respect of available time and relevant interest.

Government Appointed Directors

Pursuant to Section 77 of the SFO, the Financial Secretary may appoint any person as a Director but the number of such shall not exceed the number of Elected Directors, excluding the Chief Executive who is an *ex-officio* member of the Board.

Chairman

The Chairman is an INED appointed by the Board, and whose appointment is subject to the approval of the Chief Executive of the Government.

Chief Executive (ex-officio)

The Selection Committee (an ad hoc committee), comprising the Chairman of the Board, Chairman of the Remuneration Committee, Chairman of the Nomination Committee and two other Directors appointed by the Board, will be formed (as appropriate) for selecting candidates for making recommendation for the Board's approval. The appointment of the Chief Executive is subject to the SFC's approval.

Changes in 2005

The Nomination Committee met twice in 2005. At the meeting held in February 2005, the Nomination Committee nominated and the Board recommended Dr Bill C P Kwok and Mr Vincent K H Lee to stand for re-election at the 2005 AGM, and both of them were successfully re-elected by the Shareholders thereat for a service term of approximately three years from 12 April 2005 until the conclusion of the annual general meeting to be held in 2008.

On 12 April 2005, the Financial Secretary appointed Dr Marvin K T Cheung and re-appointed Messrs Henry H L Fan and Fong Hup as Government Appointed Directors each for a term of approximately two years from 12 April 2005 until the conclusion of the annual general meeting to be held in 2007. Mr Leong Ka Chai, a Government Appointed Director, retired after the conclusion of the 2005 AGM.

Board Process

The proceedings of the Board are well defined and follow all the recommended best practices of the CG Code.

Regular Board meetings are held normally once a month, with additional meetings arranged, if and when required. Thirteen Board meetings were held in 2005 and the average attendance rate was 92 per cent. Individual attendance records are set out on page 81 of this Annual Report. Other than regular Board meetings, Directors also meet periodically without management to discuss matters of particular interest.

The Chief Operating Officer and the Deputy Chief Operating Officer are invited to attend Board meetings, and other senior executives will from time to time be invited to attend Board meetings to make presentations or answer the Board's enquires.

Regular Board/committee meeting schedules of each year are normally available to all Directors/committee members before the start of the year. Comprehensive Board/committees papers are distributed to the Directors/committee members, normally four days in advance of the meeting.

Directors are free to contribute alternative views at meetings and major decisions would only be taken after deliberation at Board meetings. Directors who are considered having conflict of interests or material interests in the proposed transactions or issues to be discussed, would not be counted in the quorum of meeting and would abstain from voting on the relevant resolution. According to the Articles of Association, interests of five per cent or more is considered material. Minutes of the Board/committee meetings are kept by the Company Secretary and are open for inspection by Directors.

All Directors have access to the Company Secretary who is responsible for ensuring that the Board procedures are complied with, and advising the Board on compliance matters.

Directors' Duties

Every Director is kept abreast of his responsibilities as a director of the Company and of the conduct, business activities and development of the Company:

- A comprehensive Director's Handbook is issued to every Director, which sets out guidelines on conduct by making reference to the relevant sections of the statutes or the Listing Rules, and reminds Directors of their responsibilities in making disclosure of their interests and potential conflict of interests, and informing HKEx of the changes in personal particulars in a timely manner. The Director's Handbook is updated periodically and posted on HKEx's corporate website.
- Orientation programmes are organised for providing induction to new Directors to help them familiarise with HKEx management, business and governance practices.
- Management provides appropriate and sufficient information to Directors and the committee members in a timely manner to keep them apprised of the latest development of the Group and enable them to discharge their responsibilities. Directors also have independent access to senior executives in respect of operating issues.
- Directors are encouraged to participate in continuous professional development programmes to develop and upkeep their skills and knowledge on the latest development or changes in statutes, Listing Rules, corporate governance practices etc. that are required for discharging their responsibilities. Related expenses are fully reimbursable.

Directors, committee members and Company's officers are fully indemnified against all costs, charges, losses, expenses and liabilities that may be incurred by them in the execution and discharge of their duties or in relation thereto. A Director's and Officers' Liability Insurance policy has been arranged for providing the indemnity.

Conduct on Share Dealings

All Directors are obliged to observe the requirements stipulated in the Model Code, as set out in Appendix 10 to the Main Board Listing Rules. All Directors have confirmed, following specific enquiry by HKEx, that they fully complied with the Model Code throughout the year 2005.

As for employees' conduct on share dealings, the Board has laid down stringent reporting requirements for making disclosures on their securities and derivatives dealings. The code of conduct for securities and derivatives transactions (with no less exacting terms than the Model Code), is set out in the Human Resources Manual which is available on HKEx's corporate website.

Board Committees and Consultative Panels

The Board is supported by five committees, a statutory committee, and three consultative panels. Each of them has defined terms of reference covering its duties, powers and functions. The terms of reference of each of these committees and panels are available on HKEx's corporate website. Hard copies are also available free of charge on request.

The Board and the committees are provided with sufficient resources to discharge their duties including, retention of outside advisers, if necessary, at the cost of HKEx, to provide advice on any specific matter.

Save for the Executive Committee and the Investment Advisory Committee, all committees comprised solely INEDs. The chairmen of the respective committees report regularly to the Board, and, as appropriate, make recommendations on matters discussed. The governance structure and meetings attendance record of the Committees are set out on page 75 and page 81 respectively.

The Listing Committees of the Stock Exchange operate independently under no influence of the Board. A separate Listing Committee Report for 2005 is prepared and despatched together with this Annual Report.

Board Committees

	Major roles and functions (Full terms of reference are posted on HKEx's corporate website)	Composition during 2005 A – appointed during 2005 R – retired or resigned during 2005	Operating mode
Board committees			
Executive Committee	<ul style="list-style-type: none"> To formulate policies for the Board's consideration and to implement laid down policies To oversee the Group's compliance with all statutory duties To review and recommend amendments to rules and regulations which do not involve policy matters for respective subsidiary boards' approval, and as appropriate, for submission to the SFC for its approval 	INED Charles Y K Lee (<i>Chairman</i>) Bill C P Kwok ^A Dannis J H Lee Leong Ka Chai ^R Executive Director Paul M Y Chow (<i>Chief Executive</i>) Chief Operating Officer Patrick K Conroy	Normally twice a month
Audit Committee	<ul style="list-style-type: none"> To serve as a focal point for communication between Directors, the external auditors and internal auditors To assist the Board in fulfilling its responsibilities by providing an independent review and supervision of financial reporting, and the effectiveness of the Group's internal control system To review the appointment of external auditors on an annual basis as well as to ensure continuing auditor independence 	INED John E Strickland (<i>Chairman</i>) Fong Hup * (<i>Deputy Chairman</i>) Marvin K T Cheung * ^A Henry H L Fan Vincent K H Lee * David M Webb ^R * <i>Qualified Accountants and none of them are members of the former or existing auditors of HKEx</i>	At least 4 times a year
Investment Advisory Committee	<ul style="list-style-type: none"> To provide market expertise and advice to the Board on the Group's investments, including advice on: <ul style="list-style-type: none"> – investment policies; – asset allocation; and – selection of fund managers and custodians. 	INED Tim Freshwater (<i>Chairman</i>) Oscar S H Wong (<i>Deputy Chairman</i>) David M Webb Market Professional David Sun	At least 4 times a year
Nomination Committee	<ul style="list-style-type: none"> To formulate nomination policy and lead the process for identifying and nominating suitable candidates to stand for election by the Shareholders To assess the independence of non-executive Directors To make recommendations to the Board on succession planning of the Chairman and the Chief Executive 	INED Charles Y K Lee (<i>Chairman</i>) Fong Hup ^A Vincent K H Lee ^A David M Webb ^A Oscar S H Wong Bill C P Kwok ^R	At least once a year
Remuneration Committee	<ul style="list-style-type: none"> To formulate remuneration policy and make recommendations on the annual remuneration review To determine the remuneration of Executive Director and members of the Senior Management 	INED Lo Ka Shui (<i>Chairman</i>) Marvin K T Cheung ^A Dannis J H Lee Vincent K H Lee ^R	At least once a year
Statutory Committee			
Risk Management Committee (established under Section 65 of the SFO)	<ul style="list-style-type: none"> To formulate policies on risk management matters relating to the activities of HKEx, the Stock Exchange and the Futures Exchange and their respective clearing houses, and to submit such policies to the Board for consideration 	INED Charles Y K Lee (<i>Chairman</i>) Henry H L Fan Bill C P Kwok Members Appointed by the Financial Secretary Chan Ka-lok ^A Fong Hup ^A Martin Wheatley ^A Peter T S Wong ^A Eddie W M Yue Mark Dickens ^R Lam Kin ^R Leong Ka Chai ^R Raymond C F Or ^R	Normally once a month

Consultative Panels

There are three consultative panels, namely, *Cash Market Consultative Panel*, *Clearing Consultative Panel* and *Derivatives Market Consultative Panel*. They 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.

Each panel consists of two INEDs and eight members who are respective market participants or industry experts. Executives are invited to attend the panel meetings.

Directors'/Committee Members' Attendance

	Meetings Attended/Held in 2005							2005 AGM
	Board	Executive Committee	Audit Committee	Investment Advisory Committee	Nomination Committee	Remuneration Committee	Risk Management Committee	
No of meetings held during the year	13	20	6	4	2	4	10	1
INED								
Charles Y K Lee (<i>Chairman</i>)	13/13	20/20			2/2		10/10	1/1
Marvin K T Cheung ¹	8/10		4/4			3/3		
Henry H L Fan	10/13		6/6				8/10	0/1
Fong Hup ^{2,7}	12/13		6/6		-/-		5/5	1/1
Tim Freshwater	9/13			4/4				0/1
Bill C P Kwok ³	13/13	15/15			2/2		10/10	1/1
Dannis J H Lee	13/13	20/20				4/4		1/1
Vincent K H Lee ⁴	12/13		6/6		-/-	1/1		1/1
Leong Ka Chai ^{5,9}	3/3	5/5					4/5	1/1
Lo Ka Shui	12/13					4/4		0/1
John E Strickland	12/13		6/6					1/1
David M Webb ^{2,6}	13/13		2/2	4/4	-/-			1/1
Oscar S H Wong	13/13			4/4	2/2			1/1
Executive Director								
Paul M Y Chow (<i>Chief Executive</i>)	13/13	20/20						1/1
Others								
Patrick K Conroy (<i>Chief Operating Officer</i>)		20/20						
Market Professionals								
Chan Ka-lok ⁷							4/5	
Mark Dickens ⁸							3/4	
Lam Kin ⁹							4/5	
Raymond C F Or ⁸							3/3	
David Sun				4/4				
Martin Wheatley ⁷							5/5	
Peter T S Wong ¹⁰							4/7	
Eddie W M Yue							9/10	
Average attendance rate	92%	100%	100%	100%	100%	100%	87%	77%

Notes:

1. Dr Marvin K T Cheung was appointed as a Director and a member of the respective Board Committees on 12 April 2005 and 13 April 2005 respectively.
2. Messrs Fong Hup and David M Webb were appointed as members of the Nomination Committee on 20 April 2005. No meeting had been held since then.

3. *Dr Bill C P Kwok retired from the Nomination Committee on 12 April 2005. He was then appointed as a member of the Executive Committee on 13 April 2005.*
4. *Mr Vincent K H Lee retired from the Remuneration Committee on 12 April 2005. He was then appointed as a member of the Nomination Committee on 13 April 2005.*
5. *Mr Leong Ka Chai retired from the Board and the Executive Committee on 12 April 2005.*
6. *Mr David M Webb resigned from the Audit Committee on 13 April 2005.*
7. *Messrs Chan Ka-lok, Fong Hup and Martin Wheatley were appointed as members of the Risk Management Committee on 1 July 2005.*
8. *Messrs Mark Dickens and Raymond C F Or retired from the Risk Management Committee on 31 March 2005.*
9. *Messrs Lam Kin and Leong Ka Chai retired from the Risk Management Committee on 30 June 2005.*
10. *Mr Peter T S Wong was appointed as a member of the Risk Management Committee on 1 April 2005.*

Remuneration of Directors and Senior Management

The Remuneration Committee determines the Group's remuneration policy and reviews, in particular, the remuneration packages of the Chief Executive and the Senior Management. It also makes recommendations to the Board on the annual salary adjustment and provision of the performance bonus.

The Remuneration Committee has prepared a separate report which summarises its work performed during 2005, and also sets out details of the Group's remuneration policy, and the remuneration, including the share option and awarded share benefits, of Directors and the Senior Management for the year ended 31 December 2005, on an individual named basis. The report is set out on page 94 of this Annual Report.

Accountability and Audit

Financial reporting

The Directors are responsible for overseeing the preparation of the annual accounts which give a true and fair view of the Group's state of affairs of the results and cash flow for the year. In preparing the accounts for the year ended 31 December 2005, the Directors have:

- approved adoption of all HKFRSs which are in conformity to the International Financial Reporting Standards in all material respects;
- selected suitable accounting policies and applied them consistently; and
- made judgements and estimates that are prudent and reasonable; and ensured the accounts are prepared on the going concern basis.

HKEx recognises that high quality corporate reporting is important in reinforcing the trustworthy relationship with the Company's stakeholders and aims at presenting a balanced, clear and comprehensible assessment of the Company's performance, position and prospects in all corporate communications. The annual, interim, and quarterly results of HKEx are announced in a timely manner within the limits of 3 months, 2 months, and 45 days respectively after the end of the relevant periods.

Internal control

System and procedures

The Board acknowledges its responsibility to ensure that a sound and effective internal control system is maintained, which includes a defined management structure with specified limits of authority, to:

- achieve business objectives and safeguard assets against unauthorised use or disposition;
- ensure maintenance of proper accounting records for the provision of reliable financial information for internal use or for publication; and
- ensure compliance with the relevant legislation and regulations.

The system is designed to provide reasonable, but not absolute, assurance against material misstatement or loss and manage rather than eliminate risks of failure in operational systems, and to ensure achievement of the Group's objectives.

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

- A distinct organisation structure exists with defined lines of authority and control responsibilities. Division/Departments Heads are involved in preparing the strategic plan which laid down the corporate strategies to be pursued in the next three years for achieving the annual operating plan and 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. Other than the strategic plan which was approved by the Board for a three-year period but subject to annual review, the annual operating plan and the annual budget are approved by the Board yearly.
- A comprehensive management accounting system is in place to provide financial and operational performance indicators to the management and the relevant financial information for reporting and disclosure purpose. Variances against budgets are analysed and explained, and appropriate actions are taken, if necessary, to rectify deficiencies noted.
- System and procedures are in place to identify, measure, manage and control risks including legal, credit, market, concentration, operational, environmental, behavioural and systematic risks that may have an impact on the Cash and Derivatives Markets in Hong Kong. Exposure to these risks is monitored by the Senior Management Committee, the Executive Committee, and the Risk Management Committee on a continual basis.
- Reporting to the Audit Committee functionally, Internal Audit Department ("IA") performs independent reviews of the risks associated with, and controls over, principal operations and critical applications. These risks and controls were cautiously identified and adequately addressed.

Annual assessment

In 2005, the Board, through the Audit Committee, reviewed the effectiveness of HKEx's system of internal control over financial, operational and compliance issues, broad-based risk management processes, and physical and information systems security. To formalise the annual review of internal control system, the Audit Committee made reference to the globally recognised framework with modifications to include some control evaluation on data controls and areas which are specific to HKEx operation. No suspected frauds or irregularities, internal control deficiencies or suspected infringement of laws, rules and regulations had come to the Committee's attention. The Audit Committee concluded that, in general, HKEx has set up a sound control environment and installed necessary control mechanisms to monitor and correct non-compliance. The Board, through the review of the Audit Committee, is satisfied that the Group in 2005, fully complied with the code provisions on internal controls as set forth in the CG Code.

Grievances and whistle-blowing policies

HKEx has established defined procedures for handling employees' complaints and grievances and alerts of wrongdoings. Recommendations on improvements can be channelled to the respective Division/Department Heads of the concern or escalated, as the case may be, to the Chief Operating Officers or the Chief Executive. If the complaint is about the Chief Executive or a Director, the employee can report directly to the Chairman.

To encourage employees to raise concerns about internal malpractice without hesitation, HKEx has also established the whistle-blowing policy during the year which embedded procedures for reporting such matters internally direct to the chairman of the Audit Committee, who will review complaint and decide how the investigation should be conducted.

Internal Audit Department

The internal audit methodology and process adopted by IA include:

- *Understand and analyse the business*

IA plays an important role in monitoring HKEx's internal governance and strives to provide 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. In accomplishing the objectives, IA has unrestricted access to all corporate operations, records, data files, computer programs, property, and personnel. To preserve the independence of the internal audit function, the Head of IA reports directly to the Audit Committee on audit matters and to the Chief Executive on administrative matters, and is authorised to communicate directly with the Chairman and other Board members. For this reason, he attends Management Committee meetings as an independent observer.

- *Determine risk areas*

A five-year audit plan is formulated to ensure a systematic coverage of all auditable areas. The plan is revised annually to reflect organisational changes as well as new services and operations introduced since last year. Using a risk ranking methodology, IA schedules its internal audit programmes annually based on the five-year plan and submits the audit plan to the Audit Committee for approval. Independent reviews of different financial, business and functional operations and activities will be conducted with resources being focused on higher risk areas. Ad hoc reviews will also be made on areas of concern identified by the Audit Committee and the management.

- *Analyse the process and assess controls*

To help detect frauds, IA designs audit programs to incorporate procedures such as examination of documents, analysis of trend data and verification of assets for certain audit assignments. With the help of the self-developed computer-assisted-audit-techniques, IA conducts interrogation tests for trade data processed by mission critical applications in order to verify the integrity and security of such data that have not been compromised.

As HKEx places heavy reliance on Information Technology ("IT") to support its business operations, apart from financial and operational compliance audits, IA also applies specialised IT audit skills to conduct regular reviews of major application system, development processes, and information system operations to evaluate the effectiveness of the IT controls, security and the related governance processes. IA, in particular, emphasises on the internal control adequacy prior to the system becomes operational.

- *Communicate results and follow up*

At the end of each audit, IA issues an audit report addressing the identified control deficiencies. The respective Division/Department Heads is notified of the findings observed together with recommendations for immediate rectification. On a regular basis, IA follows up on the implementation status of all audit recommendations agreed. Significant internal control weaknesses are brought to the attention of the Audit Committee in the form of monthly updates and if necessary to the Board, and to the Senior Management Committee for remedial action. IA summarises audit activities and reports audit progress to the Audit Committee every six months in July and January.

To promote corporate governance and provide the Shareholders with timely information about HKEx's financial performance, IA conducts quality assurance reviews of the quarterly, interim and final financial reports. These quality assurance reviews provide an additional level of assurance on the overall quality of the financial statements. The quality assurance reports conclude the accuracy and reliability of the financial information prepared by management, and are circulated to the Audit Committee to facilitate its review prior to making recommendations to the Board for approval.

External Auditors

The Group's external auditors are PricewaterhouseCoopers. The Audit Committee is mandated to ensure continuing auditors' objectivity and safeguarding independence of the auditors, and it has:

- determined the framework for the type and authorisation of non-audit services for which the external auditors may provide. In general, the engagement of the external auditors to perform non-audit services is prohibited except for tax-related services; and
- agreed with the Board on the policy relating to the hiring of employees or former employees of the external auditors and monitored the applications of such policy.

During 2005, the fees paid to HKEx's external auditors for non-audit related activities amounted to \$1,333,943 (2004: \$3,202,696) comprising taxation services fees of \$1,181,993 (2004: \$1,202,696), executive secondment to the Listing Division of \$300,000 (2004: \$1,800,000), and write back of provision of other miscellaneous items of \$148,050 (2004: charge of \$200,000).

HKEx has adopted a 5-year rotation policy of the engagement partner of its external auditors and the first rotation took effect from the audit for 2005.

The Group has not employed any staff who was formerly involved in the Group's statutory audit.

Audit Committee

A separate report prepared by the Audit Committee which summarised its works performed during 2005 is set out on page 92 of this Annual Report.

Corporate Communication

HKEx has in place an effective corporate communication system which provides transparent, regular and timely public disclosures to its stakeholders, including, inter alia, the general public, analysts, and the institutional and individual Shareholders.

- HKEx maintains a website on which comprehensive information about HKEx, its services and news as well as that of the listed issuers.
- HKEx establishes and maintains different communication channels with its Shareholders through the publication of annual, interim and quarterly reports and press release. A newsletter – “Exchange” is also published on a quarterly basis to provide an update on HKEx’s latest development. To promote effective communication, the Shareholders may choose to receive corporate communication electronically. Shareholders’ communications are also available on HKEx’s corporate website.
- The annual general meeting provides a useful forum for the Shareholders to exchange views with the Board. The Chairman as well as chairmen of the Audit, Nomination, and Remuneration Committees, or in their absence, members of the Committees are available to answer the Shareholders’ questions.
- Separate resolutions are proposed at general meetings for each substantial issue, including the election of individual Directors.
- Details of the poll voting procedures and the rights of shareholders to demand a poll are included in the circular to the Shareholders despatched together with the Annual Report. The circular also includes details of the procedures and the timetable of proposing appropriate candidates to stand for election as Directors at annual general meetings, relevant details of proposed resolutions, including biographies of each candidates standing for re-election, and whether such candidates are considered to be independent.
- The poll results are published in newspapers and on HKEx’s corporate website.
- An analysis of shareholding by type including a summary of the Shareholders with the top 10 holdings, and the public float capitalisation of HKEx as at 31 December 2005 are set out on pages 202 and 206 respectively of this Annual Report.
- Shareholders may refer to the Financial Calendar for important dates in 2005 on page 206 of this Annual Report.

Financial and other information such as Articles of Association, minutes of annual general meetings, and all shareholders corporate communications are made available on HKEx’s corporate website which is updated regularly.

PUBLIC RECOGNITION OF HKE_x CORPORATE GOVERNANCE PERFORMANCE

Over the past few years, a number of local and overseas professional institutions have granted awards to, or highly rated, HKE_x, in recognition of its achievements in corporate governance.

INTERNATIONAL CORPORATE GOVERNANCE ASSESSMENTS

Rating agencies or bodies	Assessments/Ratings
FTSE International Limited and Institutional Shareholder Services, Inc	FTSE ISS Corporate Governance Index Series (Apr 2005) HKE _x was mentioned as one of the five companies in Asia, which exhibited highly ranked corporate governance practices.
GovernanceMetrics International Inc	Corporate Governance Rating (Jul 2005) Global: 6.5 (2004: 6.0); Home Market: 9.5 (2004: 9.0) out of the full score of 10.0
CLSA Asia-Pacific Markets and Asian Corporate Governance Association	CG Watch 2005 (Oct 2005) <i>Corporate governance in Asia</i> HKE _x was ranked first among mid-cap stocks listed in Hong Kong.

AWARDS/RECOGNITIONS

Awarding Association	Awards/Recognition
FTSE4Good Policy Committee	FTSE4Good Index Series (Sep 2005) HKE _x has been selected a member of the FTSE4Good Index Series effective September 2005.
HKICPA	2005 Best Corporate Governance Disclosure Awards (Nov 2005) <i>Non-Hang Seng Index category</i> 2004 Annual Report – Diamond Award (top honour) – for the third consecutive year
The Hong Kong Management Association	2005 HKMA Best Annual Reports Awards (Nov 2005) <i>General Category</i> 2004 Annual Report – Bronze Award
The Hong Kong Institute of Directors	Directors Of The Year Awards 2005 (Nov 2005) <i>Listed Company (SEHK Main Board – Constituents of Hang Seng Indices)</i> Board : HKE _x Board Non-executive Director : Mr Charles Y K Lee Executive Director : Mr Paul M Y Chow

INTERESTS OF DIRECTORS AND SENIOR MANAGEMENT

INTERESTS AND SHORT POSITIONS

As at 31 December 2005, the Directors, including 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:

Directors' and Chief Executive's Interests in the shares and underlying shares of HKEx

Name of Director	Number of shares/underlying shares held				Total	% of the issued share capital
	Personal Interests	Family Interests	Corporate Interests	Other Interests		
Paul M Y Chow	3,280,000 (note 1)	–	–	–	3,280,000	0.31
Dannis J H Lee	–	–	1,610,000 (note 2)	–	1,610,000	0.15
Vincent K H Lee	–	–	3,640,000 (note 3)	–	3,640,000	0.34
John E Strickland	18,000 (note 4)	–	–	–	18,000	0.00
David M Webb	2 (note 5)	2 (note 6)	6 (note 7)	–	10	0.00

Notes:

1. Mr Chow, who is also Chief Executive of HKEx, has beneficial interests in 820,000 shares, and 2,460,000 underlying shares in respect of the share option granted to him pursuant to the Post-Listing Scheme on 2 May 2003. The said option is exercisable between 2 May 2005 and 1 May 2013 at an exercise price of \$8.28 per share. The number of shares issuable under the option granted and the exercise price had been adjusted in accordance with the resolution passed by the Shareholders at the 2004 AGM.
2. 1,610,000 shares were owned by DL Brokerage Limited, a private company beneficially wholly-owned by Mr Lee.
3. Mr Lee has interest in 460,000 shares, and 3,180,000 underlying shares through listed derivatives (physically settled options) held by Pacific Trust Company Limited, in which Mr Lee holds 33.33 per cent beneficial interests.
4. The shares were held by Mr Strickland as beneficial owner.
5. The shares were held by Mr Webb as beneficial owner.
6. The shares were owned by the spouse of Mr Webb.
7. The shares were owned by Fundamental Consultants Limited, Member One Limited and Member Two Limited which are under the control of Mr Webb.

Short positions in the shares and underlying shares of HKEx

As at 31 December 2005, Mr Vincent K H Lee was, under the SFO, interested in an aggregate short positions of 460,000 underlying shares in HKEx, representing 0.04 per cent of the total issued share capital of HKEx, which arose through certain listed equity derivatives (physically settled options) held by a corporation in which Mr Lee holds 33.33 per cent beneficial interests.

Save for those 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 the 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 or which are required pursuant to Section 352 of the SFO to be entered into 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 2005, 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.

SENIOR MANAGEMENT'S INTERESTS AND SHORT POSITIONS

As at 31 December 2005, the Senior Management had the following interests in the shares and underlying shares of HKEx:

Name of Employee	Number of shares held	Number of shares issuable under staff options granted	Number of awarded shares
Patrick K Conroy	–	1,476,000	–
Gerald D Greiner	–	400,000	40,600
Lawrence K M Fok	500,000	478,000	24,600
Mary M L Kao	654,000	220,000	28,700
Henry M W Law	–	180,000	22,900
Stewart S C Shing	–	1,094,000	–
Archie T C Tsim	–	164,000	32,700
Richard G Williams	–	844,000	–
Alfred K K Wong	190,000	200,000	32,100

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 had a material interest, whether directly or indirectly subsisted at the year-end or at any time during the year.

CONTINUING CONNECTED TRANSACTIONS

During the year ended 31 December 2005, the Group had the following continuing connected transactions, details of which are set out below:

(A) For the year ended 31 December 2005, transactions between the following connected persons and HKEx or its subsidiaries arising from or in connection with the use of (i) the facilities provided by HKEx or its subsidiaries for the trading, clearing and/or settlement of securities and futures products and transactions; and (ii) all services offered by HKEx or its subsidiaries which are ancillary, incidental or otherwise related to the foregoing:

- (1) Dr Bill C P Kwok, an INED, was interested in the transactions entered into by Wocom Securities Limited and Wocom Limited, EPs and Clearing Participants, which are associates of Dr Kwok by virtue of the Listing Rules.
- (2) Mr Dannis J H Lee, an INED, was interested in the transactions entered into by DL Brokerage Limited, an EP and a Clearing Participant, which is beneficially wholly-owned by Mr Lee.
- (3) Mr Vincent K H Lee, an INED, was interested in the transactions entered into by Tung Tai Securities Company Limited and Tung Tai Futures Limited, EPs and Clearing Participants, which are associates of Mr Lee by virtue of the Listing Rules.
- (4) Mr K C Leong, an INED who retired on 12 April 2005, was interested in the transactions entered into by Roctec Securities Company Limited and Roctec Futures Trading Company Limited, EPs and Clearing Participants, which are associates of Mr Leong by virtue of the Listing Rules.

