



Enhancing
Transparency

Corporate Governance Report

Corporate Governance Practices

The roles of the Corporation are to promote:

- banking and financial stability
- wider home ownership
- development of the local debt market

The Corporation operates on prudent commercial principles and is committed to ensuring a high standard of corporate governance to improve the overall accountability, transparency and long-term sustainability of its operations. The Corporation's corporate governance practices are set out in the "Corporate Governance Code" (the "Code") approved by the Board. The Code is premised on the principles of fairness, transparency, accountability and responsibility to all stakeholders and has been issued to the shareholders and the Directors. The Code is also available on our website and accessible to the public.

Monitoring of compliance with the Code starts with self-assessment by each department. An annual compliance report will then be submitted for review by the Board. The Board is empowered to require that appropriate action be taken in relation to any non-compliance. Throughout 2011, the Corporation has complied with the provisions of the Code.

Enhancements to the Corporate Governance Code

Maintaining a robust and sensible framework of corporate governance for the effective and prudent management of the Corporation has always been a top corporate priority. In order to ensure that the Corporation's corporate governance practices are commensurate with the best standards, the Board reviews the Code provisions from time to time to take on board relevant developments in corporate governance practices. In October 2011, the Hong Kong Stock Exchange announced various amendments to the Listing Rules containing enhancements to corporate

governance practices for listed companies. As a public, but non-listed, limited company, the Corporation is not required to comply with the Listing Rules. Nevertheless, the Listing Rules amendments provide useful guidance on corporate governance enhancements, and the Corporation intends to review the Code in 2012 to consider changes, as appropriate, to bolster its corporate governance practice.

Shareholders

All the shares of the Corporation are beneficially owned by the Financial Secretary of Hong Kong as Controller of the Exchange Fund.

The Board

The Board is responsible for leading the Corporation and promoting its success in an accountable and effective manner. To provide strategic leadership and effective control of the Corporation, the Board meets in person at least once every three months to oversee the Corporation's business strategy and policies, budgeting and planning, organisational and financial performance, risk management, human resources as well as community relations. In order to ensure that well-balanced decisions are made by the Board, the Directors of the Corporation include officials from the government and regulators, representatives from political parties, banking sector, insurance sector, industry associations, the accounting and legal