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

(B) For the year ended 31 December 2005, transactions between the following connected persons and HKEx or its subsidiaries arising from or in connection with the listing of securities on the Stock Exchange and all services offered by the Group which are ancillary, incidental or otherwise related to the foregoing:

- (1) Dr Bill C P Kwok, an INED, was interested in the transactions entered into by Wing On Company International Limited, a listed company on the Stock Exchange, which is an associate of Dr Kwok by virtue of the Listing Rules.
- (2) Dr Lo Ka Shui, an INED, was interested in the transactions entered into by Great Eagle Holdings Limited (“Great Eagle”), a listed company on the Stock Exchange, which is an associate of Dr Lo by virtue of the Listing Rules.

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

(C) For the year ended 31 December 2005, transactions between the following connected persons and HKEx or its subsidiaries arising from or in connection with HKSCC arrangement on behalf of Clearing Participants of Buy-in Transactions:

- (1) Dr Bill C P Kwok, an INED, was interested in the Buy-in Transactions entered into by Wocom Securities Limited which is an associate of Dr Kwok by virtue of the Listing Rules. For the year ended 31 December 2005, the total consideration of such transactions, which were transacted on normal commercial terms, was \$7,197,527.44.
- (2) Mr Dannis J H Lee, an INED, 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 2005, the total consideration of such transactions, which were transacted on normal commercial terms, was \$1,558,101.09.
- (3) Mr Vincent K H Lee, an INED, was interested in the Buy-in Transactions entered into by Tung Tai Securities Company Limited which is an associate of Mr Lee by virtue of the Listing Rules. For the year ended 31 December 2005, the total consideration of such transactions, which were transacted on normal commercial terms, was \$7,838,440.74.
- (4) Mr K C Leong, an INED who retired on 12 April 2005, was interested in the Buy-in Transactions entered into by Roctec Securities Company Limited which is an associate of Mr Leong by virtue of the Listing Rules. For the year ended 31 December 2005, the total consideration of such transactions, which were transacted on normal commercial terms, was \$21,955,552.49.

(D) On 16 February 2005, HKFE, as the tenant renewed the lease with Shine Hill Development Limited (“Shine Hill”), the landlord, in respect of the tenancy (“Tenancy”) of premises of Suites 501-3 and Storeroom on 5th Floor and Suites 1101 & 1109-11 on 11th Floor, ICBC Tower, Citibank Plaza, 3 Garden Road, Central, Hong Kong (“Premises”) for a further term of 2 years commencing 1 January 2005 at a monthly rental of \$310,440, exclusive of management charges, rates and operating expenses. Shine Hill is a subsidiary of Great Eagle and is a connected person of HKEx for being an associate of Dr Lo Ka Shui, an INED. For the year ended 31 December 2005, the total rent, management charges and operating expenses paid in respect of the Tenancy was \$5,326,986.73. The Tenancy constituted a continuing connected transaction of HKEx, and details of which were announced on 14 December 2004.

In respect of the above continuing connected transactions, two INEDs who have not entered into any connected transactions with the Group, have reviewed the transactions and confirmed that the continuing connected transactions entered into by the Group were in compliance with the conditions of the waiver granted by the SFC and with the requirements of the Listing Rules in such a way that:

- (a) the continuing connected transactions disclosed above were entered into 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 and the Tenancy, 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 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 acting 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) in respect of the Tenancy, it was entered into in the ordinary and usual course of business of HKFE, and the terms as contained therein, were normal commercial ones.

Based on the opinion of the two INEDs, the Board considered and decided that the continuing connected transactions were fair and reasonable so far as the Shareholders are concerned.

The external auditors of HKEx have also confirmed that:

- (a) the continuing connected transactions disclosed above had been approved by the Directors;
- (b) the continuing connected transactions, other than the Tenancy, 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, were in accordance with the standard terms and conditions of the relevant Group company relating to the applicable facilities, services or goods provided by, or to, the Group; and
- (c) the Tenancy had been entered into in accordance with the relevant agreement governing the transaction, and the annual rental had not exceeded the cap disclosed in the announcement of HKEx made on 14 December 2004.

RELATED PARTY TRANSACTION

The Group also entered into certain transactions with parties regarded as "related parties" under the applicable accounting standards. Details of these transactions are set out in note 43 to the consolidated accounts.

On behalf of the Board
Mau Kam Shing, Joseph
Company Secretary
 Hong Kong, 8 March 2006

Audit Committee Report

AUDIT COMMITTEE

The Audit Committee (“AC”) comprises five INEDs appointed by the Board who have extensive experience in financial matters. Messrs Marvin K T Cheung, Fong Hup and Vincent K H Lee are certified public accountants but none of them were employed by or otherwise affiliated with the former or existing auditors of HKEx.

The AC assists the Board by providing an independent review and supervision of financial reporting, and satisfying themselves as to the effectiveness of the Group’s internal controls and the adequacy of the external and internal audits. In performing its duties, the AC examines all matters relating to the Group’s adopted accounting principles and practices and reviews the Group’s information systems. External auditors, the Chief Executive and senior executives are invited to attend the meetings, as and when necessary. The terms of reference (“TOR”) of the AC setting out its role and the responsibilities are posted on HKEx’s corporate website.

The AC is provided with sufficient resources to discharge its responsibilities and is supported by the Internal Audit Department (“IA”). The AC is accountable to the Board and the minutes of all its meetings are circulated to the Board for information.

The AC holds regular meetings at least four times a year and additional meetings are organised if and when necessary. In 2005, a total of six meetings were convened and the attendance was 100 per cent. The following is a summary of the work of the AC during 2005:

- review of the 2004 Internal Audit activities and approval of the 2005 Internal Audit Plan;
- review of the financial reports for the year ended 31 December 2004, for the six months ended 30 June 2005, and for the quarters ended 31 March 2005 and 30 September 2005;
- review of the findings and recommendations of the IA on the performance of various Divisions/Departments and HKEx’s services and products;
- follow-up on the implementation of recommendations made by the IA;
- review of the effectiveness of the internal control system;
- review of the external auditors’ statutory audit plan and the letters of representation;
- consideration and approval of the 2005 audit fees;
- review of the whistle-blowing policy and procedures;
- review of the grievance procedures;
- review of the 2005 frauds detection report;
- review of the revisions to the TOR of the AC to conform to the CG Code; and
- review of the “Continuing Connected Transactions” set forth on page 89.

INTERNAL CONTROL

In mid-2005, the AC considered alternative approaches to formalise the annual review framework and decided to use the globally recognised internal control framework-based questionnaire to facilitate its review of the effectiveness of HKEx’s internal control system. Based on the result of this review, the AC considered that the HKEx’s internal control system is effective and that HKEx has adopted the necessary control mechanisms to monitor and correct non-compliance.

On 12 August 2005, the AC endorsed the whistle-blowing policy and procedures which provide, inter alia, that malpractices could be reported directly to the chairman of the AC.

Upon review of the reports on ad hoc investigations and reports from management and internal/external auditors, the AC was of the view that no suspected fraud or irregularities, internal control deficiencies, or suspected infringement of laws, rules or regulations had been found, and concluded at the meeting held on 19 January 2006 that the system of internal controls was adequate and effective.

At the same meeting, the AC considered and approved the 2006 Internal Audit Plan and authorised the IA to conduct ad hoc audits if and when the situation deems appropriate.

REVIEW OF 2005 CONSOLIDATED FINANCIAL STATEMENTS

On 3 March 2006, the AC reviewed the 2005 consolidated financial statements, including the Groups' adopted accounting principles and practices, in conjunction with HKEx's external and internal auditors. Based on this review and discussions with the management, internal auditors and external auditors, the AC endorsed the accounting treatment adopted by HKEx and had to the best of its ability assured itself that the disclosure of the financial information in this report complies with the applicable accounting standards and Appendix 16 of the Main Board Listing Rules. The AC therefore recommended the Board to approve the consolidated financial statements for the year ended 31 December 2005 for public release.

RE-APPOINTMENT OF EXTERNAL AUDITORS

The AC's recommendation on the re-appointment of PricewaterhouseCoopers as the Group's external auditors for 2005 was approved by the Shareholders at the 2005 AGM. Starting from 2005, the engagement partner of the external auditors will be subject to rotation every five years.

The AC acknowledges the delegation of responsibilities from the Board to oversee the effectiveness of the system of internal controls, including financial and operational. In view of the above measures, the AC has fully complied with and fulfilled its responsibilities as stated under the Code Provisions C.2 on Internal Controls and C.3 on Audit Committee of the CG Code.

Members of the Audit Committee

STRICKLAND, John Estmond (*Chairman*)

FONG Hup (*Deputy Chairman*)

CHEUNG Kin Tung, Marvin

FAN Hung Ling, Henry

LEE Kwan Ho, Vincent Marshall

Hong Kong, 8 March 2006

Remuneration Committee Report

REMUNERATION COMMITTEE

The Remuneration Committee (“RC”) currently comprises three INEDs, namely, Dr Lo Ka Shui (Chairman), Dr Marvin K T Cheung (appointed 13 April 2005) and Mr Dannis J H Lee.

The RC meets regularly to formulate remuneration policy for the Board’s approval. It reviews and determines the remuneration of the Chief Executive who is the only Executive Director, and that of the Senior Management. The ultimate objective of the remuneration policy is to ensure that HKEx is able to attract, retain and motivate a high-calibre team which is essential to the success of HKEx.

The RC is accountable to the Board and submits regular reports containing recommendations, where appropriate, to the Board for its consideration and/or approval. The RC is provided with sufficient resources to discharge its duties, and it can engage external professional advisers to provide advice on issues which it considers necessary. The terms of reference of the RC setting out its role and the authority delegated to it by the Board are posted on HKEx’s corporate website.

The RC held four meetings in 2005 and recorded a full attendance for all meetings. The work performed by the RC included the following:

- making recommendations on the Group’s annual salary adjustment and performance bonus in accordance with a performance-based evaluation mechanism for the Board’s approval;
- determining the salary adjustments for the Chief Executive and the Senior Management in accordance with the Board’s guidelines;
- endorsing the Employees’ Share Award Scheme;
- making recommendations on the quantity of shares to be awarded to eligible employees under the Employees’ Share Award Scheme;
- setting the guidelines for the recruitment of the Chief Executive and the Senior Management;
- endorsing the Employee Benefits Insurance Scheme including Group Medical and Dental Insurance, Group Life Insurance, Group Personal Accident Insurance, and Employees’ Compensation Insurance for the Executive Committee’s approval; and
- determining the scope of the review to be conducted by an independent consultant on the Group’s remuneration policy and structure.

REMUNERATION POLICY

Quality and dedicated staff are reckoned valuable assets contributing to the Group’s performance. HKEx’s remuneration policy is built upon the principles of providing an equitable, motivating and market-competitive remuneration package that can stimulate and drive staff at all levels to work towards achieving the Group’s strategic objectives.

Non-executive Directors are remunerated sufficiently but not excessively for their efforts and time dedicated to HKEx. No individual Director and executive is involved in deciding his own remuneration.

REMUNERATION STRUCTURE

Employee's remuneration package is performance-based, and comprises three key components:

Base Salary

Base salary constitutes the significant element of the remuneration package. HKEx's policy is to pay a competitive base salary close to market median or at market upper quartile for key positions.

Incentives

Incentives are given in the form of discretionary cash bonus and an opportunity to participate in the Group's long-term success through the Share Option Scheme which has been replaced by the Employees' Share Award Scheme adopted in September 2005. Details of Share Option Schemes and the Employees' Share Award Scheme are set out respectively on page 99 and page 101 of this Annual Report.

Fringe Benefits

Provident fund benefits are offered to all full-time employees through the Hong Kong Exchanges and Clearing Provident Fund Scheme which is a registered scheme under the Occupational Retirement Schemes Ordinance ("ORSO") with the Mandatory Provident Fund ("MPF") exemption. The ORSO scheme is a defined contribution scheme providing employees with investment choices. HSBC Provident Fund Trustee (Hong Kong) Ltd and HSBC Life (International) Ltd are the trustee and administrator of the scheme respectively.

Under the ORSO scheme, HKEx contributes 12.5 per cent of the employee's base salary if the employee contributes 5 per cent, or HKEx contributes 10 per cent when the employee chooses not to contribute.

In addition, a master trust MPF scheme providing retirement benefits is offered to all temporary employees or those full-time employees who elect not to join the ORSO scheme. Under the MPF scheme, HKEx provides contributions to each employee up to the statutory limit, i.e. 5 per cent of the employee's relevant income subject to a maximum of \$1,000.

Other benefits offered to employees include, inter alia, medical insurance, dental insurance, life and personal accident insurance, employee compensation and business travel insurance.

PAY REVIEW 2005/2006

In determining the performance bonus and the share awards for 2005, the RC adopted a performance-based evaluation mechanism which comprises a number of quantitative and qualitative performance indicators, including profitability, system reliance, product and market development, organisation development and public interests. Different weightings are assigned to each of these indicators for assessing the overall score which determines the amount of performance bonus to be granted, and the shares to be awarded for the year.

In addition to individual's performance, the RC took into consideration the competitive market position and practices, relativity among peer groups and market competitiveness in making recommendations on annual salary adjustments. For the 2006 salary review, the RC

recommended, and the Board approved an average salary increase of two per cent for cost of living adjustment, and another average of two per cent for market catch up and promotions with the total does not exceed a maximum of four per cent in average.

Neither the Chief Executive nor the Senior Management had participated in the RC's discussion on their pay review and performance award. The RC had consulted the Chairman on the Chief Executive's performance, and the Chief Executive on the individual performance of the Senior Management.

Details of the remuneration of the Executive Director and the Senior Management for year 2005 are set out in the following section.

In February 2006, an independent consultant has been retained to conduct an overall review of HKEx's remuneration policy and structure with the objective of introducing refinements to better support achievement of the Group's strategic goals. The review is scheduled to be completed in the third quarter of 2006 and the recommendations thereof would be considered by the Board for establishing the remuneration policy and guidelines to be observed in future.

REMUNERATION OF DIRECTORS AND THE SENIOR MANAGEMENT

Non-executive Directors

Non-executive Directors' remuneration is regularly reviewed with reference to market norms. In November 2004, a comprehensive review of the non-executive Directors' remuneration was conducted for determining an equitable remuneration for the non-executive Directors in order to properly reflect their public accountability and time and effort spent on the Board and various committees and/or panels meetings. The recommendation to increase the remuneration, comprising director's fee only, of each non-executive Director from \$100,000 to \$240,000 was approved by the Shareholders at the 2005 AGM. The new director's fee is payable in proportion to the period of service during the period from the conclusion of the 2005 AGM to the conclusion of the 2006 AGM.

Non-executive Directors are, however not entitled to participate in the Share Option Schemes and the Employees' Share Award Scheme. The remuneration of all non-executive Directors for year 2005 is set out below:

Name	Director's Fee (\$)
Charles Y K Lee	205,000
Marvin K T Cheung (<i>appointment effective 12 April 2005</i>)	180,000
Henry H L Fan	205,000
Fong Hup	205,000
Tim Freshwater	205,000
Bill C P Kwok	205,000
Dannis J H Lee	205,000
Vincent K H Lee	205,000
Leong Ka Chai (<i>retired on 12 April 2005</i>)	25,000
Lo Ka Shui	205,000
John E Strickland	205,000
David M Webb	205,000
Oscar S H Wong	205,000
Total	2,460,000

Particulars of the Directors' emoluments disclosed pursuant to Section 161 of the Companies Ordinance and Appendix 16 of the Main Board Listing Rules are set out in note 13 to the consolidated accounts.

Executive Director

The Chief Executive (*ex-officio* member of the Board) is the only Executive Director. His remuneration for year 2005 and interest in share option are set out below:

Remuneration

Chief Executive	Director's Fee (\$)	Salary (\$)	Performance Bonus (\$)	Other Benefits (\$) (note 1)	Retirement Benefit Costs (\$) (note 2)	Total (\$)	Share Option Benefits (\$)	Share Award Benefits (\$)
Paul M Y Chow	–	7,200,000	1,200,000	61,576	900,000	9,361,576	1,791,480	–

The share option benefits represent amortised fair value of the share option granted to him under the Post-Listing Scheme that was charged to the profit and loss account for the year ended 31 December 2005.

Share Option

Date of grant	Exercise Price	Number of shares issuable under the option granted				Exercise Period
		As at 1 January 2005	Granted during the year	Subscribed during the year	As at 31 December 2005	
2 May 2003	\$8.28	3,280,000	–	820,000	2,460,000	2 May 2005 – 1 May 2013

During 2005, no shares were awarded to the Chief Executive under the Employees' Share Award Scheme.

Senior Management

The remuneration of the Senior Management, and their interests in share options and awarded shares are set out below:

Remuneration

Name	Salary (\$)	Performance Bonus (\$)	Other Benefits (\$) (note 1)	Retirement Benefit Costs (\$) (note 2)	Compensation for Loss of Office (\$)	Total (\$)	Share Option Benefits (\$)	Share Award Benefits (\$)
Patrick K Conroy	5,460,000	730,000	114,448	682,500	–	6,986,948	2,108,107	–
Gerald D Greiner	3,720,000	650,000	68,035	465,000	–	4,903,035	542,834	12,351
Lawrence K M Fok	4,125,000	560,000	78,988	515,625	–	5,279,613	299,448	7,483
Mary M L Kao	3,504,000	520,000	60,844	438,000	–	4,522,844	299,448	8,731
Henry M W Law	2,295,000	380,000	25,231	286,875	–	2,987,106	245,768	6,966
Karen K Y Lee (note 3)	2,121,750	–	442,284	265,219	–	2,829,253	–	–
Stewart S C Shing	3,720,000	600,000	66,646	465,000	–	4,851,646	1,795,645	–
Archie T C Tsim (note 4)	2,910,000	520,000	57,799	363,750	–	3,851,549	185,582	9,947
Richard G Williams (note 5)	3,900,000	900,000	104,075	487,500	–	5,391,575	1,163,450	–
Alfred K K Wong	2,785,500	520,000	67,520	348,188	–	3,721,208	268,400	9,765

The share option benefits and the share award benefits represent the aggregate of the amortised fair value of the share options granted and shares awarded to the respective members of the Senior Management under the Post-Listing Scheme and the Employees' Share Award Scheme respectively that were charged to the profit and loss account for the year ended 31 December 2005. (Under HKFRS2, amortisation of the fair value of the options granted under the Pre-Listing Scheme is not required.)

Share Options

Name	Date of Grant	Exercise Price (\$)	Number of shares issuable under the options granted					Exercise Period
			As at 1 January 2005	Granted during the year	Subscribed during the year	Lapsed during the year	As at 31 December 2005	
Patrick K Conroy	18 Aug 2003	12.49	1,968,000	–	492,000	–	1,476,000	18 Aug 2005 – 17 Aug 2013
Gerald D Greiner	17 May 2004	15.91	200,000	–	–	–	200,000	17 May 2006 – 16 May 2014
	26 Jan 2005	19.25	–	200,000	–	–	200,000	26 Jan 2007 – 25 Jan 2015
Lawrence K M Fok	20 Jun 2000	6.88	758,000	–	500,000	–	258,000	6 Mar 2002 – 30 May 2010
	31 Mar 2004	16.96	120,000	–	–	–	120,000	31 Mar 2006 – 30 Mar 2014
	26 Jan 2005	19.25	–	100,000	–	–	100,000	26 Jan 2007 – 25 Jan 2015
Mary M L Kao	20 Jun 2000	6.88	178,000	–	178,000	–	–	6 Mar 2002 – 30 May 2010
	31 Mar 2004	16.96	120,000	–	–	–	120,000	31 Mar 2006 – 30 Mar 2014
	26 Jan 2005	19.25	–	100,000	–	–	100,000	26 Jan 2007 – 25 Jan 2015
Henry M W Law	20 Jun 2000	6.88	88,000	–	88,000	–	–	6 Mar 2002 – 30 May 2010
	31 Mar 2004	16.96	100,000	–	–	–	100,000	31 Mar 2006 – 30 Mar 2014
	26 Jan 2005	19.25	–	80,000	–	–	80,000	26 Jan 2007 – 25 Jan 2015
Karen K Y Lee (note 3)	20 Jun 2000	6.88	114,000	–	114,000	–	–	6 Mar 2002 – 30 May 2010
	31 Mar 2004	16.96	88,000	–	–	88,000	–	31 Mar 2006 – 30 Mar 2014
	26 Jan 2005	19.25	–	100,000	–	100,000	–	26 Jan 2007 – 25 Jan 2015
Stewart S C Shing	15 Jan 2004	17.30	1,094,000	–	–	–	1,094,000	15 Jan 2006 – 14 Jan 2014
Archie T C Tsim	26 Jan 2005	19.25	–	164,000	–	–	164,000	26 Jan 2007 – 25 Jan 2015
Richard G Williams	14 Aug 2003	12.45	1,094,000	–	250,000	–	844,000	14 Aug 2005 – 13 Aug 2013
Alfred K K Wong	20 Jun 2000	6.88	80,000	–	80,000	–	–	6 Mar 2002 – 30 May 2010
	31 Mar 2004	16.96	100,000	–	–	–	100,000	31 Mar 2006 – 30 Mar 2014
	26 Jan 2005	19.25	–	100,000	–	–	100,000	26 Jan 2007 – 25 Jan 2015

Awarded Shares

Name	Date of Award	Average fair value per share (\$)	Number of shares					Vesting Period (note 6)
			As at 1 January 2005	Awarded during the year	Vested during the year	Lapsed during the year	As at 31 December 2005	
Gerald D Greiner	19 Dec 2005	31.20	–	40,600	–	–	40,600	19 Dec 2007 – 19 Dec 2010
Lawrence K M Fok	19 Dec 2005	31.20	–	24,600	–	–	24,600	19 Dec 2007 – 19 Dec 2010
Mary M L Kao	19 Dec 2005	31.20	–	28,700	–	–	28,700	19 Dec 2007 – 19 Dec 2010
Henry M W Law	19 Dec 2005	31.20	–	22,900	–	–	22,900	19 Dec 2007 – 19 Dec 2010
Archie T C Tsim	19 Dec 2005	31.20	–	32,700	–	–	32,700	19 Dec 2007 – 19 Dec 2010
Alfred K K Wong	19 Dec 2005	31.20	–	32,100	–	–	32,100	19 Dec 2007 – 19 Dec 2010

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. Ms Karen K Y Lee retired as the Chief Financial Officer on 30 September 2005.
4. Mr Archie T C Tsim became the Chief Financial Officer effective 1 October 2005.
5. Mr Richard G Williams is a member of a pension scheme operating in the 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.
6. The shares awarded are vested in tranches of 25 per cent per annum starting from the second anniversary (i.e. 19 December 2007) until the fifth anniversary (i.e. 19 December 2010) of the date of award.

SHARE OPTION SCHEMES

HKEx operates two share option schemes, the Pre-Listing Scheme and the Post-Listing Scheme, under which the Board may, at its discretion, offer any employee (including any Executive Director) of HKEx or its subsidiaries, options to subscribe for shares in HKEx, for the purpose of attracting and retaining high calibre employees. Both schemes were approved by the Shareholders on 31 May 2000 and have a life of 10 years until 30 May 2010. Amendments to the Post-Listing Scheme, including, inter alia, the abolition of granting options at discounted price, were approved by the Shareholders on 17 April 2002 so as to comply with the new requirements of Chapter 17 of the Main Board Listing Rules which came into effect on 1 September 2001.

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 granted option.

The maximum number of shares in respect of which options may be granted under these schemes shall not in aggregate exceed 10 per cent of the shares of HKEx in issue as at the date of approval of the schemes, i.e. a total of 104,066,484 shares. The key terms of these two schemes are summarised below.

Pre-Listing Scheme

Options for the subscription of 34,890,262 shares were granted to employees of HKEx or its subsidiaries on 20 June 2000. The options granted were exercisable subject to a vesting scale which commenced on 6 March 2002 in tranches of 25 per cent per annum 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. 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 maximum entitlement of each 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.

The subscription price for a share in HKEx in respect of any particular option granted was determined based on a formula: $P = 80 \text{ per cent } (A \times B)$, 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 per share 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. Based on this formula, the subscription price of the option granted was \$7.52 per share, which was subsequently adjusted by the Shareholders at the 2004 AGM, to \$6.88 per share as the result of the payment of a special dividend of \$1.68 per share in 2004.

Post-Listing Scheme

Unless approved by the 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 in issue at the relevant time.

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

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.

As at the date of this Annual Report, the total number of shares available for issue, save for those granted but yet to be exercised, under the Pre-Listing Scheme and the Post-Listing Scheme aggregated to 63,302,484 shares, which represented 5.96 per cent of the issued share capital of HKEx as at 8 March 2006. Following the adoption of the Employees' Share Award Scheme by the Board in September 2005, no further options will be granted under the Post-Listing Scheme.

Outstanding Share Options

Details of the share options granted under the Schemes and remained outstanding as at 31 December 2005 were as follows:

Pre-Listing Scheme

	Date of Grant	Exercise Price	Number of shares issuable under the options granted				Exercise Period
			As at 1 January 2005	Issued upon subscription during the year	Lapsed during the year	As at 31 December 2005	
Aggregate total for employees (<i>note 1</i>)	20 June 2000	\$6.88	6,680,000	4,554,000 (<i>note 2</i>)	–	2,126,000	6 Mar 2002 – 30 May 2010 (<i>note 3</i>)

Post-Listing Scheme

Date of Grant	Exercise Price	As at 1 January 2005	Number of shares issuable under the options granted				Exercise Period <i>(note 6)</i>
			Granted during the year	Issued upon subscription during the year <i>(note 5)</i>	Lapsed during the year	As at 31 December 2005	
Director <i>(note 4)</i>							
2 May 2003	\$8.28	3,280,000	–	820,000	–	2,460,000	2 May 2005 – 1 May 2013
Employees <i>(note 1)</i>							
14 Aug 2003	\$12.45	1,094,000	–	250,000	–	844,000	14 Aug 2005 – 13 Aug 2013
18 Aug 2003	\$12.49	1,968,000	–	492,000	–	1,476,000	18 Aug 2005 – 17 Aug 2013
15 Jan 2004	\$17.30	1,094,000	–	–	–	1,094,000	15 Jan 2006 – 14 Jan 2014
31 Mar 2004	\$16.96	5,582,000	–	–	508,000	5,074,000	31 Mar 2006 – 30 Mar 2014
17 May 2004	\$15.91	200,000	–	–	–	200,000	17 May 2006 – 16 May 2014
26 Jan 2005	\$19.25 <i>(note 7)</i>	–	5,884,000 <i>(note 8)</i>	–	458,000	5,426,000	26 Jan 2007 – 25 Jan 2015

No options granted under the two share option schemes were cancelled during the year ended 31 December 2005.

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 \$20.73.
3. Options granted are exercisable between 6 March 2002 and 30 May 2010, subject to a vesting scale in tranches of 25 per cent each per annum reaching 100 per cent as from 6 March 2005.
4. The option was granted to Mr Chow Man Yiu, Paul, a Director and the Chief Executive of HKEx.
5. The weighted average closing price immediately before the dates on which the options were exercised was \$22.34.
6. Options granted are subject to a vesting scale in tranches of 25 per cent each per annum starting from the second anniversary and fully vested in the fifth anniversary of the date of grant.
7. The closing price immediately before the date of grant was \$19.05.
8. HKEx adopts the Binomial Option Pricing Model for estimating the fair value of options issued under the Post-Listing Scheme. The assumptions used in the model for the following factors are:
 - Risk-free rate of return – the yield of 10-year Exchange Fund Notes
 - Expected volatility of share price – annualised volatility for 1 year immediately preceding the grant date
 - Expected dividend yields – annual dividend (excluding special dividend) of the most recent financial year and the closing price on grant date

The amortised fair value of the share options charged to the profit and loss account for the year ended 31 December 2005 was \$22,663,000 (2004: \$14,290,000).

According to the Binomial Option Pricing Model, the value of the options granted on 26 January 2005 was \$26,183,800, details of which are set out in note 31 to the consolidated accounts.

The Binomial Option Pricing Model was 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.

EMPLOYEES’ SHARE AWARD SCHEME

On 14 September 2005 (“Adoption Date”), the Board adopted an Employees’ Share Award Scheme (“Award Scheme”) in which all employees (including without limitation any executive directors) of the Group will be entitled to participate. Unless early terminated by the Board, the Award Scheme shall be valid and effective for a term of 15 years commencing on the Adoption Date provided that no contribution to the trust fund will be made by HKEx on or after the tenth anniversary date of the Adoption Date. Details of the Award Scheme were announced on the Adoption Date. The rules and the trust deed relating to the Award Scheme are posted on HKEx’s corporate website.

Pursuant to the rules relating to the Award Scheme, the Board or the trustee of the Award Scheme (as the case may be) shall select the employees of the Group for participation in the Award Scheme, and determine the number of shares to be awarded. Relevant number of shares awarded will be acquired by the trustee from the market at the cost of HKEx and be held in trust for those selected employees until the end of each vesting period. Awarded shares and the related income derived therefrom are subject to a vesting scale in tranches of 25 per cent each on every anniversary date starting from the second anniversary date of the date of award until the fifth. Vested shares will be transferred at no cost to the relevant selected employees of the Group.

The Board has decided that, after adoption of the Award Scheme, no further options will be granted under the existing Post-Listing Scheme.

During the year, the Board awarded 960,000 shares, representing 0.09 per cent of the issued share capital as at the Adoption Date, to 139 eligible employees. The purchase of the awarded shares was completed on 4 January 2006 and the total payout, including the related expenses, amounted to \$30,098,839.62.

As at 31 December 2005, details of the awarded shares under the Award Scheme were as follows:

Date of Award	Average fair value per share (\$)	Number of shares				As at 31 December 2005	Vesting Period
		As at 1 January 2005	Awarded during the year	Vested during the year	Lapsed during the year		
19 Dec 2005	31.20	–	960,000	–	–	960,000	19 Dec 2007 – 19 Dec 2010

Notes:

1. The shares were purchased by the trustee of the Award Scheme at an average price of \$31.26 per share.
2. The amortised fair value of the awarded shares charged to the profit and loss account for the year ended 31 December 2005 was \$292,000 (2004: Nil).

DIRECTORS' SERVICE CONTRACTS

Mr Paul M Y Chow is employed as the Chief Executive under a contract term of four years from 1 May 2003 to 30 April 2007.

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)).

Members of the Remuneration Committee

LO Ka Shui (*Chairman*)

CHEUNG Kin Tung, Marvin

LEE Jor Hung, Dannis

Hong Kong, 8 March 2006

Corporate and Social Responsibility Report

CORPORATE AND SOCIAL RESPONSIBILITY

As the controller of the exchanges and clearing houses in Hong Kong, HKEx is well aware of our corporate and social responsibilities. First and foremost, Section 63 of the SFO requires HKEx to act in the interest of the public, having particular regard to the interest of the investing public, and to ensure the interest of the public prevails if it conflicts with HKEx's own interest upon discharging its duties. HKEx also has specific responsibilities as a listed company, an employer, a service provider and a member of the community. In 2005, HKEx endeavoured to excel further in all these areas.

AS A LISTED COMPANY

HKEx aims to operate transparently and communicate clearly so as to ensure that the market as well as investors have a better understanding of the operating philosophy and details of HKEx. Regular quarterly, interim and annual reports are published to explain the Company's financial position and operating performance. Other periodic reports such as the quarterly newsletter "Exchange" and corporate releases are either directly despatched to the Shareholders or posted on HKEx's corporate website for easy access by the Shareholders and other interested parties. Minutes of the annual general meetings, poll voting results and corporate governance practices are also posted on the corporate website along with HKEx's Memorandum & Articles of Association.

Proactive dialogue is maintained with our investors through the Investor Relations Corner on HKEx's corporate website. Our Investor Services team is dedicated to listen to and pursue investors' suggestions. During the year, a total of about 70 investor meetings, including the first large-scale conference for retail investors, were held.

In respect of corporate governance, HKEx is committed to adopting the best practices and meeting the highest standards. Details in this area can be found from the Corporate Governance Report on page 72.

AS AN EMPLOYER

Employer of Choice

HKEx's success depends on the performance and commitment of all its employees. Therefore, the organisation seeks to attract and retain the best people and motivate them to perform well. HKEx offers competitive remuneration, which includes bonuses and share awards for good performers (the Employees' Share Award Scheme was adopted by the Board on 14 September 2005, and details are set out on page 101 of this Annual Report), and we are committed to providing a positive working environment where employees' rights and interests are protected. As an equal opportunity employer, HKEx encourages all employees to develop knowledge and skills for career growth and applies human resources policies uniformly to all employees irrespective of their gender, age, nationality or grading in the organisation.

Training and Development

Staff development is essential to the competitiveness of any organisation. Given the growing complexity and sophistication of the marketplace, HKEx encourages and sponsors employees at all levels to participate in training and career development programmes in order to strengthen their technical and professional knowledge.

In 2005, HKEx sponsored 234 courses and organised 44 in-house programmes. The latter included training in management skills, project management, customer service, communication skills, English writing and Putonghua communication. In addition, HKEx commissioned Deloitte Touche Tohmatsu to provide a 12-day training programme to update professional staff, in particular those in the Listing Division, on the International Financial Reporting Standards. A sum of \$8 million has been set aside for staff training in 2006, an increase of one-third against that for 2005.

Occupational Safety and Health

To help maintain high occupational safety and health standards, HKEx invites key personnel to attend trainings on occupational risk assessment, identifies any actual or potential hazards and risks to individuals, monitors and reviews the safety management system, performs regular audits on safety and health matters, and maintains a complete set of emergency procedures. Training courses have been organised from time to time to equip employees with the knowledge and skills to perform their duties in a safe and healthy manner. The Occupational Safety and Health Policy is included in the Human Resources Manual which is posted on HKEx's corporate website.

Equal Opportunities

HKEx has adopted the Code of Practice on Equal Opportunities recommended by the Equal Opportunities Commission in Hong Kong. It is the Group's policy to eliminate discrimination, harassment and vilification in employment, to promote equal employment opportunities, and to adopt good management practices. Procedures for handling grievances are set out in the Human Resources Manual.

Code of Ethics

As a designated public body under the Prevention of Bribery Ordinance and a front-line market regulator, HKEx takes a neutral stance in political matters and does not make donations to any political parties. All its employees are public servants and are also subject to the provisions of the above Ordinance. To ensure full understanding of the requirements, briefings on integrity and corruption prevention are periodically arranged for employees.

Employees at all levels are expected to perform their duties at the highest standard in respect of integrity, impartiality and honesty. They are required to comply with the Code of Conduct set out in the Human Resources Manual which governs mainly securities dealings, soliciting and accepting advantages, loans to and from business associates, conflicts of interest and confidentiality in handling information. It is also every employee's responsibility, and in the interest of the Company to ensure that any inappropriate behaviour or organisational malpractice at the expenses of the interests of the Shareholders, investors, customers and the wider public does not occur. To this end, HKEx has devised a whistle-blowing policy which is set out in the Human Resources Manual.

Employee Benefits

HKEx offers its employees a comprehensive range of benefits, details of which are set out in the Remuneration Committee Report on page 94.

From 2006, free medical check-ups will be provided to employees and dependants who are aged 45 and above. HKEx has been operating on a five-day work week since 2000. This helps to promote a healthy work life for employees.

Communication

HKEx encourages communication among all levels of the organisation to foster staff commitment to the Group. The Chief Executive regularly explains key policies and developments to executives at the Monthly Executive Forum and the Quarterly Staff Briefing. After the quarterly briefings, the material presented is posted on HKEx's Intranet for the staff's reference.

To further encourage employees to share their views on how to improve the operations and business of the Group, a Staff Suggestion Scheme was launched during the year. The aim of the Scheme is to create an environment that encourages positive thinking, stimulates novel and constructive ideas, and promotes continuous improvement and teamwork. Employees will receive a gratuity of up to \$5,000 if their suggestions are accepted. Effective communication and teamwork are strongly promoted within the organisation and employees at different grades and divisions/departments are invited to participate in various task groups or committees, e.g., employees have provided advice on the operation of the provident fund and employee benefit schemes.

Staff Social Club

The Staff Social Club has continued to play an important role in advising the management on employee benefit initiatives and organising a wide range of activities to help increase employees' sense of belonging. Activities in 2005 included the annual dinner party, group outings, health talks, cookery lessons, wine tasting and other leisure events. A parents' club was added during the year to promote a family-friendly environment for employees with children. We also encourage our employees to participate in different sports competitions to enhance team spirit. HKEx's championships in the Public Organisations Challenge League Soccer Competition and the Supervisory Cup Basketball Competition in 2005 for respectively the third and second consecutive years were noteworthy examples of what can be accomplished through HKEx's strong teamwork.

AS A SERVICE PROVIDER

As an exchange controller, clearing house operator and information provider, HKEx has a wide variety of customers. To meet their needs, HKEx dedicates a substantial portion of its resources to providing a quality market and quality services. Details of last year's initiatives in these areas are set out in the Chief Executive's Review on page 14.

HKEx meets from time to time with panels of experienced market participants to discuss market developments and possible changes. Major changes are proposed through consultation papers which invite market participants and other interested parties to submit their views to HKEx. Customer satisfaction and market trends are tracked by regular Cash and Derivatives Markets transaction surveys. In addition, there are periodic surveys that focus on retail investors, the primary market and the secondary market.

AS A MEMBER OF THE COMMUNITY

HKEx strives to be a more caring company and a good corporate citizen, and encourages its employees to contribute to the community. Efforts are concentrated in three key areas – charity, the environment and the promotion of Hong Kong's role as an international financial centre.

Charitable Activities

HKEx helped raise about \$40 million for the Hong Kong Community Chest in 2005 through the Stock Code Balloting Scheme.

Employees are also encouraged to participate in various charitable activities, such as the Hong Kong Community Chest Dress Casual Day fund raising scheme, the MTR Hong Kong Race Walking event, which raised funds for the Hospital Authority Charitable Foundation, the St James Settlement holiday food and gift collection campaigns, and visit to Po Leung Kok, a home for underprivileged children. The Hong Kong Council of Social Service chose HKEx as a Caring Company for 2005/2006 to recognise its contributions towards building a caring community spirit and cultivating corporate citizenship.



With the assistance from the Staff Social Club, a HKEx Volunteer Team has been formed in 2006 to participate regularly in charity and community services.

Environmental Protection

Although HKEx does not operate an environmentally sensitive business, we recognise our duty to minimise the environmental impact arising from our operations. As a result, the Group always identifies opportunities to reduce and recycle the resources it has consumed. Current environmental management procedures include launching the eIPO, by which applications for shares in an IPO can be made online, recycling paper waste and IT equipment, using energy saving office equipment, and sending electronic Christmas and Lunar New Year greetings instead of posting holiday cards.

Other means of environmental protection include the implementation of e-Submission by which issuers and listing applicants can submit documents to the Exchange for processing and/or posting on the HKEx website via electronic means, and the posting of Listing Rules-related announcements by GEM issuers on the GEM website instead of paid announcements in newspapers, which arrangement will be extended to Main Board issuers (details are set out on page 35 of this Annual Report). Looking ahead, HKEx hopes to work with the SFC and market practitioners on proposals to reduce the size of prospectuses and thus decrease the use of paper.

Promoting Hong Kong's Role as an International Financial Centre

HKEx takes advantage of every opportunity to promote Hong Kong's role as an international financial centre; for instance, through the provision of briefings and presentations in Hong Kong, the Mainland or overseas on the operation of the Cash and Derivatives Markets in Hong Kong.

In 2005, HKEx carried out massive renovation of the Trading Hall which is recognised as an icon of the Hong Kong financial market. New facilities are also constructed in the Exchange Exhibition Hall for the display of market information with an aim of improving public's understanding of the Hong Kong Cash and Derivatives Markets, and promoting Hong Kong's prominent status as an international financial centre.

On behalf of the Board
MAU Kam Shing, Joseph
Company Secretary
 Hong Kong, 8 March 2006

Directors' Report

The Directors submit their report together with the audited financial statements for the year ended 31 December 2005.

PRINCIPAL ACTIVITIES

HKEx is the recognised exchange controller under the SFO. It owns and operates the only stock exchange and futures exchange in Hong Kong and their related clearing houses, namely HKSCC, SEOCH and HKCC.

The Stock Exchange and the 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 2005 is set out in note 4 to the consolidated accounts.

RESULTS AND APPROPRIATIONS

The results of the Group for the year ended 31 December 2005 are set out in the consolidated profit and loss account on page 113.

An interim dividend of \$0.49 per share, amounting to a total of about \$521 million, was paid to Shareholders on 15 September 2005.

The Directors recommend the payment of a final dividend of \$0.64 (2004: \$0.47) per share to Shareholders whose names appear on the register of members on 26 April 2006, which together with the interim dividend payment amounts to a total of about \$1,201 million (2004: \$953 million), and the retention of the remaining profit for the year.

RESERVES

The distributable reserves of HKEx as at 31 December 2005, calculated under Section 79B of the Companies Ordinance, amounted to \$3,235 million (2004: \$3,221 million).

Movements in reserves of the Group and HKEx during the year are set out in notes 31 to 35 and 37 to the consolidated accounts.

GROUP FINANCIAL SUMMARY

A summary of the results and the assets and liabilities of the Group for the past six financial years is set out on page 70.

FIXED ASSETS

Movements in fixed assets of the Group and HKEx during the year are set out in note 17 to the consolidated accounts.

SHARE CAPITAL

Details of the movements in the share capital during the year are set out in note 30 to the consolidated accounts.

DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

Share Option Schemes

HKEx operates two share option schemes, the Pre-Listing Scheme and the Post-Listing Scheme, under which the Board may, at its discretion, offer any employee (including any Executive Director) of HKEx or its subsidiaries, options to subscribe for shares in HKEx. However, the Board decided that, after adoption of the Employees' Share Award Scheme as mentioned hereunder, no further options will be granted under the Post-Listing Scheme.

Employees' Share Award Scheme

HKEx adopted an Employees' Share Award Scheme ("Award Scheme") on 14 September 2005, under which the Board or the trustee of the scheme shall select the employees (including without limitation any Executive Directors) of the Group for participation in the scheme, and determine the number of shares of HKEx to be awarded.

Details of the schemes, the options granted and shares awarded thereunder are set out in the "Remuneration Committee Report" on page 94.

Apart from the schemes, at no time during 2005 was HKEx or any of its subsidiaries a party to any arrangements to enable the Directors of HKEx to acquire benefits by means of acquisition of shares in, or debenture of, HKEx or any body corporate.

SUBSIDIARIES

Particulars of HKEx's subsidiaries as at 31 December 2005 are set out in note 29 to the consolidated accounts.

DIRECTORS

The list of Directors of HKEx during the year and up to the date of this Annual Report is set out on page 20.

As at 31 December 2005, the Board consisted of 13 Directors. Six of them are Government Appointed Directors, namely, Mr Charles Y K Lee, Dr Marvin K T Cheung, Mr Henry H L Fan, Mr Fong Hup, Mr Tim Freshwater and Dr Lo Ka Shui, who were appointed by the Financial Secretary pursuant to Section 77 of the SFO. Six of them are Elected Directors, namely, Dr Bill C P Kwok, Mr Dannis J H Lee, Mr Vincent K H Lee, Mr John E Strickland, Mr David M Webb and Mr Oscar S H Wong, who were elected by Shareholders at annual general meetings. The Chief Executive of HKEx is an *ex-officio* member of the Board.

According to Articles 90(1), 90(1A) and 90(3) of the Articles of Association of HKEx, any Elected Director and any Government Appointed Director shall be elected or appointed for a term of not more than approximately three years expiring at the conclusion of the annual general meeting of HKEx held in the third year following the year of his appointment. On expiration of his term, he shall retire but be eligible for re-appointment pursuant to Article 93(5). Two of the Elected Directors, Messrs Dannis J H Lee and David M Webb, whose terms of office will expire at the conclusion of the 2006 AGM, shall retire but both of them are eligible for re-appointment. Shareholders are invited to elect up to two Elected Directors at the 2006 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 to the Shareholders sent together with this Annual Report.

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

The biographical details of Directors and Senior Management are set out on page 22.

DIRECTORS' INTERESTS IN CONTRACTS

Details of the connected transactions and related party transactions are set out on page 89 in the "Corporate Governance Report" and note 43 to the consolidated accounts respectively.

Save for the above, 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.

CORPORATE GOVERNANCE

HKEx is committed to building and maintaining high standards of corporate governance. HKEx applied the principles and complied with all requirements set out in the CG Code contained in Appendix 14 of the Main Board Listing Rules.

Further information on the HKEx's corporate governance practices is set out in the following reports:

- (a) "Corporate Governance Report" – it sets out details on how HKEx applied and complied with the corporate governance principles, including practices as set out in the CG Code and provides information regarding interests of the Directors and the Senior Management in shares of HKEx and contracts with the Group.
- (b) "Audit Committee Report" – it gives a summary of work performed by the Audit Committee during 2005.
- (c) "Remuneration Committee Report" – it gives a summary of work performed by the Remuneration Committee during 2005 and an overview of the remuneration policy of HKEx and remuneration information, including the options and share awards granted, of the Directors and the Senior Management.
- (d) "Corporate and Social Responsibility Report" – it explains how HKEx strives to achieve the well being of its stakeholders and to be a socially responsible corporate citizen.

DIRECTORS' EMOLUMENTS

Details of the remuneration of the Directors for year 2005 are set out in the "Remuneration Committee Report" on page 94. Particulars of the Directors' emoluments disclosed pursuant to Section 161 of the Companies Ordinance and Appendix 16 of the Main Board Listing Rules are set out in note 13 to the consolidated accounts.

DISCLOSABLE INTERESTS AND SHORT POSITIONS OF SHAREHOLDERS UNDER THE SFO

As at 31 December 2005, the Directors are not aware of any party who was directly or indirectly interested in five per cent or more of 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 Section 61 of the SFO, no person shall be or become a Minority Controller, i.e. a person who either alone or with any associated person or persons, is entitled to exercise, or control the exercise of five per cent or more of the voting power at any general meeting of the recognised exchange controller, except with the approval in writing of the SFC after consultation with the Financial Secretary.

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 2005, the Minority Controllers were in aggregate holding 64.5 per cent of the issued share capital of HKEx (31 December 2004: 62.2 per cent).

PUBLIC FLOAT

As at the date of this report, the Directors acknowledge that 100 per cent of the issued capital of HKEx are held by the public.

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 2005. 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 2005.

PURCHASE, SALE OR REDEMPTION OF HKEx's LISTED SECURITIES

During the year ended 31 December 2005, HKEx had not redeemed, and neither HKEx nor any of its subsidiaries had purchased or sold, any of HKEx's listed securities.

Following the adoption of the Award Scheme on 14 September 2005 ("Adoption Date"), the Board awarded 960,000 shares, representing 0.09 per cent of the issued share capital as at the Adoption Date, to 139 eligible employees during the year. The purchase of the awarded shares from the market was completed on 4 January 2006 by the trustee of the Award Scheme and the total payout, including the related expenses, amounted to \$30,098,839.62. Details of the Award Scheme are set out in the "Remuneration Committee Report" on page 101.

PROVIDENT FUND SCHEMES

Particulars of provident fund schemes of the Group are set out in note 9 to the consolidated accounts.

AUDITORS

The accounts for the year ended 31 December 2005 have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment at the 2006 AGM.

On behalf of the Board of Directors

LEE Yeh Kwong, Charles

Chairman

Hong Kong, 8 March 2006

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 113 to 201 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 Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public 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 2005 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, 8 March 2006

Consolidated Profit and Loss Account

For the year ended 31 December 2005

(Financial figures are expressed in Hong Kong Dollar)

	Note	2005 \$'000	2004 \$'000
INCOME			
Trading fees and trading tariff	5	793,247	682,293
Stock Exchange listing fees	6	413,000	378,427
Clearing and settlement fees		384,019	356,274
Depository, custody and nominee services fees		259,952	251,722
Income from sale of information		322,713	307,633
Investment income	7	300,109	228,587
Other income	8	221,017	189,001
	4	2,694,057	2,393,937
OPERATING EXPENSES			
Staff costs and related expenses	9	586,033	545,654
Information technology and computer maintenance expenses	10	201,725	221,624
Premises expenses		80,679	78,833
Product marketing and promotion expenses		10,065	11,263
Legal and professional fees		13,641	11,083
Depreciation		150,995	183,400
Payment to SFC under dual filing regime		20,000	20,000
Other operating expenses	11	82,344	84,439
	4	1,145,482	1,156,296
OPERATING PROFIT	4	1,548,575	1,237,641
SHARE OF PROFITS LESS LOSSES OF ASSOCIATES	4/20(a)	18,433	12,884
PROFIT BEFORE TAXATION	4/12	1,567,008	1,250,525
TAXATION	4/15(a)	(227,460)	(193,641)
PROFIT ATTRIBUTABLE TO SHAREHOLDERS	4/37	1,339,548	1,056,884
DIVIDENDS		1,200,730	950,911
Earnings per share	16	\$1.26	\$1.00
Dividends per share			
Interim dividend paid		\$0.49	\$0.43
Final dividend proposed/declared		\$0.64	\$0.47
		\$1.13	\$0.90
Dividend payout ratio		90%	90%

Consolidated Statement of Changes in Equity

For the year ended 31 December 2005

(Financial figures are expressed in Hong Kong Dollar)

	Share capital and share premium (note 30) \$'000	Employee share-based compensation reserve (note 31) \$'000	Revaluation reserves (note 32) \$'000	Hedging reserve (note 33) \$'000	Designated reserves (note 34) \$'000	Retained earnings (note 37) \$'000	Total equity \$'000
At 1 Jan 2005, as previously reported	1,160,673	17,061	18,829	-	680,996	2,174,584	4,052,143
Effect of initial adoption of HKAS 39 and HKFRS 4 (Amendment)	-	-	-	-	-	(19,909)	(19,909)
At 1 Jan 2005, as restated	1,160,673	17,061	18,829	-	680,996	2,154,675	4,032,234
Change in valuation of leasehold buildings	-	-	(377)	-	-	-	(377)
Change in fair value of available-for-sale financial assets	-	-	(52,985)	-	-	-	(52,985)
Realisation of change in fair value of available-for-sale financial assets on maturity and disposal	-	-	(5,775)	-	-	-	(5,775)
Cash flow hedges:							
- fair value loss of hedging instrument	-	-	-	(129)	-	-	(129)
- transfer to profit and loss account as information technology and computer maintenance expenses	-	-	-	129	-	-	129
Deferred tax arising from change in valuation of leasehold buildings	-	-	65	-	-	-	65
Deferred tax arising from change in fair value of available-for-sale financial assets	-	-	3,136	-	-	-	3,136
Net loss recognised directly in equity	-	-	(55,936)	-	-	-	(55,936)
Profit attributable to shareholders	-	-	-	-	-	1,339,548	1,339,548
Total recognised (loss)/profit	-	-	(55,936)	-	-	1,339,548	1,283,612
2004 final dividend	-	-	-	-	-	(498,217)	(498,217)
2005 interim dividend	-	-	-	-	-	(520,567)	(520,567)
Shares issued under employee share option schemes	47,379	-	-	-	-	-	47,379
Employee share-based compensation benefits	-	22,955	-	-	-	-	22,955
Share of reserves of an associate	-	72	21	-	-	-	93
Transfer of reserves	5,108	(5,108)	-	-	19,645	(19,645)	-
At 31 Dec 2005	1,213,160	34,980	(37,086)	-	700,641	2,455,794	4,367,489

	Share capital and share premium (note 30) \$'000	Employee share-based compensation reserve (note 31) \$'000	Revaluation reserves (note 32) \$'000	Designated reserves (note 34) \$'000	Retained earnings (note 37) \$'000	Total equity \$'000
At 1 Jan 2004, as previously reported	1,103,337	2,771	36,499	689,657	3,781,889	5,614,153
Effect of initial adoption of HKAS 39 and HKFRS 4 (Amendment)	-	-	-	-	(19,909)	(19,909)
At 1 Jan 2004, as restated	1,103,337	2,771	36,499	689,657	3,761,980	5,594,244
Change in valuation of leasehold buildings	-	-	36	-	-	36
Change in fair value of available-for-sale financial assets	-	-	10,535	-	-	10,535
Realisation of change in fair value of financial assets on maturity and disposal	-	-	(26,741)	-	-	(26,741)
Deferred tax arising from change in valuation of leasehold buildings	-	-	(6)	-	-	(6)
Deferred tax arising from change in fair value of available-for-sale financial assets	-	-	(1,494)	-	-	(1,494)
Net loss recognised directly in equity	-	-	(17,670)	-	-	(17,670)
Profit attributable to shareholders	-	-	-	-	1,056,884	1,056,884
Total recognised (loss)/profit	-	-	(17,670)	-	1,056,884	1,039,214
2003 special and final dividends	-	-	-	-	(2,218,559)	(2,218,559)
2004 interim dividend	-	-	-	-	(454,291)	(454,291)
Shares issued under employee share option schemes	57,336	-	-	-	-	57,336
Employee share-based compensation benefits	-	14,290	-	-	-	14,290
Transfer of reserves	-	-	-	(8,661)	8,661	-
At 31 Dec 2004, as restated	1,160,673	17,061	18,829	680,996	2,154,675	4,032,234

Consolidated Balance Sheet

As at 31 December 2005

(Financial figures are expressed in Hong Kong Dollar)

	Note	2005 \$'000	As restated 2004 \$'000
NON-CURRENT ASSETS			
Fixed assets	17(a)	257,876	324,300
Investment property	18	17,700	13,300
Lease premiums for land	19	94,123	94,670
Investments in associates	20	64,581	38,731
Clearing House Funds	21	1,340,410	1,861,487
Compensation Fund Reserve Account	22	38,410	37,451
Time deposit with maturity over one year		38,768	38,941
Contributions to The HKEx Employees' Share Award Scheme	31(c)	30,037	–
Deferred tax assets	36(e)	3,060	1,227
Other assets		20,374	13,142
		1,905,339	2,423,249
CURRENT ASSETS			
Accounts receivable, prepayments and deposits	23	3,286,835	4,691,846
Lease premiums for land	19	547	548
Taxation recoverable		108	91
Margin Funds on derivatives contracts	24	13,648,581	10,529,692
Financial assets at fair value through profit or loss	25	2,643,788	2,761,593
Time deposits with original maturities over three months		116,622	1,340
Cash and cash equivalents		1,359,113	1,035,045
		21,055,594	19,020,155
CURRENT LIABILITIES			
Margin deposits from Clearing Participants on derivatives contracts	24	13,648,581	10,529,692
Accounts payable, accruals and other liabilities	26	3,641,070	4,902,350
Financial liabilities at fair value through profit or loss	25	1,443	10,749
Participants' admission fees received	27	2,550	4,850
Deferred revenue		284,851	284,148
Taxation payable		92,628	199,678
Provisions	28(a)	27,145	23,212
		17,698,268	15,954,679
NET CURRENT ASSETS		3,357,326	3,065,476
TOTAL ASSETS LESS CURRENT LIABILITIES		5,262,665	5,488,725

	Note	2005 \$'000	As restated 2004 \$'000
NON-CURRENT LIABILITIES			
Participants' admission fees received	27	80,150	82,850
Participants' contributions to Clearing House Funds	21	751,751	1,298,752
Deferred tax liabilities	36(c)	20,770	30,876
Financial guarantee contract	40(a)(ii)	19,909	19,909
Provisions	28(a)	22,596	24,104
		895,176	1,456,491
NET ASSETS		4,367,489	4,032,234
CAPITAL AND RESERVES			
Share capital	30	1,062,755	1,056,639
Share premium	30	150,405	104,034
Employee share-based compensation reserve	31	34,980	17,061
Revaluation reserves	32	(37,086)	18,829
Designated reserves	34	700,641	680,996
Retained earnings	37	1,775,631	1,658,055
Proposed/declared dividends	37	680,163	496,620
SHAREHOLDERS' FUNDS		4,367,489	4,032,234

Approved by the Board of Directors on 8 March 2006

LEE Yeh Kwong, Charles
Director

CHOW Man Yiu, Paul
Director

Hong Kong Exchanges and Clearing Limited

Balance Sheet

As at 31 December 2005

(Financial figures are expressed in Hong Kong Dollar)

	Note	2005 \$'000	As restated 2004 \$'000
NON-CURRENT ASSETS			
Fixed assets	17(b)	17,723	25,164
Investments in subsidiaries	29(a)	4,156,588	4,156,588
Contributions to The HKEx Employees' Share Award Scheme	31(c)	30,037	–
Deferred tax assets	36(e)	2,967	1,227
Other assets		3,569	3,545
		4,210,884	4,186,524
CURRENT ASSETS			
Accounts receivable, prepayments and deposits	23	26,274	20,638
Amounts due from subsidiaries	29(b)	583,102	497,463
Time deposits with original maturities over three months		10,184	–
Cash and cash equivalents		43,383	26,394
		662,943	544,495
CURRENT LIABILITIES			
Accounts payable, accruals and other liabilities	26	162,018	110,601
Amounts due to subsidiaries	29(b)	183,116	180,603
Taxation payable		8,257	5,610
Provisions	28(b)	25,613	23,212
		379,004	320,026
NET CURRENT ASSETS		283,939	224,469
TOTAL ASSETS LESS CURRENT LIABILITIES		4,494,823	4,410,993
NON-CURRENT LIABILITIES			
Provisions	28(b)	575	555
Financial guarantee contract	40(b)(i)	11,390	11,390
		11,965	11,945
NET ASSETS		4,482,858	4,399,048
CAPITAL AND RESERVES			
Share capital	30	1,062,755	1,056,639
Share premium	30	150,405	104,034
Employee share-based compensation reserve	31	34,908	17,061
Merger reserve	35	2,997,115	2,997,115
Accumulated losses	37	(442,488)	(272,421)
Proposed/declared dividends	37	680,163	496,620
SHAREHOLDERS' FUNDS		4,482,858	4,399,048

Approved by the Board of Directors on 8 March 2006

LEE Yeh Kwong, Charles
Director

CHOW Man Yiu, Paul
Director

Consolidated Cash Flow Statement

For the year ended 31 December 2005

(Financial figures are expressed in Hong Kong Dollar)

	Note	2005 \$'000	2004 \$'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Net cash inflow from operating activities	38(a)	1,399,898	1,816,353
CASH FLOWS FROM INVESTING ACTIVITIES			
Payments for purchases of fixed assets		(62,080)	(23,377)
Proceeds from sales of fixed assets		56	158
Proceeds from sales of other assets		–	1,175
Proceeds from sales of available-for-sale financial assets		–	75,773
Payments for acquisition of interest in an associate		(24,876)	–
(Increase)/decrease in time deposits with original maturities more than three months		(115,109)	383,100
Dividends received from an associate		12,668	10,801
Dividends received from available-for-sale financial assets		–	1,070
Interest received from available-for-sale financial assets		89,916	56,693
Interest paid on bank loan		–	(827)
Net cash (outflow)/inflow from investing activities		(99,425)	504,566
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issue of shares under employee share option schemes		47,379	57,336
Admission fees refunded to less receipts from Participants		(5,000)	(1,350)
Repayment of bank loan		–	(50,286)
Dividends paid		(1,018,784)	(2,672,850)
Net cash outflow from financing activities		(976,405)	(2,667,150)
Net increase/(decrease) in cash and cash equivalents		324,068	(346,231)
Cash and cash equivalents at 31 Dec 2004/2003		1,035,045	1,355,390
Effect of initial adoption of HKAS 39		–	25,886
Cash and cash equivalents at 31 Dec 2005/2004		1,359,113	1,035,045
Analysis of cash and cash equivalents			
Time deposits with original maturities within three months		1,174,313	829,879
Cash at bank and in hand		184,800	205,166
Cash and cash equivalents at 31 Dec 2005/2004		1,359,113	1,035,045

Notes to the Consolidated Accounts

(Financial figures are expressed in Hong Kong Dollar)

1. General Information

Hong Kong Exchanges and Clearing Limited (“HKEx”) and its subsidiaries (collectively, “Group”) own and operate the only stock exchange and futures exchange in Hong Kong and their related clearing houses.

HKEx is a limited company incorporated and domiciled in Hong Kong. The address of its registered office is 12th Floor, One International Finance Centre, 1 Harbour View Street, Central, Hong Kong.

These consolidated accounts were approved for issue by the Board of Directors on 8 March 2006.

2. Principal Accounting Policies

(a) Statement of compliance

These consolidated accounts have been prepared in accordance with Hong Kong Financial Reporting Standards (“HKFRSs”), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (“HKASs”) and interpretations issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”), and have been aligned with the requirements of International Financial Reporting Standards in all material respects as at 31 December 2005, accounting principles generally accepted in Hong Kong, 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

These consolidated accounts have been prepared under the historical cost convention, as modified by the revaluation of leasehold buildings, investment properties, available-for-sale financial assets and financial assets and financial liabilities at fair value through profit or loss and the marking to market of shares borrowed and receivable by Hong Kong Securities Clearing Company Limited (“HKSCC”) for the purpose of settlement under the Continuous Net Settlement (“CNS”) basis.

The preparation of financial statements in conformity with HKFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group’s accounting policies. The areas involving higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated accounts are disclosed in note 3.

2. Principal Accounting Policies *(Continued)*

(b) Basis of preparation *(Continued)*

Adoption of new/revised HKFRSs that were effective during 2005

In 2005, the Group adopted all new/revised HKFRSs that were relevant to its operations, details of which are set out below.

HK(SIC)-INT 12 (Amendment)	Scope of HK(SIC)-INT 12 Consolidation – Special Purpose Entities
HK-INT 4	Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases

The adoption of HK (SIC)-INT 12 (Amendment) does not have any financial impact to the Group in 2005 or prior years. In 2005, the Board of HKEx approved an Employees' Share Award Scheme ("Share Award Scheme"), under which shares of HKEx ("Awarded Shares") may be awarded to an Executive Director and employees of the Group. A trust, The HKEx Employees' Share Award Scheme ("HKEx Employee Share Trust"), has been set up and HKEx shares will be acquired by an independent trustee at the cost of HKEx and held in trust for the awardees until the Awarded Shares become vested. Prior to the amended interpretation, the HKEx Employee Share Trust did not need to be consolidated as equity compensation plans were not within the scope of HK(SIC)-INT 12. Following the adoption of the amended interpretation, equity compensation plans fall under the scope of HK(SIC)-INT 12, and the HKEx Employee Share Trust should be consolidated. In accordance with HKAS 27 – Consolidated and Separate Financial Statements, however, as HKEx is a Hong Kong incorporated company, and the HKEx Employee Share Trust was not considered as a subsidiary under the Hong Kong Companies Ordinance as at 31 December 2005, the HKEx Employee Share Trust should not be consolidated. Details of the effect on the consolidated accounts had the HKEx Employee Share Trust been consolidated are disclosed in note 29(d). With the enactment of the Companies (Amendment) Ordinance 2005, which is effective for accounting periods beginning on or after 1 January 2006, the HKEx Employee Share Trust will need to be consolidated into the Group's accounts in 2006. More details are set out under the section entitled "Effects of HKFRSs that had been issued as at 31 December 2005 but not yet effective".

The adoption of HK-INT 4 has no financial impact to the Group as the Group's accounting policies already comply with the interpretation.

2. Principal Accounting Policies *(Continued)*

(b) Basis of preparation *(Continued)*

Early adoption of HKFRSs

In the fourth quarter of 2005, the Group early adopted all HKFRSs issued up to 31 December 2005 which were pertinent to its operations where early adoption was permitted. The applicable HKFRSs are set out below:

HKFRS 7	Financial Instruments: Disclosures
HKAS 1 (Amendment)	Capital Disclosures
HKAS 39 (Amendment)	The Fair Value Option
HKAS 39 and HKFRS 4 (Amendment)	Financial Guarantee Contracts

The early adoption of HKAS 39 (Amendment) – The Fair Value Option does not have any financial impact as the Group's accounting policies already comply with the amendment. The early adoption of HKFRS 7 and HKAS 1 (Amendment) only affects the disclosures on financial instruments and capital.

Financial guarantee contracts were previously only disclosed as contingent liabilities as they did not fall within the scope of HKAS 39. Following the introduction of HKAS 39 and HKFRS 4 (Amendment), financial guarantee contracts should be treated as financial liabilities. Financial guarantee contracts should be measured initially at fair value and subsequently at the higher of (i) the amount determined in accordance with HKAS 37 – Provisions, Contingent Liabilities and Contingent Assets and (ii) the amount initially recognised less, where appropriate, cumulative amortisation recognised over the life of the guarantee on a straight-line basis.

All relevant changes in accounting policies have been made in accordance with the provisions of the respective standards, which require retrospective application to prior year comparatives, except as follows:

HKAS 39 (Amendment):

- designate previously recognised financial assets or financial liabilities at fair value through profit or loss that qualified for such designation on 1 January 2005; and
- de-designate all financial assets or financial liabilities previously designated at fair value through profit or loss if they did not qualify for such designation on 1 January 2005.

HKAS 39 and HKFRS 4 (Amendment):

- the fair value of financial guarantee contracts is recognised in the balance sheet on the date when HKAS 39 was initially adopted by the Group (i.e. 1 January 2004) by adjusting the retained earnings.

2. Principal Accounting Policies (Continued)

(b) Basis of preparation (Continued)

Early adoption of HKFRSs (Continued)

HKFRS 7:

- comparative information for the disclosures about the nature and extent of risks arising from financial instruments is not required if the standard is adopted for annual periods beginning before 1 January 2006.

Effects of changes in accounting policies on consolidated balance sheet and HKEx's balance sheet

The adoption of HKAS 39 and HKFRS 4 (Amendment) has the following impact on the consolidated balance sheet and HKEx's balance sheet as at 1 January 2004, 31 December 2004 and 31 December 2005:

	Group \$'000	HKEx \$'000
Increase in assets		
Increase in investments in subsidiaries	–	11,390
(Increase)/decrease in liabilities/equity		
Increase in financial guarantee contract	(19,909)	(11,390)
Decrease in retained earnings	19,909	–

Effects of HKFRSs that had been issued as at 31 December 2005 but not yet effective

The Group has not early adopted one HKFRS, HKAS 27 (Revised) – Consolidated and Separate Financial Statements, which is effective for accounting periods beginning on or after 1 January 2006 as early adoption is not permitted.

The adoption of the revised HKAS 27 will result in a change in accounting policy relating to the consolidation of special purpose entities (including trusts) of the Group. Prior to the revision, trusts could not be consolidated as they are not considered as subsidiaries under the Hong Kong Companies Ordinance. The Companies (Amendment) Ordinance 2005, effective for accounting periods beginning on or after 1 January 2006, removes the legal constraint that prevents a Hong Kong incorporated company from consolidating in its group accounts a subsidiary that does not meet the definition of a subsidiary under the current Hong Kong Companies Ordinance. The Group is, therefore, required to consolidate the HKEx Employee Share Trust, under HKAS 27 (Revised) from 2006 onwards.

Details of the effects on the consolidated accounts had the HKEx Employee Share Trust been consolidated as at 31 December 2005 are disclosed in note 29(d).

2. Principal Accounting Policies *(Continued)*

(b) Basis of preparation *(Continued)*

Effects of HKFRSs that were issued after 31 December 2005 and up to the date of approval of the consolidated accounts

At the date of approval of these consolidated accounts, the following HKFRSs were issued after 31 December 2005 but were not applicable to the Group's operations:

HK(IFRIC)-Int 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies
HKAS 21 (Amendment)	The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation
HKAS 39 (Amendment)	Financial Instruments: Recognition and Measurement

(c) 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.

(i) Subsidiaries

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. Where HKEx, directly or indirectly, otherwise controls any special purpose entity as described in HK(SIC)-INT 12 by way of having the power to govern its financial and operating policies so that the Group obtains benefits from its activities, such special purpose entity is not considered as a subsidiary and is not included in the consolidated accounts except by way of note disclosure to show the effects on the consolidated accounts had the special purpose entity been consolidated.

The accounts of subsidiaries are included in the consolidated accounts from the date on which control commences until the date that control ceases. All material intra-group transactions and balances have been eliminated on consolidation.

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

2. Principal Accounting Policies *(Continued)*

(c) Consolidation *(Continued)*

(ii) Associates

An associate is a company, not being a subsidiary nor an interest in a joint venture, in which the Group has significant influence generally accompanying a shareholding of between 20 per cent and 50 per cent of the voting rights.

Investments in associates 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 associates for the year, and the consolidated balance sheet includes the Group's share of the net assets of associates and goodwill (net of accumulated impairment losses).

(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.

(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 and trading fees on derivatives contracts traded on the Futures Exchange are recognised on a trade date basis.
- (ii) Settlement fees on derivatives contracts traded on the Futures Exchange are recognised on outstanding contracts at the official final settlement day.
- (iii) 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 other settlement transactions are recognised upon completion of the settlement.
- (iv) 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.

2. Principal Accounting Policies *(Continued)*

(e) Revenue recognition *(Continued)*

- (v) Initial listing fees for initial public offering (“IPO”) are recognised upon the listing of an applicant, cancellation of the application or six months after submission of the application, whichever is earlier. Income from annual listing fees is recognised on a straight-line basis over the period covered by the respective fees received in advance.
- (vi) Income from sale of information and other fees are recognised when the related services are rendered.
- (vii) Interest income represents gross interest income from bank deposits and investments and is recognised on a time apportionment basis using the effective interest method.
- (viii) Dividend income is recognised when the right to receive payment is established.
- (ix) Rental income is recognised on an accrual basis.

(f) Interest expenses

Interest expenses are recognised on a time apportionment basis, taking into account the principal outstanding and the applicable interest rates. All interest expenses are charged to the profit and loss account in the year in which they are incurred.

(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

For share options granted under the Post-Listing Share Option Scheme (“Post-Listing Scheme”) and the Awarded Shares granted under the Share Award Scheme, the fair value of the employee services received in exchange for the grant of the options and the Awarded Shares is recognised as an expense and credited to an employee share-based compensation reserve under equity. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options and Awarded Shares granted at grant date.

At each balance sheet date, the Group revises its estimates of the number of options and Awarded Shares that are expected to ultimately vest. The impact of the revision of the original estimates, if any, is recognised in the profit and loss account over the remaining vesting period, with a corresponding adjustment to the employee share-based compensation reserve.

2. Principal Accounting Policies *(Continued)*

(g) Employee benefit costs *(Continued)*

(ii) Equity compensation benefits *(Continued)*

Share options granted under the Pre-Listing Share Option Scheme (“Pre-Listing Scheme”) are not expensed as the options were granted before 7 November 2002 and not subject to requirements of HKFRS 2.

When the options are exercised, the proceeds received are credited to share capital (nominal value) and share premium, and the associated amount in the employee share-based compensation reserve, if any, is transferred to share premium.

(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.

(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

The building component of owner-occupied leasehold 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 the basis of depreciated replacement cost. Depreciated replacement cost is used as open market value cannot be reliably allocated to the building component. The Directors review the carrying value of the leasehold buildings and adjustment is made where they consider that there has been a material change. Increases in valuation are credited to the leasehold buildings 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 leasehold buildings revaluation reserve.

2. Principal Accounting Policies *(Continued)*

(i) Fixed assets *(Continued)*

Other tangible fixed assets are stated at historical cost less accumulated depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Tangible fixed assets are depreciated at rates sufficient to write off their cost net of expected residual value over their estimated useful lives on a straight-line basis. The useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

The useful lives of major categories of fixed assets are as follows:

Leasehold buildings	25 years
Leasehold improvements	over the remaining life of the leases but not exceeding 5 years
Computer trading and clearing systems	
– hardware and software	5 years
Other computer hardware and software	3 years
Furniture and equipment	Up to 5 years
Motor vehicles	3 years

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to the profit and loss account during the year in which they are incurred.

An asset is written down immediately to its recoverable amount if its carrying amount is higher than the asset's estimated recoverable amount (note 2(m)).

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 that are attributable to the assets 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.

2. Principal Accounting Policies *(Continued)*

(i) Fixed assets *(Continued)*

Amortisation of the cost of capitalised software system development expenditures is provided from the dates when the systems are available for use.

Upon the disposal of leasehold buildings, the relevant portion of the revaluation reserve realised in respect of previous valuations is released from the leasehold buildings revaluation reserve to retained earnings.

The gain or loss on disposal of a fixed asset 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.

(j) Investment properties

Investment properties are properties held for long-term rental yields and not occupied by the Group. Investment properties comprise land held under operating leases and buildings held under finance leases. Investment properties are carried at fair value, representing open-market value determined by independent qualified valuers in accordance with the “HKIS Valuation Standards on Properties” issued by the Hong Kong Institute of Surveyors (“HKIS Valuation Standards”), “The RICS Appraisal and Valuation Standards” published by the Royal Institution of Chartered Surveyors (“RICS”) and the “International Valuation Standards” published by the International Valuation Standards Committee where the HKIS Valuation Standards are silent on subjects requiring guidance. Changes in fair value are recognised in the profit and loss account.

Subsequent costs are included in the asset’s carrying amount only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance costs are expensed in the profit and loss account during the year in which such expenses are incurred.

(k) Lease premiums for land

Leasehold land premiums are up-front payments to acquire long-term interests in lessee-occupied properties. The premiums are stated at cost and are amortised over the period of the lease on a straight-line basis to the profit and loss account.

(l) 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. Goodwill on acquisition of associates is included in investments in associates.

Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses.

2. Principal Accounting Policies *(Continued)*

(m) Impairment of assets other than investments

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment and are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount may not be recoverable. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount (i.e., the higher of an asset's fair value less costs to sell and value in use). 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.

In respects of assets other than goodwill, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount and the circumstances and events leading to the impairment cease to exist. A reversal of impairment loss is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversal of impairment losses is credited to the profit and loss account except when the asset is carried at valuation, in which case the reversal of impairment loss is credited to the profit and loss account up to the amount previously charged to the profit and loss account and thereafter treated as a revaluation movement.

(n) 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. Investment income net of expenses of the Clearing House Funds is appropriated from retained earnings to the respective designated reserves of these funds and allocated to amounts attributable to Clearing Participants' contributions and to clearing houses' contributions based on the ratio of their respective average initial contributions and accumulated allocated investment income net of expenses. 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 available-for-sale financial assets comprising these funds are dealt with in the investment revaluation reserve.

Net assets of the Clearing House Funds, which are derived from contributions from CCASS Participants (other than investor participants), HKCC Participants and The SEHK Options Clearing House Limited ("SECH") Participants ("Clearing Participants") and the respective clearing houses, and the accumulated investment income net of expenses of these funds appropriated from retained earnings, are included in the balance sheet as non-current assets. Clearing Participants' contributions are treated as non-current liabilities in the balance sheet. Non-cash collateral of the Clearing House funds (i.e. contributions receivable from Clearing Participants fully secured by bank guarantees) and the corresponding liabilities are not reflected as assets and liabilities in the balance sheet in accordance with HKAS 39 but are disclosed in note 42 to the consolidated accounts. 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.

2. Principal Accounting Policies *(Continued)*

(n) Clearing House Funds/Cash and Derivatives Market Development Fund (“CDMD Fund”) *(Continued)*

The CDMD Fund was fully utilised in 2004 for funding initiatives that were for the development and betterment of the Cash and Derivatives Markets in Hong Kong.

(o) Margin Funds on derivatives contracts/margin deposits and securities received from Clearing Participants on derivatives contracts

Margin Funds are established by cash received or receivable 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. 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. Cash margin deposits received are disclosed as Margin Funds on derivatives contracts under current assets and the obligation to refund such deposits as Margin deposits from Clearing Participants on derivatives contracts under current liabilities. Non-cash collateral (i.e. securities and bank guarantees) received from Clearing Participants for satisfying margin requirements and the corresponding liabilities are not recorded as assets and liabilities of the Margin Funds in accordance with HKAS 39 but are disclosed in note 42 to the consolidated accounts.

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 available-for-sale financial assets comprising these Margin Funds are dealt with in the investment revaluation reserve. Changes in fair value of investments designated as financial assets at fair value through profit or loss are included in the profit and loss account. The Clearing Participants of SEOCH and HKCC are entitled to interest at a rate determined by SEOCH and HKCC on the margin deposits they place with SEOCH and HKCC respectively.

(p) Cash marks received from Participants

Cash marks received from HKSCC Participants for their open positions are recorded as assets in the balance sheet. As these funds are refundable to the Participants when they close their positions, the marks received are reflected as liabilities to the Participants in the balance sheet.

Income arising from bank deposits comprising these funds is dealt with in the profit and loss account. HKSCC Participants are entitled to interest at a rate determined by HKSCC on the marks they place with HKSCC.

2. Principal Accounting Policies *(Continued)*

(q) Derivative financial instruments

Derivatives, which include forward foreign exchange contracts, are initially recognised at fair value on the date on which a derivative contract is entered into and subsequently remeasured at their fair values. Fair values are based on quoted market prices in active markets or recent market transactions or valuation techniques such as discounted cash flow models and options pricing models, as appropriate. Changes in fair value of the derivatives are recognised in the profit and loss account except where derivatives are designated as a qualifying cash flow hedge in which case recognition of any resultant fair value gain or loss depends on the nature of the item being hedged (note 2 (r)). All derivatives except those designated as qualifying cash flow hedges are classified as financial assets at fair value through profit or loss when the fair value is positive and as financial liabilities at fair value through profit or loss when the fair value is negative.

(r) Hedge accounting

The Group documents at the inception of the transactions the relationship between the hedging instruments and the hedged items, as well as the risk management objectives and strategies for undertaking various hedge transactions. The Group also documents its assessment, both at the inception of the hedges and on an ongoing basis, of whether the hedging instruments are highly effective in offsetting changes in fair values or cash flows of the hedged items.

(i) Fair value hedges

Changes in the fair value of hedging instruments that are designated and qualify as fair value hedges are recognised in the profit and loss account, together with any changes in the fair value of the hedged assets, liabilities or firm commitments that are attributable to the hedged risk.

(ii) Cash flow hedges

For hedging instruments that are designated as cash flow hedges, the changes in the fair value relating to the effective portion of the hedges are recognised in equity. The gains or losses relating to the ineffective portion of the hedges are recognised immediately in the profit and loss account.

Amounts accumulated in equity are recycled to the profit and loss account in the periods when the hedged items affect profit or loss. However, when the forecast transactions that are hedged result in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the non-financial asset or non-financial liability.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss retained in equity at that time remains in equity and is recognised in accordance with the above policy when the forecast transaction occurs. When a forecast transaction is no longer expected to occur, the cumulative gain or loss retained in equity is immediately transferred to the profit and loss account.

2. Principal Accounting Policies *(Continued)*

(s) Investments

(i) Classification

Investments of the Group are classified under the following categories:

Financial assets at fair value through profit or loss

This category comprises financial assets held for trading (i.e., those acquired for the purpose of selling in short-term or derivatives which are not designated as hedging instruments) and those designated as fair value through profit and loss at inception if the designation:

- eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring financial assets or financial liabilities or recognising the gains and losses on them on different bases; or
- applies to a group of financial assets, financial liabilities or both that is managed and its performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and where information about that group of financial instruments is provided internally on that basis to key management personnel; or
- relates to financial instruments containing one or more embedded derivatives that significantly modify the cash flows resulting from those financial instruments.

Available-for-sale financial assets

This category comprises financial assets which are non-derivatives and are designated as available-for-sale financial assets or not classified under other investment categories.

Loans and receivables

Loans and receivables which comprise bank deposits, trade and accounts receivable, deposits and other assets, are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and the Group has no intention of trading the loans or receivables. Bank deposits are disclosed as time deposits and cash equivalents.

(ii) Recognition and initial measurement

Loans and receivables arise when the Group provides money, goods or services directly to a debtor.

Purchases and sales of investments are recognised on trade-date – the date on which the Group commits to purchase or sell the asset. Investments at fair value through profit or loss are initially recognised at fair value with transaction costs recognised as expenses in the profit and loss account. Investments not designated as fair value through profit or loss are initially recognised at fair value plus transaction costs.

2. Principal Accounting Policies *(Continued)*

(s) Investments *(Continued)*

(iii) Derecognition

Investments are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all the risks and rewards of ownership of the investments.

(iv) Gains or losses on subsequent measurement and interest income

Financial assets at fair value through profit or loss

- Investments under this category are carried at fair value. Unrealised gains and losses arising from changes in the fair value are included in the profit and loss account in the period in which they arise. Upon disposal, the difference between the net sale proceeds and the carrying value is included in the profit and loss account.
- Interest income is recognised using the effective interest method and included as net realised and unrealised gains/(losses) and interest income from these investments.

Available-for-sale financial assets

- Available-for-sale financial assets are carried at fair value. Unrealised gains and losses (including transaction costs on acquisition) arising from changes in the fair value are recognised in investment revaluation reserve in accordance with HKAS 39, except for impairment losses in excess of previous revaluation surpluses and exchange differences of monetary securities resulting from changes in amortised costs are recognised in profit and loss account. For the purpose of recognising foreign exchange gains and losses under HKAS 21, monetary available-for-sale financial assets are treated as if they were carried at amortised cost in the foreign currency and, accordingly, exchange differences resulting from changes in amortised cost are recognised in profit or loss and other changes in carrying amount are recognised in reserve in accordance with HKAS 39. When the securities are sold, the difference between the net sale proceeds and the carrying value, and the accumulated fair value adjustments in the investment revaluation reserve are treated as gains or losses on disposal.
- Interest income is recognised using the effective interest method and disclosed as interest income.

Loans and receivables

- Loans and receivables are carried at amortised cost using the effective interest method less provision for impairment.
- Interest income is recognised using the effective interest method and disclosed as interest income.

2. Principal Accounting Policies *(Continued)*

(s) Investments *(Continued)*

(v) Fair value measurement principles

Fair values of quoted investments are based on bid prices. For unlisted securities or financial assets without an active market, the Group establishes the fair value by using valuation techniques including the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, and option pricing models.

(vi) Impairment

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred, if and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Group about the following loss events:

- significant financial difficulty of the debtor or obligor;
- fees receivable that have been outstanding for over 180 days;
- the Group granting to the debtor or obligor, for economic or legal reasons relating to the debtor's or obligor's financial difficulty, a concession that the Group would not otherwise consider;
- it is becoming probable that the debtor or obligor will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties;
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the Group, including:
 - adverse changes in the payment status of debtors or obligors in the Group;
 - economic conditions that correlate with defaults on the assets in the Group.

2. Principal Accounting Policies *(Continued)*

(s) Investments *(Continued)*

(vi) Impairment *(Continued)*

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assessed them for impairment. Assets that are individually assessed for impairment and which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics relevant to the estimation of future cash flows. These financial assets are collectively assessed based on historical loss experience on each type of assets and management judgement of the current economic and credit environment.

Loans and receivables

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the assets' carrying amounts and the present values of estimated future cash flows discounted at the financial assets' original effective interest rates. The carrying amount of the asset is reduced through the use of a doubtful debt allowance account and the amount of the loss is recognised in the profit and loss account.

When there is no realistic prospect of recovery of a loan or receivable, it is written off against the related provision for impairment loss. Subsequent recovery of the amount previously written off reduces the amount of the provision for impairment loss in the profit and loss account.

As soon as a loan or receivable becomes impaired, the Group may continue to provide services or facilities to the debtor or obligor but no further accounts receivable is recognised on balance sheet as economic benefits may not flow to the Group. The revenue concerned is not recognised but tracked as doubtful deferred revenue and will only be recognised as income when received.

If, in a subsequent period, the amount of impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the doubtful debt allowance account. The amount of reversal is recognised in the profit and loss account.

2. Principal Accounting Policies (*Continued*)

(s) Investments (*Continued*)

(vi) Impairment (*Continued*)

Available-for-sale financial assets

If there is objective evidence that an impairment loss on available-for-sale financial assets has been incurred, the cumulative loss (measured as the difference between the acquisition cost and the current fair value, less any impairment loss on the financial asset previously recognised in the profit or loss account) is removed from investment revaluation reserve and recognised in the profit and loss account.

In the case of equity securities classified as available-for-sale financial assets, a significant or prolonged decline in the fair value of the securities below their cost is considered in determining whether the securities are impaired. Impairment losses recognised in the profit and loss account on equity instruments are not reversed through the profit and loss account.

If, in a subsequent period, the fair value of a debt instrument increases and the increase can be related objectively to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the profit and loss account up to the amount previously charged to the profit and loss account and any further increase in fair value thereafter is treated as a revaluation movement.

(t) Financial liabilities

(i) Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss are financial liabilities held for trading (i.e. principally held for the short-term and derivatives which are not designated as hedging instruments) and those designated at fair value through profit or loss at inception if the designation satisfies the same criteria as set out in note 2(s)(i) under the caption of “Financial assets at fair value through profit or loss”.

Liabilities under this category are initially recognised at fair value on the date on which a contract is entered into and subsequently remeasured at their fair value. Changes in fair value of the liabilities are recognised in the profit and loss account.

(ii) Financial guarantee contracts

A financial guarantee contract is a contract that requires the Group to make specified payments to reimburse the holder for a loss it incurs because a specified entity or person fails to make payment when due in accordance with the original or modified terms of a debt instrument.

Financial guarantee contracts are accounted for as financial instruments under HKAS 39 and are initially recognised at fair value. Subsequently, such contracts are measured at the higher of the amount determined in accordance with HKAS 37 – Provisions, Contingent Liabilities and Contingent Assets and the amount initially recognised less, where appropriate, cumulative amortisation recognised over the life of the guarantee on a straight-line basis.

2. Principal Accounting Policies *(Continued)*

(t) Financial liabilities *(Continued)*

(iii) Other financial liabilities

Financial liabilities, other than financial liabilities at fair value through profit and loss and financial guarantee contracts, are carried at amortised cost.

(u) 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.

(v) 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.

(w) Deferred taxation

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 or the income tax losses can be utilised. Tax rates enacted or substantively enacted by the balance sheet date are used to determine deferred tax assets and liabilities. Movements in deferred tax provision are recognised in the profit and loss account with the exception of deferred tax related to fair value re-measurement of fixed assets, available-for-sale financial assets and cash flow hedges, which are charged or credited directly to equity, is also credited or charged directly to equity.

2. Principal Accounting Policies *(Continued)*

(x) 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.

(y) 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 consolidated 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 consolidated accounts when an inflow of economic benefits is probable. When inflow is virtually certain, an asset is recognised.

(z) Foreign currency translation

(i) Functional and presentation currency

Items included in the accounts of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated accounts are presented in Hong Kong Dollar ("HKD"), which is HKEx's and the Group's functional and presentation currency.

2. Principal Accounting Policies *(Continued)*

(z) Foreign currency translation *(Continued)*

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets (accounting treatment for available-for-sale financial assets is included in note 2(s)(iv)) and liabilities denominated in foreign currencies are recognised in the profit and loss account, except when the foreign exchange gains/losses are related to a qualifying cash flow hedge in which case the amount will be deferred in hedging reserve.

Translation differences on non-monetary items, such as equity investments held that are classified as financial assets at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items such as equity instruments classified as available-for-sale financial assets are included in the investment revaluation reserve in equity.

(aa) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, bank balances and other short-term highly liquid investments (mainly time deposits) with original maturities of three months or less.

(ab) Segment reporting

Business segment assets consist primarily of fixed assets, assets of the Clearing House Funds, Compensation Fund Reserve Account, Margin Funds, financial assets and other assets. Business segment liabilities comprise primarily of liabilities to Participants, financial and other liabilities. Non-business segment assets and liabilities include taxation recoverable and payable, deferred tax assets and liabilities and dividends declared by HKEx but not yet claimed by its shareholders. Capital expenditures comprise additions to fixed assets. Business segments have been used as the primary reporting format and no geographical segment analysis is presented as all business activities are conducted in Hong Kong.

(ac) Dividends

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

Dividends declared are recognised as liabilities in the Group's accounts in the year the dividends are approved by the shareholders.

2. Principal Accounting Policies *(Continued)*

(ad) Related parties

Parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or entities and include entities which are controlled or under the significant influence of related parties of the Group where those parties are individuals, and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group.

3. Critical Accounting Estimates and Judgements

The Group makes estimates and assumptions concerning the future. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

(a) Estimated impairment of investments in associates

The Group assesses annually if investments in associates have suffered any impairment in accordance with the accounting policy stated in note 2(m). The recoverable amount of the investment in one of the associates, Computershare Hong Kong Investor Services Limited ("CHIS"), is determined using discounted cash flows which require the use of estimated dividends, proceeds on disposal and an appropriate discount rate as stated in note 20(b)(ii).

If the discount rate moves above 16 per cent, or annual dividends received fall by more than 46 per cent, an impairment loss may be considered necessary.

(b) Impairment of available-for-sale financial assets

The Group follows the guidance of HKAS 39 when determining whether an investment in available-for-sale financial assets is other-than-temporarily impaired. This determination requires significant judgement. In making this judgement, the Group evaluates, among other factors, the duration and extent to which the fair value of an investment is less than its cost, and the expected time span the Group will hold on to this investment.

The Group's available-for-sale financial assets are expected to be held till maturity and therefore any revaluation deficit arising from revaluation is not expected to have any impact to the Group's profit and loss account (note 32(b)). If the assumptions regarding the Group's intention to continue to hold on to such investments are proved to be not correct, the Group would suffer an additional \$39,332,000 loss (excluding share of associate's revaluation surplus of \$21,000) in its 2006 financial statements, being the transfer of the related investment revaluation reserve to the profit and loss account.

4. 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, capital expenditures and non-cash expenses for the year by business segment is as follows:

	2005					
	Cash Market \$'000	Derivatives Market \$'000	Clearing Business \$'000	Information Services \$'000	Others \$'000	Group \$'000
Income	1,172,850	441,755	753,695	325,757	-	2,694,057
Operating expenses						
Direct costs	429,042	111,812	305,821	46,703	-	893,378
Indirect costs	115,914	36,149	79,089	20,952	-	252,104
	544,956	147,961	384,910	67,655	-	1,145,482
Segment results	627,894	293,794	368,785	258,102	-	1,548,575
Share of profits less losses of associates	(3)	-	18,436	-	-	18,433
Segment profits before taxation	627,891	293,794	387,221	258,102	-	1,567,008
Taxation						(227,460)
Profit attributable to shareholders						1,339,548
Segment assets	2,171,939	14,619,810	6,039,165	62,270	3,168	22,896,352
Investments in associates	1,305	-	63,276	-	-	64,581
	2,173,244	14,619,810	6,102,441	62,270	3,168	22,960,933
Segment liabilities	608,182	13,697,352	4,106,773	35,451	145,686	18,593,444
Segment capital expenditures	68,364	2,875	12,416	2,148	-	85,803
Segment depreciation and amortisation	64,263	13,192	65,870	8,218	-	151,543
Segment provision for impairment losses	73	102	261	7	-	443
Segment other non-cash expenses	12,619	3,141	8,281	1,315	-	25,356

4. Segment Information (Continued)

	2004 (As restated)					
	Cash Market \$'000	Derivatives Market \$'000	Clearing Business \$'000	Information Services \$'000	Others \$'000	Group \$'000
Income	1,058,306	327,430	698,052	310,149	–	2,393,937
Operating expenses						
Direct costs	434,876	114,185	313,492	56,043	–	918,596
Indirect costs	109,096	30,943	75,796	21,865	–	237,700
	543,972	145,128	389,288	77,908	–	1,156,296
Segment results	514,334	182,302	308,764	232,241	–	1,237,641
Share of profits less losses of associates	(12)	–	12,896	–	–	12,884
Segment profits before taxation	514,322	182,302	321,660	232,241	–	1,250,525
Taxation						(193,641)
Profit attributable to shareholders						1,056,884
Segment assets	2,131,971	11,402,930	7,802,747	65,707	1,318	21,404,673
Investments in associates	1,309	–	37,422	–	–	38,731
	2,133,280	11,402,930	7,840,169	65,707	1,318	21,443,404
Segment liabilities	600,319	10,571,605	5,949,260	33,617	256,369	17,411,170
Segment capital expenditures	5,445	2,221	14,225	3,028	–	24,919
Segment depreciation and amortisation	90,326	15,594	68,202	9,826	–	183,948
Segment provision for/ (reversal of provision for) impairment losses	156	30	39	(1,000)	–	(775)
Segment other non-cash expenses	6,724	1,383	4,889	792	–	13,788

The **Cash Market** business mainly refers to the operations of the Stock Exchange, which covers all products traded on the Cash Market platforms, such as equities, debt securities, unit trusts, warrants and rights. Currently, the Group operates two Cash Market platforms, the Main Board and the Growth Enterprise Market (“GEM”). The major sources of income of the business are trading fees, trading tariff and listing fees. Costs of the Listing Function are treated as segment costs under the Cash Market. Costs of the Listing Function are further explained in note 6.

4. Segment Information *(Continued)*

The **Derivatives Market** business refers to the derivatives products traded on the Futures Exchange and stock options traded on the Stock Exchange, which includes the provision and maintenance of trading platforms for a range of derivatives products, such as equity and interest rate futures and options. Its income mainly comprises trading fees and investment income on the Margin Funds invested.

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 investment income earned on the Clearing House Funds and fees from providing clearing, settlement, depository, custody and nominee services.

The **Information Services** business is responsible for developing, promoting, compiling and sales of real-time, historical as well as statistical market data and issuer information. Its income comprises primarily income from sale of Cash Market and Derivatives Market data.

In addition to the above, central income (mainly investment income of the 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.

Assets and liabilities under the **Others Segment** represent mainly taxation recoverable and payable, deferred tax assets and liabilities and unclaimed dividends declared by HKEx.

5. Trading Fees and Trading Tariff

	2005 \$'000	2004 \$'000
Trading fees and trading tariff were derived from:		
Securities traded on the Cash Market	528,954	459,524
Derivatives contracts traded on the Derivatives Market	264,293	222,769
	793,247	682,293

6. Stock Exchange Listing Fees

Stock Exchange listing fees and costs of Listing Function comprised the following:

	2005				2004			
	Equity		Debt & Derivatives \$'000	Total \$'000	Equity		Debt & Derivatives \$'000	Total \$'000
	Main Board \$'000	GEM \$'000			Main Board \$'000	GEM \$'000		
Income								
Annual listing fees	236,125	25,946	1,874	263,945	224,875	25,435	2,048	252,358
Initial and subsequent issue listing fees	53,175	5,880	83,020	142,075	43,932	12,654	62,882	119,468
Prospectus vetting fees	2,775	375	140	3,290	2,690	300	205	3,195
Other listing fees	2,706	984	–	3,690	2,116	1,290	–	3,406
Total income	294,781	33,185	85,034	413,000	273,613	39,679	65,135	378,427
Costs of Listing Function								
<i>Direct costs</i>								
Staff costs and related expenses	98,408	28,749	5,645	132,802	80,806	30,223	5,464	116,493
Information technology and computer maintenance expenses	1,608	441	2	2,051	2,217	584	3	2,804
Premises expenses	6,336	1,846	363	8,545	5,706	2,113	381	8,200
Legal and professional fees	4,907	1,202	1	6,110	2,471	1,446	–	3,917
Depreciation	6,234	1,918	206	8,358	10,417	3,769	544	14,730
Payment to SFC under dual filing regime	16,369	3,631	–	20,000	16,353	3,647	–	20,000
Other operating expenses	4,408	1,706	164	6,278	5,702	1,889	181	7,772
Total direct costs	138,270	39,493	6,381	184,144	123,672	43,671	6,573	173,916
<i>Indirect costs</i>	27,822	5,602	4,571	37,995	19,810	4,917	2,899	27,626
Contribution	128,689	(11,910)	74,082	190,861	130,131	(8,909)	55,663	176,885

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.

The direct costs listed above are regulatory in nature, which comprise costs of the Listing Function on vetting IPOs and enforcing the Listing Rules and the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited, disseminating information relating to listed companies, and payments to the Securities and Futures Commission (“SFC”) under the dual filing regime. Indirect costs comprise costs of support services and other central overheads attributable to the Listing Function.

7. Investment Income

	2005 \$'000	2004 \$'000
Interest income		
– bank deposits	246,729	26,481
– listed available-for-sale financial assets	11,852	4,401
– unlisted available-for-sale financial assets	78,064	52,292
	336,645	83,174
Interest expenses	(126,260)	(1,309)
Net interest income	210,385	81,865
Net realised and unrealised gains/(losses) and interest income on financial assets and financial liabilities at fair value through profit or loss		
On designation		
– bank deposits with embedded derivatives	266	3,529
– unlisted debt securities with embedded derivatives	–	2,032
	266	5,561
Held for trading		
– listed securities	84,644	76,834
– unlisted securities	15,513	31,433
– exchange differences	(17,928)	530
	82,229	108,797
	82,495	114,358
Gains/(losses) on disposal and maturity of available-for-sale financial assets		
– listed securities (note a)	–	24,841
– unlisted securities	–	101
– exchange differences	–	(192)
	–	24,750
Dividend income		
– listed available-for-sale financial assets	–	1,070
– listed financial assets at fair value through profit or loss	7,630	6,378
	7,630	7,448
Other exchange differences on loans and receivables	(401)	166
Total investment income	300,109	228,587
Total investment income was derived from:		
Corporate Funds (note b)	119,187	148,781
Margin Funds	150,209	69,313
Clearing House Funds	30,713	10,493
	300,109	228,587

(a) Amount in 2004 represented profit on sale of investment in Singapore Exchange Limited in July 2004.

(b) Investment income derived from the Corporate Funds included investment income of the Compensation Fund Reserve Account of \$1,286,000 (2004: \$576,000) and CDMD Fund of \$Nil (2004: \$20,000). The CDMD Fund was fully utilised in 2004.

8. Other Income

	2005 \$'000	2004 \$'000
Network, terminal user, dataline and software sub-license fees	129,733	120,261
Participants' subscription and application fees	34,351	34,341
Brokerage on direct IPO applications	34,123	17,586
Fair value gain of an investment property (note 18)	4,400	3,300
Accommodation income on cash margin deposits in non-contract settlement currencies and securities deposited by Participants as alternatives to cash deposits of the Margin Funds	2,154	5,133
Miscellaneous income	16,256	8,380
	221,017	189,001

9. Staff Costs and Related Expenses

(a) Staff costs and related expenses comprised the following:

	2005 \$'000	2004 \$'000
Salaries and other short-term employee benefits	512,548	479,352
Employee share-based compensation benefits (note 31)	22,955	14,290
Termination benefits	237	4,418
Retirement benefit costs (note b):		
– ORSO Plan	50,011	47,270
– MPF Scheme	282	324
	586,033	545,654

(b) Retirement Benefit Costs

The Group has sponsored a defined contribution provident fund scheme, namely the Hong Kong Exchanges and Clearing Provident Fund Scheme (“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 (“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.

9. Staff Costs and Related Expenses *(Continued)*

(b) Retirement Benefit Costs *(Continued)*

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 and related fees. No contribution payable was outstanding as at 31 December 2004 and 2005.

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

	2005 \$'000	2004 \$'000
Forfeited contributions during the year and retained in the ORSO Plan	3,143	5,847

10. Information Technology and Computer Maintenance Expenses

	2005 \$'000	2004 \$'000
Costs of services and goods:		
– consumed by the Group	146,568	161,142
– directly consumed by Participants	55,157	60,482
	201,725	221,624

11. Other Operating Expenses

	2005 \$'000	2004 \$'000
Reversal of provision for impairment losses of trade receivables (note 23(b))	(389)	(850)
Impairment losses of leasehold buildings – revaluation deficit (note 17(a)(iii))	837	–
Insurance	16,187	16,401
Financial data subscription fees	4,954	7,414
Custodian and fund management fees	7,887	7,772
Bank charges	4,420	7,889
Repair and maintenance expenses	8,476	6,984
License fees	6,279	5,181
Communication expenses	4,659	5,018
Other miscellaneous expenses	29,034	28,630
	82,344	84,439

12. Profit before Taxation

	2005 \$'000	2004 \$'000
Profit before taxation is stated after crediting/(charging):		
Amortisation of lease premiums for land	(548)	(548)
Auditors' remuneration		
– audit fees	(2,000)	(1,862)
– secondment fee	(300)	(1,800)
– non-audit fees	(1,034)	(1,403)
Interest on bank loans and overdrafts repayable within five years	(9)	(95)
Operating lease rentals		
– land and buildings	(44,976)	(43,797)
– computer systems and equipment	(6,514)	(9,292)
Rental income from investment property	501	465
Direct operating expenses of the investment property that generates rental income	(166)	(165)
Depreciation	(150,995)	(183,400)
Impairment losses of leasehold buildings under other operating expenses – revaluation deficit	(837)	–
Reversal of provision for/(provision for) impairment loss of club debenture under other income/(other operating expenses)	5	(75)
Gain/(loss) on disposal or write-off of fixed assets	38	(24)
Exchange (losses)/gains on:		
– financial assets (excluding financial assets at fair value through profit or loss)	(401)	(26)
– Others	1,604	(185)

13. Directors' Emoluments

All Directors, including one Executive Director, received emoluments during the years ended 31 December 2005 and 31 December 2004. The aggregate emoluments paid and payable to the Directors during the year were as follows:

	2005 \$'000	2004 \$'000
Executive Director:		
Salaries and other short-term employee benefits	7,262	7,275
Performance bonus	1,200	900
Retirement benefit costs	900	900
	9,362	9,075
Employee share-based compensation benefits (note a)	1,791	2,204
	11,153	11,279
Non-executive Directors:		
Fees	2,460	1,200
	13,613	12,479

- (a) Employee share-based compensation benefits represent fair value at grant date of share options issued under the Post-Listing Scheme amortised to the profit and loss account during the year disregarding whether the options have been vested/exercised or not.
- (b) The emoluments, including employee share-based compensation benefits for options issued under the Post-Listing Scheme, of the Directors were within the following bands:

	2005 Number of Directors	2004 Number of Directors
\$1 – \$500,000	13	12
\$11,000,001 – \$11,500,000	1	1
	14	13

13. Directors' Emoluments (Continued)

The emoluments of all Directors, including the Chief Executive who is an ex-officio member, for the years ended 31 December 2005 and 2004 are set out below:

Name of Director	2005							
	Fees \$'000	Salary \$'000	Other benefits (note 1) \$'000	Performance bonus \$'000	Retirement benefit costs (note 2) \$'000	Sub-total \$'000	Employee share-based compensation benefits \$'000	Total \$'000
Charles Y K Lee	205	–	–	–	–	205	–	205
Paul M Y Chow	–	7,200	62	1,200	900	9,362	1,791	11,153
Marvin K T Cheung (note 3)	180	–	–	–	–	180	–	180
Henry H L Fan	205	–	–	–	–	205	–	205
Fong Hup	205	–	–	–	–	205	–	205
Tim Freshwater	205	–	–	–	–	205	–	205
Bill C P Kwok	205	–	–	–	–	205	–	205
Dannis J H Lee	205	–	–	–	–	205	–	205
Vincent K H Lee	205	–	–	–	–	205	–	205
Leong Ka Chai (note 4)	25	–	–	–	–	25	–	25
Lo Ka Shui	205	–	–	–	–	205	–	205
John E Strickland	205	–	–	–	–	205	–	205
David M Webb	205	–	–	–	–	205	–	205
Oscar S H Wong	205	–	–	–	–	205	–	205

Name of Director	2004							
	Fees \$'000	Salary \$'000	Other benefits (note 1) \$'000	Performance bonus \$'000	Retirement benefit costs (note 2) \$'000	Sub-total \$'000	Employee share-based compensation benefits \$'000	Total \$'000
Charles Y K Lee	100	–	–	–	–	100	–	100
Paul M Y Chow	–	7,200	75	900	900	9,075	2,204	11,279
Marvin K T Cheung (note 3)	–	–	–	–	–	–	–	–
Henry H L Fan	100	–	–	–	–	100	–	100
Fong Hup	100	–	–	–	–	100	–	100
Tim Freshwater	100	–	–	–	–	100	–	100
Bill C P Kwok	100	–	–	–	–	100	–	100
Dannis J H Lee	100	–	–	–	–	100	–	100
Vincent K H Lee	100	–	–	–	–	100	–	100
Leong Ka Chai (note 4)	100	–	–	–	–	100	–	100
Lo Ka Shui	100	–	–	–	–	100	–	100
John E Strickland	100	–	–	–	–	100	–	100
David M Webb	100	–	–	–	–	100	–	100
Oscar S H Wong	100	–	–	–	–	100	–	100

Notes:

1. Other benefits include insurance premium and club membership.
2. Employees who retire before normal retirement age are eligible for 18% of the employer's contribution to the provident fund after completion of two years of service. The rate of vested benefit increases at an annual increment of 18% thereafter reaching 100% after completion of seven years of service.
3. Appointment effective on 12 April 2005.
4. Retired on 12 April 2005.

14. Five Top-paid Employees

One (2004: one) of the five top-paid employees was a Director, whose emoluments were disclosed in note 13. Details of the emoluments of the other four (2004: four) top-paid employees were as follows:

	2005 \$'000	2004 \$'000
Salaries and other short-term employee benefits (note a)	17,569	17,287
Performance bonus	2,790	2,470
Retirement benefit costs	2,151	2,135
	22,510	21,892
Employee share-based compensation benefits (note b)	5,374	5,375
	27,884	27,267

- (a) The 2004 emoluments disclosed above excluded individual income tax paid or incurred by an employee of \$410,000 in respect of his services as the Chief Representative of the Group's representative office in the Mainland. No such cost was incurred in 2005.
- (b) Employee share-based compensation benefits represent fair value at grant date of share options issued under the Post-Listing Scheme and Awarded Shares issued under the Share Award Scheme amortised to the profit and loss account during the year disregarding whether the options and the Awarded Shares have been vested/exercised or not.
- (c) The emoluments of these four (2004: four) employees, including employee share-based compensation benefits for options issued under the Post-Listing Scheme and Awarded Shares issued under the Share Award Scheme, were within the following bands:

	2005 Number of employees	2004 Number of employees
\$5,500,001 – \$6,000,000	1	1
\$6,000,001 – \$6,500,000	1	2
\$6,500,001 – \$7,000,000	1	–
\$9,000,001 – \$9,500,000	1	1
	4	4

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

15. Taxation

(a) Taxation charge/(credit) in the consolidated profit and loss account represented:

	2005 \$'000	2004 \$'000
Provision for Hong Kong Profits Tax for the year (note i)	245,043	219,086
Over provision in respect of prior years	(8,845)	(79)
	236,198	219,007
Deferred taxation (note 36(a))	(8,738)	(25,366)
	227,460	193,641

- (i) Hong Kong Profits Tax has been provided for at 17.5 per cent (2004: 17.5 per cent) on the estimated assessable profit for the year.
- (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 (2004: 17.5 per cent) as follows:

	2005 \$'000	2004 \$'000
Profit before taxation (excluding share of profit less losses of associates)	1,548,575	1,237,641
Calculated at a taxation rate of 17.5 per cent (2004: 17.5 per cent)	271,001	216,587
Income not subject to taxation	(53,959)	(32,906)
Expenses not deductible for taxation purposes	7,735	6,485
Change in deferred tax arising from unrecognised tax losses	11,390	3,411
Adjustment of deferred tax	138	143
Over provision in respect of prior years	(8,845)	(79)
Taxation charge	227,460	193,641

16. Earnings Per Share

The calculation of basic earnings per share is based on the profit attributable to shareholders of \$1,339,548,000 (2004: \$1,056,884,000) and the weighted average of 1,060,349,075 shares (2004: 1,054,985,321 shares) in issue during the year.

The employee share options outstanding as set out in note 31 did not have a material dilutive effect on the basic earnings per share.

17. Fixed Assets

(a) Group

	Leasehold buildings \$'000	Computer trading and clearing systems \$'000	Other computer hardware and software \$'000	Leasehold improvements, furniture, equipment and motor vehicles \$'000	Total \$'000
Net book value at 1 Jan 2004					
(note i)	18,300	344,679	75,717	44,231	482,927
Additions	–	12,739	10,275	1,905	24,919
Disposals (note ii)	–	(159)	(9)	(14)	(182)
Depreciation	(736)	(116,882)	(38,487)	(27,295)	(183,400)
Revaluation (note iii)	36	–	–	–	36
Net book value at 31 Dec 2004	17,600	240,377	47,496	18,827	324,300
At 31 Dec 2004					
At cost	–	1,223,047	352,106	229,674	1,804,827
At valuation	17,600	–	–	–	17,600
Accumulated depreciation	–	(982,670)	(304,610)	(210,847)	(1,498,127)
Net book value	17,600	240,377	47,496	18,827	324,300
Net book value at 1 Jan 2005	17,600	240,377	47,496	18,827	324,300
Additions	–	48,137	10,004	27,662	85,803
Disposals (note ii)	–	(17)	(1)	–	(18)
Depreciation	(686)	(103,393)	(30,410)	(16,506)	(150,995)
Revaluation (note iii)	(1,214)	–	–	–	(1,214)
Net book value at 31 Dec 2005	15,700	185,104	27,089	29,983	257,876
At 31 Dec 2005					
At cost	–	1,271,146	350,659	253,746	1,875,551
At valuation	15,700	–	–	–	15,700
Accumulated depreciation	–	(1,086,042)	(323,570)	(223,763)	(1,633,375)
Net book value	15,700	185,104	27,089	29,983	257,876

(i) The analysis of net book value as at 1 January 2004 was as follows:

At cost	–	1,345,403	347,385	231,519	1,924,307
At valuation	18,300	–	–	–	18,300
Accumulated depreciation	–	(1,000,724)	(271,668)	(187,288)	(1,459,680)
Net book value	18,300	344,679	75,717	44,231	482,927

(ii) The total cost of fixed assets disposed of or written off during 2005 was \$15,079,000 (2004: \$144,400,000).

17. Fixed Assets *(Continued)*

(a) Group *(Continued)*

- (iii) Leasehold buildings were revalued as at 31 December 2005 on the basis of their depreciated replacement costs calculated by Jones Lang LaSalle, an independent firm of qualified property valuers. The total revaluation deficit of the leasehold buildings for the year ended 31 December 2005 amounted to \$1,214,000, of which \$377,000 has been taken to leasehold buildings revaluation reserve to set off against previous valuation surpluses (note 32), whereas the remaining \$837,000 has been charged to the profit and loss account as impairment losses of leasehold buildings under other operating expenses (note 11). The revaluation gain of \$36,000 for the year ended 31 December 2004 was credited to leasehold buildings revaluation reserve (note 32).
- (iv) The cost of leasehold buildings of the Group was \$26,900,000 (2004: \$26,900,000). The carrying value of these leasehold buildings as at 31 December 2005 would have been \$12,077,000 (2004: \$13,153,000) had they been carried at cost less accumulated depreciation.

(b) HKEx

	Other computer hardware and software \$'000	Leasehold improvements, furniture, equipment and motor vehicles \$'000	Total \$'000
Net book value at 1 Jan 2004 (note i)	29,612	7,246	36,858
Additions	5,178	343	5,521
Depreciation	(12,728)	(4,487)	(17,215)
Net book value at 31 Dec 2004	22,062	3,102	25,164
At 31 Dec 2004			
Cost	46,695	16,565	63,260
Accumulated depreciation	(24,633)	(13,463)	(38,096)
Net book value	22,062	3,102	25,164
Net book value at 1 Jan 2005	22,062	3,102	25,164
Additions	5,828	1,771	7,599
Disposals (note ii)	(1)	–	(1)
Depreciation	(12,532)	(2,507)	(15,039)
Net book value at 31 Dec 2005	15,357	2,366	17,723
At 31 Dec 2005			
Cost	52,673	19,128	71,801
Accumulated depreciation	(37,316)	(16,762)	(54,078)
Net book value	15,357	2,366	17,723

17. Fixed Assets *(Continued)*

(b) HKEx *(Continued)*

(i) The analysis of net book value as at 1 January 2004 was as follows:

	Other computer hardware and software \$'000	Leasehold improvements, furniture, equipment and motor vehicles \$'000	Total \$'000
At cost	43,278	16,226	59,504
Accumulated depreciation	(13,666)	(8,980)	(22,646)
Net book value	29,612	7,246	36,858

(ii) The total cost of fixed assets disposed of or written off during 2005 was \$3,000 (2004: \$1,765,000).

18. Investment Property

	Group	
	2005 \$'000	2004 \$'000
At 1 Jan	13,300	10,000
Fair value gain	4,400	3,300
At 31 Dec	17,700	13,300

The investment property is held under long-term lease and situated in Hong Kong. The cost of investment property was \$8,229,000 (2004: \$8,229,000). The investment property was revalued as at 31 December 2005 on the basis of its open market value by Jones Lang LaSalle, an independent firm of qualified property valuers. The fair value gain during the year amounted to \$4,400,000 (2004: \$3,300,000) and was credited to the profit and loss account under other income (note 8).

19. Lease Premiums for Land

	Group	
	2005 \$'000	2004 \$'000
Net book value at 1 Jan	95,218	95,766
Amortisation	(548)	(548)
Net book value at 31 Dec	94,670	95,218
Current portion of non-current assets	(547)	(548)
Non-current portion	94,123	94,670

The leasehold land is held under long-term lease and situated in Hong Kong. The cost of the leasehold land was \$102,770,000 (2004: \$102,770,000).

20. Investments in Associates

	Group	
	2005 \$'000	2004 \$'000
Share of net assets of associates (note a)	14,374	13,790
Goodwill (note b)	50,207	24,941
	64,581	38,731

(a) Share of net assets of associates

	2005 \$'000	2004 \$'000
At 1 Jan	13,790	11,707
Further acquisition of 6% interest in CHIS on 3 May 2005	10	–
Share of profits less losses of associates:		
– share of profits less losses before taxation	22,110	15,770
– share of taxation	(3,677)	(2,886)
	18,433	12,884
Share of reserves of an associate	93	–
Dividends received and receivable from an associate	(17,952)	(10,801)
At 31 Dec	14,374	13,790

(b) Goodwill

	2005 \$'000	2004 \$'000
At 1 Jan (note i)	24,941	24,941
Further acquisition of 6% interest in CHIS on 3 May 2005	25,266	–
At 31 Dec	50,207	24,941
Represented by:		
Opening value upon adoption of HKFRS 3	25,321	25,321
Addition at cost	25,266	–
Accumulated impairment	(380)	(380)
	50,207	24,941

- (i) Goodwill as at 1 January 2004 represented the opening value upon adoption of HKFRS 3 of \$25,321,000 less accumulated impairment of \$380,000.

20. Investments in Associates (Continued)

(b) Goodwill (Continued)

(ii) Impairment tests for investments in associates

The recoverable amount of the investment in CHIS is determined using discounted cash flows which represents the present value of estimated future cash flows expected to arise from dividends to be received from CHIS and its ultimate disposal. The discount rate used is the ten-year Hong Kong Government bond rate as at 31 December 2005 of 4.18 per cent (2004: 3.55 per cent).

The recoverable amount of the investment in ADP Wilco Processing Services Limited (“AWPS”) is based on the share of the net assets of the associate, which comprise predominantly cash and bank balances.

(c) Details of the unlisted associates as at 31 December 2005 were 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	7,317 Class A ordinary shares	30%
ADP Wilco Processing Services Limited	Hong Kong	Provision of transaction processing services to Stock Exchange Participants	6 Class B ordinary shares	30%

AWPS has an accounting year end of 30 June, which is not coterminous with the Group's accounting year end. Voluntary liquidation of AWPS commenced in April 2005.

(d) The summarised financial information based on the unaudited management accounts of the associates as at 31 December was as follows:

	2005 \$'000	2004 \$'000
Assets	90,387	82,540
Liabilities	42,537	26,172
Income	232,098	209,953
Profit	66,071	53,708

21. Clearing House Funds

	Group	
	2005 \$'000	2004 \$'000
Net assets of the Clearing House Funds were as follows:		
HKSCC Guarantee Fund	342,679	339,598
SEIOCH Reserve Fund	376,758	160,119
HKCC Reserve Fund	620,973	1,361,770
	1,340,410	1,861,487
Net assets of the Clearing House Funds were composed of:		
Available-for-sale financial assets, at fair value		
– listed debt securities	98,896	–
– unlisted debt securities	125,241	127,569
Time deposits with original maturities over three months	30,290	144,610
Cash and cash equivalents	1,091,233	1,604,089
	1,345,660	1,876,268
Less: Other liabilities	(5,250)	(14,781)
	1,340,410	1,861,487
The Clearing House Funds were funded by:		
Clearing Participants' cash contributions (note a)	751,751	1,298,752
Designated reserves (note 34):		
– Clearing houses' contributions	320,200	320,200
– Forfeiture of a defaulted Clearing Participant's contributions	1,928	1,928
– Accumulated investment income net of expenses attributable to:		
– Clearing Participants' contributions	204,213	182,839
– Clearing houses' contributions	63,635	55,659
	589,976	560,626
Revaluation reserve (Note 32(b))	(1,317)	2,109
	1,340,410	1,861,487
The maturity profile of the net assets of the Clearing House Funds was as follows:		
Amounts maturing after more than twelve months	98,896	157,858
Amounts maturing within twelve months	1,241,514	1,703,629
	1,340,410	1,861,487

- (a) Amount included Participants' additional deposits of \$393,701,000 (2004: \$961,502,000).
- (b) 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 SEIOCH Reserve Fund and the HKCC Reserve Fund were established for the exclusive purpose of supporting SEIOCH and HKCC to fulfil their counterparty obligations in the event that one or more of their Clearing Participants fail to meet their obligations to SEIOCH and HKCC respectively.

22. Compensation Fund Reserve Account

	Group	
	2005 \$'000	2004 \$'000
Net assets of the Compensation Fund Reserve Account were composed of:		
Available-for-sale financial assets, at fair value		
– unlisted debt securities	18,488	18,831
Cash and cash equivalents	30,240	29,137
Other receivable	–	100
	48,728	48,068
Less: Other liabilities	(10,318)	(10,617)
	38,410	37,451
The Fund represented:		
Accumulated investment income net of expenses included in designated reserves (note 34)	38,420	37,117
Revaluation reserve (note 32(b))	(10)	334
	38,410	37,451
The maturity profile of the net assets of the Compensation Fund Reserve Account was as follows:		
Amounts maturing after more than twelve months	–	18,831
Amounts maturing within twelve months	38,410	18,620
	38,410	37,451

The 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:

- (i) 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;
- (ii) Amounts received or paid out in relation to each of the Stock Exchange Trading Rights granted or revoked by the Stock Exchange respectively; and
- (iii) Amounts reserved for the replenishment to the Compensation Fund.

The Compensation Fund is further explained in note 40(a)(i).

23. Accounts Receivable, Prepayments and Deposits

	Group		HKEx	
	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000
Receivable from Exchange and Clearing Participants:				
– CNS money obligations	2,889,804	4,261,202	–	–
– transaction levy, stamp duty and fees receivable	193,849	217,270	–	–
– others	10,084	13,103	–	–
Other fees receivable	137,848	161,638	–	–
Prepayments	36,638	39,275	26,114	20,315
Other receivables and deposits	22,941	4,525	160	323
Less: Provision for impairment losses of trade receivables (note b)	(4,329)	(5,167)	–	–
	3,286,835	4,691,846	26,274	20,638

- (a) The carrying amounts of accounts receivable and deposits approximated their fair values.
- (b) The movements in provision for impairment losses of trade receivables were as follows:

	Group	
	2005 \$'000	2004 \$'000
At 1 Jan	5,167	6,112
Reversal of provision for impairment losses of trade receivables (note 11)	(389)	(850)
Trade receivables written off during the year as uncollectible	(449)	(95)
At 31 Dec	4,329	5,167

- (c) CNS money obligations receivable accounted for 88 per cent (2004: 91 per cent) of the total accounts receivable, prepayments and deposits. CNS money obligations receivable mature within two days after the trade date. Fees receivable are due immediately or up to 30 days depending on the type of services rendered. The majority of the remaining accounts receivable, prepayments and deposits would mature within three months.

24. Margin Funds on Derivatives Contracts

	Group	
	2005 \$'000	2004 \$'000
The Margin Funds comprised:		
SEOCH Clearing Participants' Margin Funds	1,506,962	915,250
HKCC Clearing Participants' Margin Funds	12,141,619	9,614,442
	13,648,581	10,529,692
The assets of the Margin Funds comprised:		
Financial assets at fair value through profit or loss, on designation		
– bank deposits with embedded derivatives, at fair value (note a)	–	130,871
Available-for-sale financial assets, at fair value		
– listed debt securities	438,542	339,158
– unlisted debt securities	3,390,291	3,280,786
Time deposits with original maturities over three months	100,018	300,784
Cash and cash equivalents	9,686,026	6,443,406
Margin receivable from Clearing Participants	33,704	34,687
	13,648,581	10,529,692
The Group's liabilities in respect of the Margin Funds were as follows:		
Margin deposits from SEOCH and HKCC Participants on derivatives contracts	13,648,581	10,529,692
The maturity profile of the assets of Margin Funds was as follows:		
Amounts maturing after more than twelve months	1,114,326	2,138,362
Amounts maturing within twelve months	12,534,255	8,391,330
	13,648,581	10,529,692

- (a) The maximum exposure to credit risk of the bank deposits as at 31 December 2004 was \$130,871,000. No related credit derivatives or similar instruments were used to mitigate the maximum exposure to credit risk. There was no fair value change of the bank deposits attributable to changes in credit risk since its acquisition, during 2004 and up to its maturity in 2005, which was determined as the amount of change in its fair value that was not attributable to changes in market conditions that gave rise to market risk.

25. Financial Assets/Liabilities at Fair Value through Profit or Loss

	Group	
	2005 \$'000	2004 \$'000
Analysis of financial assets at fair value through profit or loss:		
<i>Held for trading</i>		
Equity securities, at fair value		
– listed in Hong Kong	139,220	93,154
– listed outside Hong Kong	173,349	151,954
	312,569	245,108
<i>Held for trading</i>		
Debt securities, at fair value		
– listed in Hong Kong	86,509	–
– listed outside Hong Kong	1,070,100	1,278,858
– unlisted	1,172,015	1,200,195
	2,328,624	2,479,053
<i>Held for trading</i>		
Derivative financial instruments, at fair value		
– forward foreign exchange contracts	2,595	247
<i>Designated as financial assets at fair value through profit or loss</i>		
Bank deposits with embedded derivatives, at fair value (note a)	–	37,185
	2,643,788	2,761,593
Analysis of financial liabilities at fair value through profit or loss:		
<i>Held for trading</i>		
Derivative financial instruments, at fair value		
– forward foreign exchange contracts	1,443	10,749

- (a) The maximum exposure to credit risk of the bank deposits as at 31 December 2004 was \$37,185,000. No related credit derivatives or similar instruments were used to mitigate the maximum exposure to credit risk. There was no fair value change of the bank deposits attributable to changes in credit risk since its acquisition, during 2004 and up to its maturity in 2005, which was determined as the amount of change in its fair value that was not attributable to changes in market conditions that gave rise to market risk.

26. Accounts Payable, Accruals and Other Liabilities

	Group		HKEx	
	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000
Payable to Exchange and Clearing Participants:				
– CNS money obligations	2,889,524	4,261,382	–	–
– cash collateral and marks	144,144	95,677	–	–
– others	46,450	54,368	–	–
Transaction levy payable to the SFC	55,027	63,736	–	–
Unclaimed dividends (note b)	180,327	143,177	32,288	25,815
Stamp duty payable	75,899	70,854	–	–
Deposits received	22,156	29,376	–	–
Other payables and accruals	227,543	183,780	129,730	84,786
	3,641,070	4,902,350	162,018	110,601

- (a) The carrying amounts of accounts payable and other liabilities approximated their fair values.
- (b) Unclaimed dividends for the Group represent dividends declared by listed companies which were 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.
- (c) CNS money obligations payable accounted for 79 per cent (2004: 87 per cent) of the total accounts payable, accruals and other liabilities. CNS money obligations payable mature within two days after the trade date. The majority of the remaining accounts payable, accruals and other liabilities would mature within three months.

27. 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.

28. Provisions

(a) Group

	Reinstatement costs \$'000	Employee benefit costs \$'000	Total \$'000
At 1 Jan 2005	24,104	23,212	47,316
Provision for the year	1,492	34,403	35,895
Amount used during the year	(1,468)	(29,560)	(31,028)
Amount paid during the year	–	(2,442)	(2,442)
At 31 Dec 2005	24,128	25,613	49,741
		2005 \$'000	2004 \$'000
Analysis of provisions:			
Current		27,145	23,212
Non-current		22,596	24,104
		49,741	47,316

(b) HKEx

	Reinstatement costs \$'000	Employee benefit costs \$'000	Total \$'000
At 1 Jan 2005	555	23,212	23,767
Provision for the year	20	34,403	34,423
Amount used during the year	–	(29,560)	(29,560)
Amount paid during the year	–	(2,442)	(2,442)
At 31 Dec 2005	575	25,613	26,188
		2005 \$'000	2004 \$'000
Analysis of provisions:			
Current		25,613	23,212
Non-current		575	555
		26,188	23,767

29. Investments in and Amounts Due from/(to) Subsidiaries

(a) Investments in subsidiaries

	HKEx	
	2005 \$'000	As restated 2004 \$'000
Investments in unlisted shares, at cost	4,145,198	4,145,198
Financial guarantee granted to a subsidiary (note 40(b)(i))	11,390	11,390
	4,156,588	4,156,588

(b) Amounts due from/(to) subsidiaries

The amounts due from/(to) subsidiaries are interest-free and repayable on demand.

(c) Particulars of subsidiaries

HKEx had direct or indirect interests in the following subsidiaries as at 31 December 2005, 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 were 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%
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%

29. 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
HKEx (China) Limited	Ordinary \$2	Promotes HKEx products and services in the Mainland	100%
HKEx (Singapore) Limited	Ordinary \$2	Dormant	100%
Indirect subsidiaries:			
The SEHK Options Clearing House Limited	Ordinary \$1,000,000	Operates a clearing house for options contracts traded on the Stock Exchange	100%
HKEx Information Services Limited	Ordinary \$100	Sale of stock market information	100%
Prime View Company Limited	Ordinary \$20	Property holding	100%
The Stock Exchange Club Limited	Ordinary \$8	Property holding	100%
The Stock Exchange Nominee Limited	Ordinary \$2	Nominee services	100%
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%

29. Investments in and Amounts Due from/(to) Subsidiaries (Continued)

- (d) Effects on the consolidated accounts of consolidating the HKEx Employee Share Trust

The HKEx Employee Share Trust is a trust set up for the purpose of administering and holding HKEx shares for the Share Award Scheme, details of which are set out in note 31(c). As HKEx has the power to govern its financial and operating policies and can derive benefits from the contributions of the employees who have been awarded the Awarded Shares through their continued employment with the Group, the Group is required to consolidate the HKEx Employee Share Trust under HK(SIC)-INT 12 (Amendment). As at 31 December 2005, however, the HKEx Employee Share Trust was not consolidated as it was not a subsidiary under the Hong Kong Companies Ordinance.

The effects on the consolidated accounts had the HKEx Employee Share Trust been consolidated as at 31 December 2005 were as follows:

	Group	
	2005 \$'000	2004 \$'000
<i>Consolidated profit and loss account</i>		
Increase in investment income	11	—
Increase in other operating expenses	(1)	—
Total increase in profit	10	—
	Group	
	2005 \$'000	2004 \$'000
<i>Consolidated balance sheet</i>		
Increase/(decrease) in assets		
Contributions to The HKEx Employees' Share Award Scheme	(30,037)	—
Cash and cash equivalents	20	—
Increase/(decrease) in liabilities/equity		
Accounts payable, accruals and other liabilities	1	—
Treasury shares*	(30,028)	—
Retained earnings	10	—

- * The HKEx shares held by the HKEx Employee Share Trust are classified as "Treasury shares" and presented as a deduction of total equity. The amount represented the consideration paid and directly attributable incremental costs in acquiring the shares.

30. Share Capital and Share Premium

	Group and HKEx			
	2005 \$'000	2004 \$'000		
Authorised:				
2,000,000,000 shares of \$1 each	2,000,000	2,000,000		
Issued and fully paid:				
	Number of shares of \$1 each	Share capital \$'000	Share premium \$'000	Total \$'000
At 1 Jan 2004	1,048,998,846	1,048,999	54,338	1,103,337
Shares issued under employee share option schemes	7,640,000	7,640	49,696	57,336
At 31 Dec 2004	1,056,638,846	1,056,639	104,034	1,160,673
At 1 Jan 2005	1,056,638,846	1,056,639	104,034	1,160,673
Shares issued under employee share option schemes	6,116,000	6,116	41,263	47,379
Transfer from employee share- based compensation reserve	–	–	5,108	5,108
At 31 Dec 2005	1,062,754,846	1,062,755	150,405	1,213,160

During the year, employee share options granted under the Pre-Listing Scheme and the Post-Listing Scheme were exercised to subscribe for 6,116,000 shares (2004: 7,640,000 shares) in HKEx at an average consideration of \$7.75 per share (2004: \$7.50 per share), of which \$1.00 per share was credited to share capital and the balance was credited to the share premium account.

31. Employee Share-based Compensation Reserve

	Group		HKEx	
	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000
At 1 Jan	17,061	2,771	17,061	2,771
Employee share-based compensation benefits (note (a) and note 9(a))	22,955	14,290	22,955	14,290
Transfer to share premium upon exercise of employee share options	(5,108)	–	(5,108)	–
Share of reserve of an associate	72	–	–	–
At 31 Dec	34,980	17,061	34,908	17,061

31. Employee Share-based Compensation Reserve *(Continued)*

- (a) Employee share-based compensation benefits represent the fair value of employee services estimated to be received in exchange for the grant of the relevant options and Awarded Shares over the relevant vesting periods, the total of which is based on the fair value of the options and Awarded Shares at grant date. The amount for each period is determined by spreading the fair value of the options and Awarded Shares over the relevant vesting periods and is recognised as staff costs and related expenses (note 9(a)) with a corresponding increase in the employee share-based compensation reserve.

(b) Share options

- (i) Share options are granted to an Executive Director and employees of the Group to subscribe for shares in HKEx in accordance with the terms and conditions of the Share Option Schemes approved by the shareholders of HKEx at an extraordinary general meeting held on 31 May 2000. Share options granted are subject to a vesting scale in tranches of 25 per cent each per annum starting from the second anniversary and fully vested in the fifth anniversary of the date of grant, providing that the grantees remain under the employ of the Group. The vested share options are exercisable within ten years of the grant date.

During the year, options for the subscription of 5,884,000 shares were granted under the Post-Listing Scheme to a number of employees on 26 January 2005 which are exercisable between 26 January 2007 and 25 January 2015 at an exercise price of \$19.25 per share.

Shares are issued when options are exercised. The Group has no legal or constructive obligations to repurchase or settle the options in cash.

31. Employee Share-based Compensation Reserve (Continued)

(b) Share options (Continued)

- (ii) Movements in the number of shares issuable under options granted and their related weighted average exercise prices were as follows:

	2005		2004	
	Average exercise price per share \$	Number of shares issuable under options granted	Average exercise price per share \$	Number of shares issuable under options granted
Pre-Listing Scheme				
Outstanding at 1 Jan	6.88	6,680,000	7.52	14,171,626
Exercised	6.88	(4,554,000)	7.50	(7,640,000)
Forfeited	–	–	7.00	(524,829)
Adjusted*	–	–	N/A	673,203
Outstanding at 31 Dec	6.88	2,126,000	6.88	6,680,000
Post-Listing Scheme				
Outstanding at 1 Jan	13.78	13,218,000	11.26	5,800,000
Granted	19.25	5,884,000	17.21	6,888,000
Exercised	10.27	(1,562,000)	–	–
Forfeited	18.05	(966,000)	16.96	(106,000)
Adjusted*	–	–	N/A	636,000
Outstanding at 31 Dec	15.80	16,574,000	13.78	13,218,000
Total	14.79	18,700,000	11.46	19,898,000

* Adjustments approved by shareholders at the 2004 annual general meeting held on 31 March 2004

At 31 December 2005, out of the 18,700,000 outstanding options (2004: 19,898,000), 2,148,000 options (2004: 2,093,000 options) were exercisable at a weighted average exercise price of \$6.94 (2004: \$6.88) per share.

During the year, employee share options granted under the Pre-Listing Scheme and the Post-Listing Scheme were exercised to subscribe for 6,116,000 shares (2004: 7,640,000 shares) in HKEx at a weighted average exercise price of \$7.75 per share (2004: \$7.50 per share). The weighted average closing share price on the dates on which the options were exercised was \$21.06 (2004: \$18.45) per share.

31. Employee Share-based Compensation Reserve (Continued)**(b) Share options (Continued)**

(iii) Share options outstanding as at 31 December had the following remaining contractual lives and exercise prices:

	2005		2004	
	Remaining contractual life	Number of shares issuable under options granted	Remaining contractual life	Number of shares issuable under options granted
Exercise price				
\$6.88	4.41 years	2,126,000	5.41 years	6,680,000
\$8.28	7.33 years	2,460,000	8.33 years	3,280,000
\$12.45	7.62 years	844,000	8.62 years	1,094,000
\$12.49	7.63 years	1,476,000	8.63 years	1,968,000
\$17.30	8.04 years	1,094,000	9.04 years	1,094,000
\$16.96	8.24 years	5,074,000	9.24 years	5,582,000
\$15.91	8.37 years	200,000	9.37 years	200,000
\$19.25	9.07 years	5,426,000	–	–
	7.84 years	18,700,000	7.70 years	19,898,000

31. Employee Share-based Compensation Reserve *(Continued)*

(b) Share options *(Continued)*

- (iv) According to the Binomial Option Pricing Model, the value and adjusted value of the options granted during the year and 2004 were as follows:

	Date of grant			
	2005	2004		
	26 Jan 2005	15 Jan 2004	31 Mar 2004	17 May 2004
Option value ^Ω				
Before adjustment	\$26,183,800	\$6,550,000	\$32,250,960	\$1,156,000
After adjustment*	Not subject to adjustment	\$6,564,000	Not subject to adjustment	Not subject to adjustment
Variables				
Closing share price at date of grant	\$19.25	\$18.90	\$16.70	\$14.65
Risk Free Rate (being the yield of 10-year Exchange Fund Notes)	3.67% as at 26 Jan 2005	3.96% as at 15 Jan 2004	3.78% as at 31 Mar 2004	4.55% as at 17 May 2004
Expected Volatility [#]	26%	34%	35%	37%
Expiration of the options	10 years from 26 Jan 2005	10 years from 15 Jan 2004	10 years from 31 Mar 2004	10 years from 17 May 2004
Expected ordinary dividend	4.42% (2005 prospective dividend yield of the shares as at 26 Jan 2005)	3.23% (2004 prospective dividend yield of the shares as at 15 Jan 2004)	3.59% (2004 prospective dividend yield of the shares as at 31 Mar 2004)	3.77% (2004 prospective dividend yield of the shares as at 17 May 2004)

* Adjustments approved by the shareholders at the 2004 annual general meeting held on 31 March 2004

The volatility measured at the standard deviation of expected share price returns is based on statistical analysis of daily share prices annualised for one year immediately preceding the grant date.

^Ω The above calculation is based on the assumption that there is no material difference between the expected volatility over the whole life of the options and the historical volatility of the shares in HKEx set out above.

31. Employee Share-based Compensation Reserve (Continued)

(b) Share options (Continued)

- (v) Had all the outstanding employee share options been fully exercised on 31 December 2005, the Group would have received \$276,552,460 in proceeds. The market value of the shares issued based on the closing price of \$32.15 per share on that date would have been \$601,205,000. The theoretical gains made by the employees or Executive Director concerned would have been as follows:

	Number of shares issuable under options granted as at 31 Dec 2005	Exercise price \$	Gain per share \$	Aggregate gain \$'000
Pre-Listing Scheme				
– granted to employees on 20 Jun 2000	2,126,000	6.88	25.27	53,724
Post-Listing Scheme				
– granted to an Executive Director on 2 May 2003	2,460,000	8.28	23.87	58,720
– granted to an employee on 14 Aug 2003	844,000	12.45	19.70	16,627
– granted to an employee on 18 Aug 2003	1,476,000	12.49	19.66	29,018
– granted to an employee on 15 Jan 2004	1,094,000	17.30	14.85	16,246
– granted to employees on 31 Mar 2004	5,074,000	16.96	15.19	77,074
– granted to an employee on 17 May 2004	200,000	15.91	16.24	3,248
– granted to employees on 26 Jan 2005	5,426,000	19.25	12.90	69,996
Total	18,700,000			324,653

(c) Awarded Shares

- (i) On 14 September 2005, the Board of HKEx approved the Share Award Scheme under which Awarded Shares may be awarded to an Executive Director and employees of the Group in accordance with the terms and conditions of the Share Award Scheme. Awarded Shares awarded are subject to a vesting scale in tranches of 25 per cent each per annum starting from the second anniversary and fully vested in the fifth anniversary of the date of award, providing that the awardees remain under the employ of the Group.

Pursuant to the rules of the Share Award Scheme, upon awarding of the Awarded Shares, the number of HKEx shares awarded will be acquired from the market at the cost of HKEx by the trustee of the HKEx Employee Share Trust, which has been set up for the purpose of administering the Share Award Scheme. The Awarded Shares will be held by the trustee until the end of each vesting period.

On 19 December 2005, 960,000 Awarded Shares were awarded to a number of employees, which will be transferred to the employees at nil consideration upon vesting between 19 December 2007 and 19 December 2010. As at 31 December 2005, the Group had advanced \$30,037,000 to the HKEx Employee Share Trust and the amount was recorded as “Contributions to The HKEx Employees’ Share Award Scheme” in the consolidated balance sheet. The trustee acquired 958,000 HKEx shares in December 2005 and the remaining 2,000 shares in January 2006.

31. Employee Share-based Compensation Reserve *(Continued)*

(c) Awarded Shares *(Continued)*

- (ii) Movements in the number of Awarded Shares awarded and their related average fair value were as follows:

	2005		2004	
	Average fair value per share \$	Number of Awarded Shares awarded	Average fair value per share \$	Number of Awarded Shares awarded
Outstanding at 1 Jan	–	–	–	–
Awarded	31.20	960,000	–	–
Outstanding at 31 Dec	31.20	960,000	–	–

The fair value of the Awarded Shares awarded under the Share Award Scheme was based on the fair value (i.e. market value) of HKEx shares at award date, taking into account the expected dividends during the vesting periods.

- (iii) The remaining vesting periods of the Awarded Shares outstanding as at 31 December 2005 ranged from 1.97 years to 4.97 years.
- (iv) Had all the outstanding Awarded Shares been fully vested on 31 December 2005, the theoretical benefits of the employees based on the closing price of \$32.15 per share on that date would have been \$30,864,000.

32. Revaluation Reserves

	Group		Total \$'000
	Leasehold buildings revaluation reserve \$'000	Investment revaluation reserve \$'000	
At 1 Jan 2004	2,507	33,992	36,499
Change in valuation of leasehold buildings (note 17(a)(iii))	36	–	36
Change in fair value of available-for-sale financial assets	–	10,535	10,535
Realisation of change in fair value of financial assets on maturity and disposal	–	(26,741)	(26,741)
Deferred tax arising from change in valuation of leasehold buildings (note 36(b))	(6)	–	(6)
Deferred tax arising from change in fair value of available-for-sale financial assets (note 36(b))	–	(1,494)	(1,494)
At 31 Dec 2004	2,537	16,292	18,829
At 1 Jan 2005	2,537	16,292	18,829
Change in valuation of leasehold buildings (note 17(a)(iii))	(377)	–	(377)
Change in fair value of available-for-sale financial assets	–	(52,985)	(52,985)
Realisation of change in fair value of available-for-sale financial assets on maturity and disposal	–	(5,775)	(5,775)
Deferred tax arising from change in valuation of leasehold buildings (note 36(b))	65	–	65
Deferred tax arising from change in fair value of available-for-sale financial assets (note 36(b))	–	3,136	3,136
Share of reserve of an associate	–	21	21
At 31 Dec 2005	2,225	(39,311)	(37,086)

- (a) The revaluation reserves are segregated for their respective specific purposes and are stated net of applicable deferred taxes.
- (b) Included gross investment revaluation deficits of \$1,317,000 and \$10,000 which were attributable to investments of the Clearing House Funds and the Compensation Fund Reserve Account respectively (2004: gross surpluses of \$2,109,000 and \$334,000 respectively). The significant decrease in investment revaluation reserve was primarily due to the decrease in fair value of available-for-sale financial assets of the Margin Funds arising mainly from increases in interest rates during the year. The revaluation deficit is not expected to have any impact to the Group's profit and loss account as the available-for-sale financial assets are expected to be held till maturity and the deficit will gradually reduce to zero (note 3(b)).

33. Hedging Reserve

	Group		HKEx	
	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000
At 1 Jan	–	–	–	–
Cash flow hedges:				
– fair value loss of hedging instrument	(129)	–	(332)	–
– transfer to profit and loss account as information technology and computer maintenance expenses	129	–	332	–
At 31 Dec	–	–	–	–
Fair value of hedging instrument at 31 Dec	8,281	–	8,281	–
Ineffectiveness of cash flow hedge credited to profit and loss account	1	–	3	–

During the year, one of the subsidiaries designated a bank deposit of 8,500,000 Swedish Krona (“SEK”) as a cash flow hedge for hedging the foreign exchange risk of forecast information technology and computer maintenance expenses payable of SEK 8,500,000 from 1 August 2005 to 31 December 2005. On 29 August 2005, the said bank deposit was transferred to HKEx without changing the terms of the cash flow hedge.

34. Designated Reserves

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

	Group				
	Clearing House Funds reserves (note a) \$'000	Compensation Fund Reserve Account reserve \$'000	CDMD Fund reserve \$'000	Development reserve (note b) \$'000	Total \$'000
At 1 Jan 2004	565,666	36,541	914	86,536	689,657
(Deficit)/surplus of investment income net of expenses transferred from retained earnings	(5,040)	576	–	–	(4,464)
Transfer to retained earnings	–	–	(914)	(3,283)	(4,197)
Transfer (to)/from retained earnings	(5,040)	576	(914)	(3,283)	(8,661)
At 31 Dec 2004	560,626	37,117	–	83,253	680,996
At 1 Jan 2005	560,626	37,117	–	83,253	680,996
Surplus of investment and other income net of expenses transferred from retained earnings	29,350	1,303	–	–	30,653
Transfer to retained earnings	–	–	–	(11,008)	(11,008)
Transfer from/(to) retained earnings	29,350	1,303	–	(11,008)	19,645
At 31 Dec 2005	589,976	38,420	–	72,245	700,641

34. Designated Reserves (Continued)

(a) Clearing House Funds reserves

	HKSCC Guarantee Fund reserve \$'000	SECH Reserve Fund reserve \$'000	HKCC Reserve Fund reserve \$'000	Total \$'000
At 1 Jan 2004	255,912	48,571	261,183	565,666
(Deficit)/surplus of investment income net of expenses of Clearing House Funds transferred from retained earnings	(8,059)	203	2,816	(5,040)
At 31 Dec 2004	247,853	48,774	263,999	560,626
At 1 Jan 2005	247,853	48,774	263,999	560,626
Surplus of investment income net of expenses of Clearing House Funds transferred from retained earnings	2,591	7,572	19,187	29,350
At 31 Dec 2005	250,444	56,346	283,186	589,976

(b) Development reserve

The reserve was set aside for systems development for the Stock Exchange. During 2005, \$11,008,000 (2004: \$3,283,000) of the reserve was utilised and transferred to the Group's retained earnings (note 37) for funding systems development projects related to the securities market.

35. 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 37(c).

36. 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 (2004: 17.5 per cent).

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

	Group		HKEx	
	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000
At 1 Jan	29,649	53,515	(1,227)	150
Transfer to the profit and loss account (note 15(a))	(8,738)	(25,366)	(1,740)	(1,377)
Transfer (to)/from shareholders' equity (note b)	(3,201)	1,500	–	–
At 31 Dec (note c)	17,710	29,649	(2,967)	(1,227)

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

	Group	
	2005 \$'000	2004 \$'000
Reserves in shareholders' equity:		
– leasehold buildings revaluation reserve (note 32)	(65)	6
– investment revaluation reserve (note 32)	(3,136)	1,494
	(3,201)	1,500

(c) Deferred tax assets are recognised for tax losses carried forward to the extent that realisation of the related tax benefit through future taxable profits is probable. The Group had unrecognised tax losses of \$276,331,000 as at 31 December 2005 (2004: \$208,207,000) carried forward for offsetting against future taxable income.

36. Deferred Taxation (Continued)

(d) The movements on the deferred tax liabilities/(assets) account were as follows:

	Group											
	Accelerated tax depreciation		Revaluation of properties		Tax losses		Revaluation of available-for-sale financial assets		Employee benefits		Total	
	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000
At 1 Jan	38,085	63,853	1,663	1,021	(9,158)	(8,856)	3,121	1,627	(4,062)	(4,130)	29,649	53,515
Charged/(credited) to profit and loss account	(13,033)	(25,768)	693	636	4,022	(302)	-	-	(420)	68	(8,738)	(25,366)
Charged/(credited) to equity	-	-	(65)	6	-	-	(3,136)	1,494	-	-	(3,201)	1,500
At 31 Dec	25,052	38,085	2,291	1,663	(5,136)	(9,158)	(15)	3,121	(4,482)	(4,062)	17,710	29,649

	HKEx							
	Accelerated tax depreciation		Tax losses		Employee benefits		Total	
	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000
At 1 Jan	2,835	4,825	-	(545)	(4,062)	(4,130)	(1,227)	150
Charged/(credited) to profit and loss account	(1,320)	(1,990)	-	545	(420)	68	(1,740)	(1,377)
At 31 Dec	1,515	2,835	-	-	(4,482)	(4,062)	(2,967)	(1,227)

(e) Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred taxes relate to the same fiscal authority. The following amounts, determined after appropriate offsetting, are shown in the balance sheet:

	Group		HKEx	
	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000
Net deferred tax assets recognised on the balance sheet	(3,060)	(1,227)	(2,967)	(1,227)
Net deferred tax liabilities recognised on the balance sheet	20,770	30,876	-	-
	17,710	29,649	(2,967)	(1,227)

37. Retained Earnings (Including Proposed/Declared Dividends)

	Group		HKEx	
	2005 \$'000	As restated 2004 \$'000	2005 \$'000	2004 \$'000
At 1 Jan, as previously reported				
Retained earnings/ (accumulated losses)	1,677,964	1,578,991	(272,421)	(1,825,358)
Proposed/declared dividends	496,620	2,202,898	496,620	2,202,898
	2,174,584	3,781,889	224,199	377,540
Effect of initial adoption of HKAS 39 and HKFRS 4 (Amendment)	(19,909)	(19,909)	–	–
At 1 Jan, as restated	2,154,675	3,761,980	224,199	377,540
Profit for the year	1,339,548	1,056,884	1,032,260	2,519,509
(Surplus)/deficit of investment income net of expenses of Clearing House Funds transferred to Clearing House Funds reserves	(29,350)	5,040	–	–
Investment and other income net of expenses of Compensation Fund Reserve Account transferred to Compensation Fund Reserve Account reserve	(1,303)	(576)	–	–
Transfer from CDMD Fund reserve	–	914	–	–
Transfer from Development reserve	11,008	3,283	–	–
Dividends paid:				
2004 final dividend/2003 special and final dividends	(496,620)	(2,202,898)	(496,620)	(2,202,898)
Dividend on shares issued for employee share options exercised after 31 Dec 2004/2003	(1,597)	(15,661)	(1,597)	(15,661)
	(498,217)	(2,218,559)	(498,217)	(2,218,559)
2005/2004 interim dividend	(519,988)	(454,283)	(519,988)	(454,283)
Dividend on shares issued for employee share options exercised after 30 Jun 2005/2004	(579)	(8)	(579)	(8)
	(520,567)	(454,291)	(520,567)	(454,291)
At 31 Dec	2,455,794	2,154,675	237,675	224,199
Representing:				
Retained earnings/ (accumulated losses)	1,775,631	1,658,055	(442,488)	(272,421)
Proposed/declared dividends	680,163	496,620	680,163	496,620
At 31 Dec	2,455,794	2,154,675	237,675	224,199

37. Retained Earnings (Including Proposed/Declared Dividends)

(Continued)

- (a) Profit attributable to shareholders included a profit of \$1,032,260,000, of which \$1,020,000,000 was dividends from subsidiaries (2004: \$2,519,509,000, of which \$2,505,957,000 was dividends from subsidiaries), which has been dealt with in the accounts of HKEx, the holding company of the Group.
- (b) The Group's profit after taxation included a net profit attributable to the investment and other income net of expenses after taxation of the Clearing House Funds, Compensation Fund Reserve Account and CDMD Fund for an aggregate amount of \$30,653,000 (2004: deficit of \$2,182,000).
- (c) The negative 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 35) and retained earnings of \$1,119,321,000.

38. Notes to the Consolidated Cash Flow Statement

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

	2005 \$'000	2004 \$'000
Profit before taxation	1,567,008	1,250,525
Adjustments for:		
Net interest income	(210,385)	(81,865)
Dividends from available-for-sale financial assets	–	(1,070)
Net realised and unrealised gains and interest income on financial assets and financial liabilities at fair value through profit or loss	(82,495)	(114,358)
Gain on disposal of available-for-sale financial assets	–	(24,841)
Amortisation of lease premiums for land	548	548
Fair value gain of an investment property	(4,400)	(3,300)
Depreciation	150,995	183,400
Employee share-based compensation benefits (Reversal of provision for)/provision for impairment loss of club debenture	22,955	14,290
Impairment losses of leasehold buildings	(5)	75
Reversal of provision for impairment losses of trade receivables	837	–
Changes in provisions	(389)	(850)
Share of profits less losses of associates	933	(526)
(Gain)/loss on disposal of fixed assets	(18,433)	(12,884)
	(38)	24
Operating profit before working capital changes	1,427,131	1,209,168
Net decrease in financial assets and financial liabilities at fair value through profit or loss	80,699	548,516
Settlement of amount transferred (from)/to retained earnings for Clearing House Funds and Compensation Fund Reserve Account	(21,842)	4,464
Settlement of amount transferred from CDMD Fund reserve to retained earnings	–	914
Contributions to The HKEx Employees' Share Award Scheme	(30,037)	–
Decrease/(increase) in accounts receivable, prepayments and deposits	1,357,096	(108,478)
(Decrease)/increase in other current liabilities	(1,261,361)	135,824
Net cash inflow from operations	1,551,686	1,790,408
Interest received	246,729	26,481
Cash received on financial assets at fair value through profit or loss	79,456	75,877
Interest paid	(125,897)	(1,181)
Hong Kong Profits Tax paid	(352,076)	(75,232)
Net cash inflow from operating activities	1,399,898	1,816,353

(b) 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 did not constitute any cash or cash equivalent transactions to the Group.

39. Commitments

- (a) Commitments in respect of capital expenditures:

	Group		HKEx	
	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000
Contracted but not provided for	18,130	4,484	3	–
Authorised but not contracted for	118,838	73,554	22,647	12,898
	136,968	78,038	22,650	12,898

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

- (b) Commitments for total future minimum lease payments under operating leases and computer maintenance contracts

- (i) Land and buildings

	Group		HKEx	
	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000
Payable				
– within one year	82,483	45,844	1,590	1,307
– in the second to fifth years	157,989	10,060	476	1,278
	240,472	55,904	2,066	2,585

39. Commitments *(Continued)*

- (b) Commitments for total future minimum lease payments under operating leases and computer maintenance contracts *(Continued)*

- (ii) Computer systems and equipment

The Group is heavily reliant on the capability and reliability of its computer systems for its business operations, including those required for its electronic trading platforms and post-trading clearing and settlement services. In order to maintain the high standard of performance of the systems, the Group has entered into various maintenance and operating lease contracts with its vendors. The future minimum payments under maintenance contracts and operating leases (including licenses) in respect of computer systems and equipment were as follows:

	Group		HKEx	
	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000
Operating leases in respect of computer systems and equipment, payable				
– within one year	9,570	17,626	8,642	9,326
– in the second to fifth years	754	2,827	754	2,667
	10,324	20,453	9,396	11,993
Maintenance contracts in respect of computer systems and equipment, payable				
– within one year	25,981	47,212	14,384	33,723
– in the second to fifth years	12,324	36,194	4,930	14,472
	38,305	83,406	19,314	48,195
	48,629	103,859	28,710	60,188

As at 31 December 2005, in respect of computer systems and equipment, the majority of the leases would mature within one year (2004: two years) and the Group did not have any purchase options.

40. Contingent Liabilities

(a) Group

- (i) The Compensation Fund is a fund set up under the repealed SO for the purpose of compensating any person (other than a Stock Exchange Participant) dealing with a Stock Exchange Participant for any pecuniary losses suffered as a result of a default by 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, and with the approval of the SFC, allow an additional payment to successful claimants before apportionment. Under section 107(1) of the SO, the Stock Exchange has contingent liabilities to the Compensation Fund as it is obligated to replenish the Compensation Fund upon the SFC's request. 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 2005, there were outstanding claims received in respect of 5 Stock Exchange Participants (2004: 10).

Pursuant to the SFO, the Stock Exchange issued a notice on 3 April 2003 inviting 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 were received in response to that notice. Claims made after the claims period are, unless the Stock Exchange otherwise determines, barred. As at 31 December 2005, no such claims had been received in response to the said notice.

Following the implementation of the new compensation arrangements under the SFO, an Investor Compensation Fund has been established to replace the existing Compensation Fund, the Commodity Exchange Compensation Fund and the Dealers' Deposit Schemes for non-exchange participant dealers. Pursuant to the SFO, Exchange Participants are no longer required to make deposits to the Investor Compensation Fund and the Stock Exchange is not required to replenish the Investor Compensation Fund. Hence, deposits to the Commodity Exchange Compensation Fund were 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. Similarly, deposits to the Compensation Fund would be returned to the Stock Exchange in accordance with the SFO pending completion of any determination of outstanding claims and replenishment to the 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 the default of any one Participant. In the unlikely event that all of its 429 trading Participants as at 31 December 2005 (2004: 434) defaulted, the maximum contingent liability of the Stock Exchange under the indemnity would amount to \$86 million (2004: \$87 million).

The carrying amount of the financial guarantee contract recognised in the consolidated balance sheet in accordance with HKAS 39 and HKFRS 4 (Amendment) was \$19,909,000 (2004: \$19,909,000).

40. Contingent Liabilities *(Continued)*

(a) Group *(Continued)*

- (iii) In May 2005, the Court of Appeal issued its judgement in the New World Development Company Limited and others (“New World”) judicial review appeal case. The Court allowed the appeal and quashed the direction of the Chairman of the Listing (Disciplinary) Committee in the New World disciplinary proceedings that legal advisers not be permitted to address the Listing (Disciplinary) Committee. New World was awarded costs which are presently unknown but estimated to be in the region of \$4 million. The Stock Exchange has been granted leave to appeal to the Court of Final Appeal. The appeal is set down to be heard by the Court of Final Appeal on 21 and 22 March 2006. In the opinion of external legal counsel, the Stock Exchange has valid grounds for an appeal, a reasonable prospect of success and consequently it is not probable that the Stock Exchange will be required to bear the costs incurred by New World in the legal proceedings. Accordingly, no provision for such costs has been made in the accounts.

(b) Group and HKEx

- (i) 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.

The carrying amount of the financial guarantee contract recognised in HKEx’s balance sheet in accordance with HKAS 39 and HKFRS 4 (Amendment) was \$11,390,000 (2004: \$11,390,000). The financial guarantee contract was eliminated on consolidation.

41. Future Operating Lease Arrangements

As at 31 December, the Group had the following future aggregate minimum lease receipts under non-cancellable operating leases:

	Group	
	2005 \$’000	2004 \$’000
Land and buildings		
– within one year	444	501
– in the second to fifth years	–	439
	444	940
Trading booths and related facilities		
– within one year	9,061	–
– in the second to fifth years	19,264	–
	28,325	–
Total	28,769	940

42. Non-cash Collateral Received from Participants

Under existing rules of the clearing houses, Participants may lodge cash or approved non-cash collateral to satisfy their Clearing House contributions and Margin Fund obligations. In accordance with HKAS 39, only cash collateral is recognised as assets and liabilities on the consolidated balance sheet.

As at 31 December, the amount of non-cash collateral received from Participants and the amount utilised for covering part of their Clearing House Fund contributions and Margin Fund obligations were as follows:

	Group			
	2005		2004	
	Amount received \$'000	Amount utilised \$'000	Amount received \$'000	Amount utilised \$'000
Clearing House Funds				
Bank guarantees	333,900	58,603	392,910	322,724
Margin Funds				
Equity securities, listed in				
Hong Kong	439,591	–	610,318	3,736
US Treasury Bills	191,965	141,086	504,287	456,996
Bank guarantees	100,000	–	100,000	–
	731,556	141,086	1,214,605	460,732
	1,065,456	199,689	1,607,515	783,456

43. Connected Transactions and Material Related Party Transactions

(a) Connected transactions and material related party transactions

- (i) Certain Directors of HKEx are investor participants of HKSCC (“Investor Participants”) or directors and/or shareholders of (i) Stock Exchange Participants and Futures Exchange Participants (“Exchange Participants”), Clearing Participants and Investor 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, Clearing Participants and Investor Participants, fees levied on these listed companies and fees paid to these Exchange Participants for buying shares on behalf of HKSCC are all undertaken in the ordinary course of business of the Group on the standard terms and conditions applicable to all other Exchange Participants, Clearing Participants, Investor Participants, listed companies and Exchange Participants for buying shares on behalf of HKSCC.

Certain transactions undertaken during the year were regarded as related party transactions in accordance with HKAS 24 but the amounts were immaterial. Certain transactions fell under the definition of continuing connected transactions under the Listing Rules are disclosed in the Corporate Governance Report.

43. Connected Transactions and Material Related Party Transactions

(Continued)

(a) Connected transactions and material related party transactions (Continued)

- (ii) During the year, the Group also entered into the following material transactions with entities that were both related parties and connected persons as one of their directors was a director of HKEx:

	Group	
	2005 \$'000	2004 \$'000
Rental payments (including air conditioning and cleaning service charges) to Shine Hill Development Limited ("Shine Hill")	5,327	4,698

On 5 February 2003, the Futures Exchange as the tenant entered into a tenancy agreement ("Lease") with Shine Hill as the landlord. The Lease expired on 31 December 2004 and was subsequently renewed for a further term of two years commencing 1 January 2005 ("New Lease"). The Futures Exchange is a wholly-owned subsidiary of HKEx. Shine Hill is a subsidiary of Great Eagle Holdings Limited ("Great Eagle"). Dr LO Ka Shui is an Independent Non-executive Director of HKEx and the deputy chairman, managing director and substantial shareholder of Great Eagle. The Lease and the New Lease were arm's length transactions entered into on normal commercial terms. The transaction was a related party transaction in accordance with HKAS 24 and a continuing connected transaction as defined under the Listing Rules.

(b) Material related party transactions

In addition to the above, the Group or HKEx entered into certain material related party transactions which were not regarded as connected transactions as defined under the Listing Rules. Details of such transactions are set out below.

(i) Transactions with an associate and subsidiaries

	Group		HKEx	
	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000
Income received and receivable from/ (expenses paid and payable to) an associate, CHIS:				
– Dividend income	17,952	10,801	–	–
– Share registration service fees	(439)	(354)	(439)	(354)
Transactions with subsidiaries:				
– Management fee and equipment rental fee charged to subsidiaries	–	–	250,352	246,172
– Expenses recharged to subsidiaries	–	–	657,734	633,545

43. Connected Transactions and Material Related Party Transactions

(Continued)

(b) Material related party transactions (Continued)

(ii) Key management personnel compensation

	Group		HKEx	
	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000
Salaries and other short-term employee benefits	55,649	51,884	49,124	43,136
Employee share-based compensation benefits	9,199	8,439	8,664	8,137
Termination benefits	–	1,569	–	750
Retirement benefit costs	5,475	5,425	4,786	4,491
	70,323	67,317	62,574	56,514

(iii) Amounts due from/(to) related parties

	Group		HKEx	
	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000
Amounts due from:				
– An associate	5,284	–	–	–
– Subsidiaries	–	–	583,102	497,463
– Related companies with common directors	867	867	–	–
Amounts due to:				
– An associate	(14)	(55)	(14)	(55)
– Subsidiaries	–	–	(183,116)	(180,603)
– Related companies with common directors	(113)	(144)	–	–

(iv) Post-retirement benefit plans

Details of transactions with the Group's post-retirement benefit plans are included in note 9(b).

(v) Save as aforesaid, the Group and HKEx have entered into other transactions in the ordinary course of business with companies where there are common directors but the amounts were immaterial.

44. Banking Facilities with Assets Pledged

The Group did not have any assets pledged as at 31 December 2004 and 31 December 2005.

45. Capital Management

The Group's objectives when managing capital are:

- To safeguard the Group's ability to continue as a going concern, so that it continues to provide returns for shareholders and benefits for other stakeholders;
- To support the Group's stability and growth; and
- To provide capital for the purpose of strengthening the Group's risk management capability.

The Group actively and regularly reviews and manages its capital structure to ensure optimal capital structure and shareholder returns, taking into consideration the future capital requirements of the Group and capital efficiency, prevailing and projected profitability, projected operating cash flows, projected capital expenditures and projected strategic investment opportunities. The Group adopts a dividend policy of providing shareholders with regular dividends with a target payout ratio of 90 per cent of the profit of the year, while retaining 10 per cent of the profit as capital of the Group for future use. The Group has set aside \$1,500 million of retained earnings for the purpose of strengthening the risk management regime of the clearing houses and supporting their roles as central counterparties.

As in prior years, the Group monitors capital by reviewing the level of capital that is at the disposal of the Group ("adjusted capital"). Adjusted capital comprises all components of shareholders' equity other than the hedging reserve relating to cash flow hedges, designated reserves and investment revaluation reserve of the Clearing House Funds and Compensation Fund Reserve Account net of applicable deferred taxes. The adjusted capital of the Group at 31 December 2005 and at 31 December 2004 was \$3,668,160,000 and \$3,349,209,000 respectively.

46. Financial Risk Management

The Group's activities expose it to a variety of financial risks: market risk (including foreign exchange risk, equity price risk and interest rate risk), liquidity risk and credit risk. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's performance.

The Group's investment policy is to prudently invest all funds managed by the Group in a manner which will satisfy liquidity requirements, safeguard financial assets and manage risks while optimising return on investments.

Investment and fund management is governed by investment policies and risk management guidelines 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 risks (e.g. permissible asset type, asset allocation, liquidity, credit, counterparty concentration, maturity, foreign exchange and interest rate risks) of the investments.

46. Financial Risk Management *(Continued)*

(a) Market risk

Market risk is the risk of loss arising from movements in observable market variables such as foreign exchange rates, equity and commodity prices and interest rates. The Group is exposed to market risk primarily through its investments held.

Funds available for investment comprise three main categories: Corporate Funds (mainly share capital and retained earnings of the Group), Clearing House Funds and Margin Funds received (which exclude non-cash collateral and contributions receivable from Participants).

An Investment Advisory Committee, comprised of Non-executive Directors of HKEx and an external member from the financial community, advises the Board on portfolio management and monitors the risk and performance of HKEx's investments. A Treasury team in the Finance Department 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. The external fund managers are stable and financially strong financial institutions and each has a worldwide aggregate fund size of a minimum of US\$10 billion under management.

(i) Foreign exchange risk

Foreign exchange risk is the risk of loss due to adverse movements in foreign exchange rates relating to investments and transactions denominated in foreign currencies. When seeking to optimise the returns on its funds available for investment, the Group may invest in non-HKD securities from time to time. Forward foreign exchange contracts and foreign currency deposits have been used to hedge the currency exposure of the Group's non-HKD investments, highly probable forecast transactions and liabilities to mitigate risks arising from fluctuations in exchange rates. Details of the exposure of foreign exchange risk and outstanding forward foreign exchange contracts of the Group and HKEx as at 31 December were as follows:

	Group		HKEx	
	2005 \$ million	2004 \$ million	2005 \$ million	2004 \$ million
Aggregate net open foreign currency positions (total)	2,031	1,996	1	4
Aggregate net open foreign currency positions (non-USD exposures)	160	170	1	4
Total nominal value of outstanding forward foreign exchange contracts	275	358	–	–
Maximum contractual maturity of forward foreign exchange contracts	One month	One month	N/A	N/A

46. Financial Risk Management *(Continued)*

(a) Market risk *(Continued)*

(i) Foreign exchange risk *(Continued)*

Foreign currency margin deposits received by the Group are hedged by investments in the same currencies.

During the year, one of the subsidiaries designated a bank deposit of SEK 8,500,000 as a cash flow hedge for hedging the foreign exchange risk of SEK 8,500,000 of forecast information technology and computer maintenance expenses payable from 1 August 2005 to 31 December 2005. On 29 August 2005, the said bank deposit was transferred to HKEx without changing the terms of the cash flow hedge.

During the year, the Group and HKEx designated another bank deposit of SEK 11,000,000 as a fair value hedge to hedge against the foreign exchange risk of a financial liability of the Group and HKEx of SEK 11,000,000. The fair value loss on the bank deposit designated as hedging instrument was \$569,000 (2004: \$Nil) whereas the fair value gain on the financial liability being hedged was \$569,000 (2004: \$Nil) during the year. The fair value of the deposit as at 31 December 2005 was \$10,717,000 (2004: \$Nil).

(ii) Equity and commodity price risk

The Group is exposed to equity price risk as equities are held as part of the Corporate Fund's investments. Equity price risk is capped by an asset allocation limit. The Group is not exposed to commodity price risk as investment in commodities is not permitted under the Group's Investment Policy.

(iii) Interest rate risks

There are two types of interest rate risk:

- Fair value interest rate risk – the risk that the value of a financial instrument will fluctuate because of changes in market interest rates; and
- Cash flow interest rate risk – the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Group is exposed to both fair value and cash flow interest rate risks as the Group has significant assets and liabilities which are interest-bearing.

46. Financial Risk Management *(Continued)*

(a) Market risk *(Continued)*

(iv) Risk management

Risk management techniques, such as Value-at-Risk (“VaR”) based on historical simulation and portfolio stress testing, are used to identify, measure and control foreign exchange risk, equity price risk and interest rate risks of the Group’s investments. VaR measures the expected maximum loss over a given time interval (a holding period of 10 trading days is used by the Group) at a given confidence level (95 per cent confidence interval is adopted by the Group) based on historical data (one year is used by the Group). The Board sets a limit on total VaR of the Group and VaR is monitored on a weekly basis.

VaR is a statistical measure of risks and has limitations associated with the assumptions employed. Historical simulation assumes that actual observed historical changes in market indices, such as interest rates, foreign exchange rates and equity prices reflect possible future changes. This implies that the approach is vulnerable to sudden changes in market behaviour. The use of a 10-day holding period assumes that the positions can be unwound in 10 trading days and the holding period may be insufficient at times of severe illiquidity. Also, VaR does not necessarily reflect all aspects of risks that affect the price of financial instruments and may underestimate real market risk exposure. In addition, VaR does not factor in the possibility of catastrophic risk but the use of stress testing for abnormal market conditions can mitigate this limitation.

The VaR for each risk factor and the total VaR of the investments of the Group and HKEx during the year were as follows:

	Group			HKEx		
	2005			2005		
	Average \$million	Highest \$million	Lowest \$million	Average \$million	Highest \$million	Lowest \$million
Foreign exchange risk	5.0	6.1	3.6	0.2	0.7	–
Equity price risk	8.5	11.2	6.6	–	–	–
Interest rate risk	20.5	24.0	14.4	–	–	–
Total VaR	23.5	26.9	20.4	0.2	0.7	–

VaR for each risk factor is the independently derived largest potential loss due to fluctuations solely in that risk factor. The individual VaRs did not add up to the total VaR as there was diversification effect due to correlation amongst the risk factors. Moreover, in respect of the highest and lowest VaRs during the year, the highest and lowest VaRs in each market did not necessarily occur on the same day.

46. Financial Risk Management *(Continued)*

(b) Liquidity risk

Liquidity risk is the risk that funds will not be available to meet liabilities as they fall due, and it results from amount and maturity mismatches of assets and liabilities. Investments of the Group are kept sufficiently liquid to meet the operating needs and possible liquid requirements of the Clearing House Funds and Margin Funds. The Group also sets a limit on the minimum level of cash or bank deposits held for the Corporate Funds, and the minimum level of investments to be held that would mature the same day and the next day for the Clearing House Funds and Margin Funds.

The financial liabilities of the Group and HKEx as at 31 December 2005 are analysed into relevant maturity buckets based on their contractual maturity dates in the table below:

	Group 2005				
	Up to 1 month \$'000	>1 month to 3 months \$'000	>3 months to 1 year \$'000	Not determinable \$'000	Total \$'000
Current liabilities					
Margin deposits from Clearing Participants	13,648,581	–	–	–	13,648,581
Accounts payable, accruals and other liabilities	3,596,564	30,405	191	13,910	3,641,070
Financial liabilities at fair value through profit or loss (note i)	153,973	–	–	–	153,973
Participants' admission fees received	900	150	1,300	200	2,550
	17,400,018	30,555	1,491	14,110	17,446,174
Non-current liabilities					
Participants' admission fees received	–	–	–	80,150	80,150
Participants' contributions to Clearing House Funds	–	–	–	751,751	751,751
Financial guarantee contract (note ii)	–	–	–	85,800	85,800
	–	–	–	917,701	917,701
Total	17,400,018	30,555	1,491	931,811	18,363,875

46. Financial Risk Management *(Continued)***(b) Liquidity risk** *(Continued)*

	HKEx				
	2005				
	Up to 1 month \$'000	>1 month to 3 months \$'000	>3 months to 1 year \$'000	Not determinable \$'000	Total \$'000
Current liabilities					
Accounts payable, accruals and other liabilities	162,018	–	–	–	162,018
Amounts due to subsidiaries	183,116	–	–	–	183,116
	345,134	–	–	–	345,134
Non-current liabilities					
Financial guarantee contract (note ii)	–	–	–	50,000	50,000
	–	–	–	50,000	50,000
Total	345,134	–	–	50,000	395,134

- (i) The amount disclosed is based on the gross contractual amounts to be exchanged under the forward foreign exchange contracts under financial liabilities at fair value through profit or loss, which is different from the carrying amount (i.e. fair value) in the consolidated balance sheet. The corresponding gross contractual amounts receivable under these forward foreign exchange contracts were \$152,530,000.
- (ii) The amount disclosed for financial guarantee contracts represented the amount of contingent liabilities at the balance sheet date.

The Group employs projected cash flow analysis to manage liquidity risk by forecasting the amount of cash required and monitoring the working capital of the Group to ensure that all liabilities due and known funding requirements could be met. In addition, banking facilities have been put in place for contingency purposes. As at 31 December 2005, the Group's total available banking facilities amounted to \$1,608 million (2004: \$1,608 million), of which \$1,500 million (2004: \$1,500 million) were repurchase facilities to augment the liquidity of the Margin Funds.

46. Financial Risk Management *(Continued)*

(c) Credit risk

(i) Investment and accounts receivable-related risk

The Group is exposed to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. It arises primarily from the Group's investments and trade receivables. Impairment provisions are made for losses that have been incurred at the balance sheet date. The Group limits its exposure to credit risk by rigorously selecting the counterparties (i.e. deposit-takers, bond issuers and debtors) and by diversification. As at 31 December 2005, the bonds held were of investment grade and had a weighted average credit rating of Aa2 (2004: Aa2), and there were no financial assets whose terms were renegotiated. Deposits are placed only with the note-issuing banks in Hong Kong, investment grade licensed banks and restricted licence banks approved by the Board from time to time. All investments are subject to a maximum concentration limit approved by the Board and there was no significant concentration risk to a single counterparty. The Group mitigates its exposure to risks relating to accounts receivable from its Participants by requiring the Participants to meet the Group's established financial requirements and criteria for admission as Participants.

(ii) Clearing and settlement-related risk

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.

Position limits are imposed by HKCC to regulate or limit the maximum number or value of gross and net positions which can be held or controlled by the Participants based on their liquid capital. Bank guarantees may also be accepted to extend Participants' position limits. As of 31 December 2005, bank guarantees of \$915,400,000 (2004: \$902,500,000) were accepted for such purpose.

In addition to the above, the Group has set aside \$1,500 million of retained earnings for the purpose of strengthening the risk management regime of the clearing houses and supporting their roles as central counterparties.

46. Financial Risk Management (Continued)

(c) Credit risk (Continued)

(iii) Exposure to credit risk

As at 31 December 2005, the financial assets and financial liabilities of the Group and HKEx that were exposed to credit risk and their maximum exposure were as follows:

	Group 2005		HKEx 2005	
	Carrying amount in balance sheet \$'000	Maximum exposure to credit risk \$'000	Carrying amount in balance sheet \$'000	Maximum exposure to credit risk \$'000
Financial assets				
Clearing House Funds:				
Available-for-sale financial assets	224,137	224,137	–	–
Time deposits with original maturities over three months	30,290	30,290	–	–
Cash and cash equivalents	1,091,233	1,091,233	–	–
Compensation Fund Reserve Account:				
Available-for-sale financial assets	18,488	18,488	–	–
Cash and cash equivalents	30,240	30,240	–	–
Time deposit with maturity over one year	38,768	38,768	–	–
Other assets	17,162	17,162	480	480
Accounts receivable and deposits [#]	3,250,197	3,250,197	160	160
Amounts due from subsidiaries	–	–	583,102	583,102
Margin Funds on derivatives contracts:				
Available-for-sale financial assets	3,828,833	3,828,833	–	–
Time deposits with original maturities over three months	100,018	100,018	–	–
Cash and cash equivalents	9,686,026	9,686,026	–	–
Margin receivable from Clearing Participants	33,704	33,704	–	–
Financial assets at fair value through profit or loss	2,643,788	2,643,788	–	–
Time deposits with original maturities over three months	116,622	116,622	10,184	10,184
Cash and cash equivalents	1,359,113	1,359,113	43,383	43,383
Financial liabilities				
Undertaking to indemnify the Collector of Stamp Revenue	(19,909)	85,800	–	–
Financial guarantee granted to HKSCC	–	–	(11,390)	50,000

[#] Certain debtors were required to place cash deposits with the Group to mitigate the maximum exposure to credit risk.

46. Financial Risk Management *(Continued)*

(c) Credit risk *(Continued)*

(iv) Financial assets that were past due but not impaired

As at 31 December 2005, trade receivables of the Group amounting to \$149,940,000 were past due but not determined to be impaired. The age analysis of the balances according to the period past due is as follows:

	Group 2005				Total \$'000
	Up to 6 months \$'000	>6 months to 1 year \$'000	>1 year to 3 years \$'000	>3 years \$'000	
Trade receivables past due but not determined to be impaired	141,277	–	8,521	142	149,940

The fair value of cash deposits placed by the related trade debtors with the Group was \$3,600,000. No provision for impairment losses has been made against trade receivables amounting to \$8,521,000 as the balances can be recovered from the Clearing House Funds.

No financial assets of HKEx were past due as at 31 December 2005.

(v) Financial assets that were impaired at balance sheet date

As at 31 December 2005, trade receivables of the Group amounting to \$4,329,000 were determined to be impaired and full provision had been made. These receivables were outstanding for over 180 days as at the balance sheet date. The factors the Group considered in determining whether the financial assets were impaired are disclosed in note 2(s)(vi). No cash deposits had been placed by the related trade debtors with the Group.

No financial assets of HKEx were impaired as at 31 December 2005.

(vi) Outstanding balances from debtors which were not recognised as Income

As soon as a loan or receivable becomes impaired, the Group may continue to provide services or facilities to the debtors concerned but no further accounts receivable will be recognised on balance sheet as economic benefits may not flow to the Group. The revenue concerned is not recognised but tracked as doubtful deferred revenue and will only be recognised as income when received. As at 31 December 2005, the amount of doubtful deferred revenue amounted to \$37,643,000 (2004: \$30,240,000).

46. Financial Risk Management (Continued)

(d) Fair values of financial assets and financial liabilities not reported at fair values

Summarised in the following table are the carrying amounts and fair values of financial assets and financial liabilities not presented in the Group's and HKEx's balance sheets at their fair values. The carrying amounts of short-term receivables (i.e. accounts receivable, deposits and cash and cash equivalents) and short-term payables (i.e. accounts payable and other liabilities) approximated their fair values, and accordingly no disclosure of the fair values of these items is presented.

	Carrying amount in balance sheet		Fair value	
	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000
Group				
Financial assets				
Time deposit with maturity over one year	38,768	38,941	36,659	37,808
Other financial assets included in other non-current assets (note i)	17,162	9,935	15,550	9,833
Financial liabilities				
Participants' admission fees received included in non-current liabilities (note i)	80,150	82,850	76,732	82,306
Participants' contributions to Clearing House Funds:				
– Minimum contributions (note i)	358,050	337,250	342,779	335,035
– Participants' additional deposits	393,701	961,502	393,701	961,502
Financial guarantee contract (note ii)	19,909	19,909	20,526	24,451
HKEx				
Financial assets				
Other financial assets included in other non-current assets (note i)	480	457	460	448
Financial liabilities				
Financial guarantee contract (note ii)	11,390	11,390	11,962	14,085

- (i) The fair values are based on cash flows discounted using Hong Kong Government bond rates of a tenor similar to the contractual maturity of the respective assets/liabilities, adjusted by an estimated credit spread. Assets/liabilities without a contractual maturity are assumed to mature exactly one year after the balance sheet date. The discount rates used range from 4.46 per cent to 4.64 per cent as at 31 December 2005 (2004: 0.66 per cent to 1.30 per cent).
- (ii) The fair values are based on the fees charged by financial institutions for granting such guarantees discounted using a ten-year Hong Kong Government bond rate to perpetuity.

47. Comparative Figures

Certain comparative figures have been adjusted to conform with changes in presentation in the current year.

Shareholding Analysis

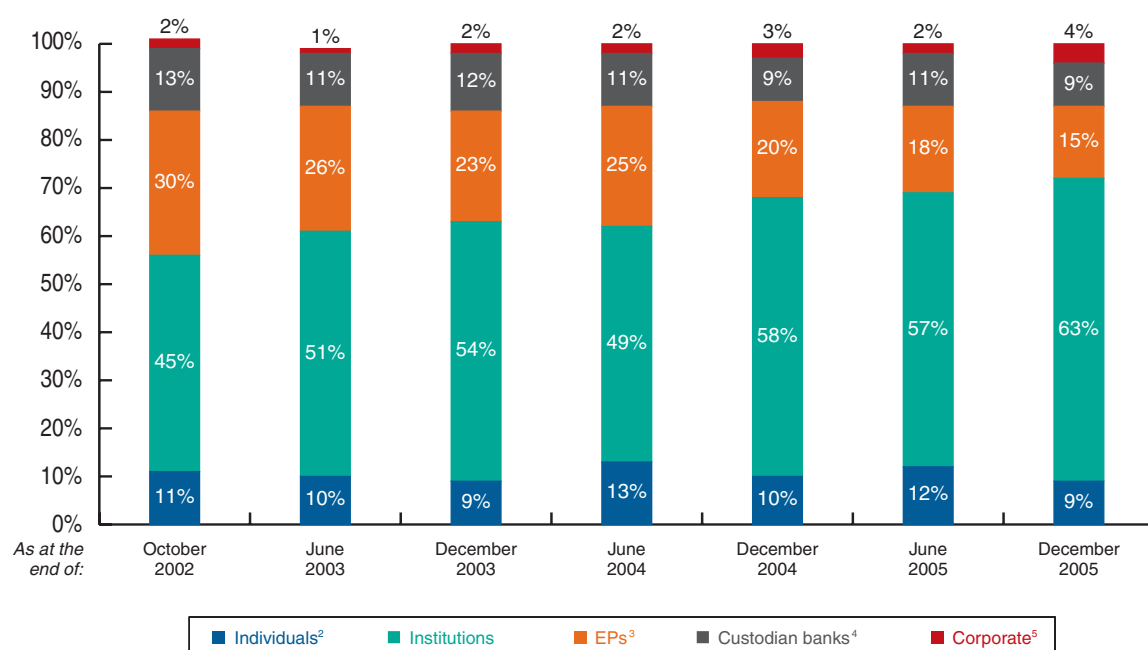
Shareholdings according to the Register of Members of HKEx ("ROM") as at 31 December 2005 and 31 December 2004:

Size of holding	Number of shareholders		Percentage of shareholders (%)		Number of shares ('000)		Percentage of total issued capital (%)	
	2005	2004	2005	2004	2005	2004	2005	2004
1-1,000	19	18	1.63	1.38	5	5	0.00	0.00
1,001-5,000	497	553	42.66	42.41	1,345	1,541	0.13	0.15
5,001-10,000	259	311	22.23	23.85	2,228	2,662	0.21	0.25
10,001-100,000	244	272	20.94	20.86	8,844	9,423	0.83	0.89
100,001 and above	146	150	12.53	11.50	1,050,332	1,043,007	98.83	98.71
Total	1,165	1,304	100.00	100.00	1,062,755	1,056,639	100.00	100.00

Further analysis of share ownership¹ as at 31 December 2005 and 31 December 2004:

Category	2005		2004	
	Number of shares ('000)	Percentage of total issued capital (%)	Number of shares ('000)	Percentage of total issued capital (%)
Individuals²	99,688	9.38	104,586	9.90
Local	97,253	9.15	101,882	9.64
Overseas	2,434	0.23	2,704	0.26
Institutions	673,076	63.33	615,120	58.21
Local	166,714	15.69	59,134	5.60
Overseas	506,363	47.65	555,986	52.62
EPs³	155,639	14.64	210,567	19.93
Custodian banks⁴	96,894	9.12	99,755	9.44
Corporate⁵	37,458	3.52	26,610	2.52
Total	1,062,755	100.00	1,056,639	100.00

Further analysis of share ownership¹ (October 2002 – December 2005):



Notes:

1. The identification of shareholders by type was done by examination of the ROM, the Participant Shareholding Report of HKSCC ("PSR") and the responses of custodian banks and EPs to enquiries conducted in the respective years. For 2005, responses were received from seven custodian banks and two EPs which are among the top ten holders of HKEx shares in HKSCC Nominees Limited; they held in aggregate 730 million shares or 69 per cent of the total issued shares at the end of 2005. For 2004, responses were received from six custodian banks and one EP which are among the top nine holders of HKEx shares in HKSCC Nominees Limited; they held in aggregate 679 million shares or 64 per cent of the total issued shares at the end of 2004.
2. Shares owned by individuals other than those who are EPs. (For 2004, some EPs may be individuals. For 2005, all EPs are corporations.)
3. Shares held by EPs (including Stock EPs and Futures EPs), but excluding shares held for clients by the respondent EPs in the respective years.
4. Shares held by custodian banks for which no analysis of clients was obtained.
5. Shares owned by companies other than those who are institutions, EPs, custodian banks, or HKSCC Nominees Limited.

SHAREHOLDERS WITH TOP TEN HOLDINGS

The top ten holdings as appeared on the ROM as at 31 December 2005 and 31 December 2004 were held by the respective shareholders as follows:

2005			2004		
Name	Number of shares ('000)	Percentage of total issued capital (%)	Name	Number of shares ('000)	Percentage of total issued capital (%)
1 HKSCC Nominees Ltd	937,438	88.21	HKSCC Nominees Ltd	917,386	86.82
Category A Participants	46,014	4.33	Category A Participants	38,849	3.68
Category B Participants	34,234	3.22	Category B Participants	35,182	3.33
Category C Participants	65,799	6.19	Category C Participants	73,205	6.93
Custodians	776,897	73.10	Custodians	760,506	71.91
IPs	6,493	0.61	IPs	9,369	0.89
	929,437*	87.46		917,112*	86.80
2 Sun Hung Kai Investment Services Ltd	8,050	0.76	Sun Hung Kai Investment Services Ltd	8,050	0.76
3 HSBC Nominees (Hong Kong) Ltd	4,097	0.39	Roctec Futures Trading Co Ltd	5,574	0.53
4 Tung Tak Securities (HK) Co Ltd	3,220	0.30	Sun Hung Kai Commodities Ltd	4,181	0.40
5 Phillip Commodities (HK) Ltd	2,787	0.26	Tung Tak Securities (HK) Co Ltd	3,220	0.30
= 5 Sun Hung Kai Commodities Ltd	2,787	0.26	HSBC Nominees (Hong Kong) Ltd	3,123	0.30
= 5 Wocom Ltd	2,787	0.26	Phillip Commodities (HK) Ltd	2,787	0.26
8 Phillip Securities (HK) Ltd	2,415	0.23	Wocom Ltd	2,787	0.26
= 8 Wong Wai Gin	2,415	0.23	Phillip Securities (HK) Ltd	2,415	0.23
10 Corporate Brokers Ltd	1,610	0.15	Roctec Securities Company Ltd	2,415	0.23
= 10 DL Brokerage Ltd	1,610	0.15	Wong Wai Gin	2,415	0.23
= 10 Full Speed Securities Co Ltd	1,610	0.15			
= 10 Grand Fortune Securities & Investment Co Ltd	1,610	0.15			
= 10 Wing Sang Securities Co Ltd	1,610	0.15			
= 10 Yu On Securities Co Ltd	1,610	0.15			

Figures in this section may not add up to the total, sub-totals or 100 per cent due to rounding.

* The breakdown of the shareholding in the name of HKSCC Nominees Ltd was obtained from the record shown in the PSR. The number of shares registered in HKSCC Nominees Ltd as shown in the PSR is different from that shown on the ROM because of the shares withdrawn from the CCASS depository had not yet been re-registered.

For 2005, there were 13 (2004: 13) Category A Participants (top 14 brokers by market turnover), 45 (2004: 43) Category B Participants (brokers ranked 15 - 65 by market turnover), 299 (2004: 312) Category C Participants (all remaining brokers), 28 (2004: 32) Custodians and 194 (2004: 234) IPs.

Information for Stakeholders

ANNUAL REPORT

This Annual Report is printed in English and Chinese and is available on HKEx's corporate website at www.hkex.com.hk under the "Investor Relations Corner". Printed copies in either one or both languages are posted to the Shareholders in accordance with their indicated preference. Shareholders may at any time choose to change their choice of language or means of receipt of the Company's corporate communications free of charge by notice in writing to the Company Secretary or HKEx's registrar, Hong Kong Registrars Limited.

CLOSURE OF REGISTER OF MEMBERS

The Register of Members will be closed from Friday, 21 April 2006 to Wednesday, 26 April 2006, both dates inclusive, during which period, no transfer of shares will be registered. Dividend warrants will be despatched to the Shareholders on or about Monday, 8 May 2006. In order to qualify for the proposed final dividend, all properly completed transfer forms accompanied by the relevant share certificates must be lodged with HKEx's registrar, Hong Kong Registrars Limited, at Rooms 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong not later than 4:00 p.m. on Thursday, 20 April 2006.

ANNUAL GENERAL MEETING

The 2006 AGM will be held on 26 April 2006. Details of the 2006 AGM are set out in the Notice of AGM which constitutes part of the circular to Shareholders sent together with this Annual Report. Notice of the AGM and the proxy form are also available on HKEx's corporate website.

REGISTERED OFFICE

Address: 12th Floor, One International Finance Centre,
1 Harbour View Street, Central, Hong Kong
Telephone number: +852 2522 1122
Fax number: +852 2295 3106
Email address: info@hkex.com.hk
Website: <http://www.hkex.com.hk>

REPRESENTATIVE OFFICE IN BEIJING

Address: Suite 1002, Tower W2, Oriental Plaza,
No. 1, East Chang An Ave, Dong Cheng District, Beijing
Postal code: 100738
Telephone number: +8610 8518 3088
Fax number: +8610 8518 3288
Email address: bjo@hkex.com.hk

GUANGZHOU SPECIAL REPRESENTATIVE

Address: Room C, 12th Floor, Guangdong International Building, Annex A,
339 Huanshi Dong Lu, Guangzhou
Postal code: 510098
Telephone number: +8620 2237 3166
Fax number: +8620 2237 3167

SHANGHAI SPECIAL REPRESENTATIVE

Address: Room 012, 14th Floor, HSBC Tower,
101 Yin Cheng East Road, Pudong New Area, Shanghai
Postal code: 200120
Telephone number: +8621 6841 1783
Fax number: +8621 6841 0938

OUR CONTACT DETAILS

Business Development

Name: Mr Lawrence Fok, Head of Business Development Division
 Address: 12th Floor, One International Finance Centre,
 1 Harbour View Street, Central, Hong Kong
 Telephone number: +852 2840 3050
 Fax number: +852 2521 7060

Corporate Communications and Investor Services

Name: Mr Henry Law, Head of Corporate Communications Department
 Address: 12th Floor, One International Finance Centre,
 1 Harbour View Street, Central, Hong Kong
 Telephone number: +852 2840 3861
 Fax number: +852 2868 4084

Issuer Services

Name: Mr Peter Curley, Senior Vice President, Listing Division
 Address: 11th Floor, One International Finance Centre,
 1 Harbour View Street, Central, Hong Kong
 Telephone number: +852 2840 3787
 Fax number: +852 2295 0198 / +852 2295 0590 / +852 2295 3599

Participant Services

Name: Mr Derek Tam, Senior Vice President, Exchange Division
 Address: 17th Floor, Worldwide House,
 19 Des Voeux Road Central, Hong Kong
 Telephone number: +852 2840 3633
 Fax number: +852 2810 9712

Secretarial Services

Name: Mr Joseph Mau, Company Secretary,
 Head of Secretarial Services Department
 Address: 12th Floor, One International Finance Centre,
 1 Harbour View Street, Central, Hong Kong
 Telephone number: +852 2840 3872
 Fax number: +852 2878 7029

HKEX'S REGISTRAR AND TRANSFER OFFICE

Name: Hong Kong Registrars Limited
 Address: 46th Floor and Rooms 1712-1716, 17th Floor, Hopewell Centre,
 183 Queen's Road East, Wanchai, Hong Kong
 Telephone number: +852 2862 8628
 Fax number: +852 2865 0990 / +852 2529 6087

FINANCIAL CALENDAR

2005 AGM	12 April 2005
Announcement of first quarter results	11 May 2005
Announcement of interim results	17 August 2005
Announcement of third quarter results	9 November 2005
Announcement of final results	8 March 2006
2006 AGM	26 April 2006

DIVIDENDS

Interim dividend	\$0.49 per share
Payment date for interim dividend	15 September 2005
Proposed final dividend	\$0.64 per share
Ex-dividend date for final dividend	19 April 2006
Book closing dates for final dividend	21-26 April 2006
Record date for final dividend	26 April 2006
Payment date for final dividend	on or about 8 May 2006

SHARE INFORMATION

Share Listing

HKEx's shares were first listed on the Stock Exchange on 27 June 2000.

Stock Code

Stock Exchange	388
Access to Reuters	0388.HK
Access to Bloomberg	388 HK Equity

Board Lot

2,000 shares

PRICE AND TURNOVER HISTORY

Year 2005	Price per Share		Turnover (in millions)	
	High (\$)	Low (\$)	(Shares)	(\$)
January	20.95	18.50	93.63	1,827.06
February	20.50	19.35	51.44	1,022.60
March	20.20	19.45	72.19	1,435.47
April	20.25	18.75	75.75	1,460.45
May	19.40	18.70	51.90	987.69
June	20.40	18.75	81.27	1,589.67
July	24.70	20.05	131.55	2,932.89
August	25.45	23.20	97.10	2,364.01
September	27.30	23.80	68.82	1,743.33
October	27.80	24.90	92.55	2,411.89
November	29.35	25.85	90.47	2,476.97
December	32.20	27.65	75.03	2,231.82

MARKET CAPITALISATION

Public Float Capitalisation as at 31 December 2005 \$34,168 million
 (Issued capital: 1,062,754,846 shares; closing price
 at 30 December 2005 (the last trading date of the year): \$32.15 per share)

Glossary

2004 AGM	Annual general meeting held on 31 March 2004
2005 AGM	Annual general meeting held on 12 April 2005
2006 AGM	Annual general meeting to be held on 26 April 2006
AMS/3	The Third Generation Automatic Order Matching and Execution System
BBS	Bronze Bauhinia Star
CBBC	Callable Bull/Bear Contract
CCASS	Central Clearing and Settlement System
CCASS/3	The Latest Generation of Central Clearing and Settlement System
CG Code	Code on Corporate Governance Practices as set out in the Listing Rules
CG Report	Corporate Governance Report as set out in the Listing Rules
CNS	Continuous Net Settlement
CSRC	China Securities Regulatory Commission
DCASS	Derivatives Clearing and Settlement System
eIPO	Electronic IPO service
Elected Directors	Directors elected by the Shareholders at general meetings
EP	Exchange Participant
ETF	Exchange Traded Fund
FSTB	Financial Services and the Treasury Bureau
Financial Secretary	Financial Secretary of Hong Kong
GBS	Gold Bauhinia Star
GEM	Growth Enterprise Market
GEM Listing Rules	Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited
Government	The Government of the Hong Kong Special Administrative Region of People's Republic of China
Government Appointed Directors	Directors appointed by the Financial Secretary of Hong Kong pursuant to Section 77 of the SFO
Group	HKEx and its subsidiaries
HKATS	Hong Kong Futures Automated Trading System
HKCC	HKFE Clearing Corporation Limited
HKEx or the Company	Hong Kong Exchanges and Clearing Limited
HKFRS(s)	Hong Kong Financial Reporting Standards
HKFE or the Futures Exchange	Hong Kong Futures Exchange Limited
HKICPA	Hong Kong Institute of Certified Public Accountants
HKSCC	Hong Kong Securities Clearing Company Limited
Hong Kong or HKSAR	Hong Kong Special Administrative Region of People's Republic of China
IFA	Independent financial adviser
INED	Independent Non-executive Director of HKEx
IP	Investor Participant
IPO	Initial public offering
JP	Justice of the Peace
Listing Committees	Listing Committee and the GEM Listing Committee
Listing Rules	Main Board Listing Rules and GEM Listing Rules
Main Board Listing Rules	Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited

MIS	Management Information System
Model Code	Model Code for Securities Transactions by Directors of Listed Issuers
ORS	Order Routing System
Post-Listing Scheme	Post-Listing Share Option Scheme approved by Shareholders on 31 May 2000 which was subsequently amended by Shareholders on 17 April 2002 so as to comply with the new Listing Rules which came into effect on 1 September 2001
Pre-Listing Scheme	Pre-Listing Share Option Scheme approved by Shareholders on 31 May 2000
PRS	Price Reporting System
REIT(s)	Real Estate Investment Trust(s)
SBS	Silver Bauhinia Star
SEHK or the Stock Exchange or the Exchange	The Stock Exchange of Hong Kong Limited
Senior Management	Senior executives of HKEx as referred to in the section “Senior Management” are set out on page 29 of this Annual Report
SEOCH	The SEHK Options Clearing House Limited
SFC	Securities and Futures Commission
SFO	Securities and Futures Ordinance
Shareholders	Shareholders of HKEx
USD	US dollars
\$/HKD	Hong Kong dollars

Hong Kong Exchanges and Clearing Limited

12/F, One International Finance Centre, 1 Harbour View Street, Central, Hong Kong

Tel: +852 2522 1122

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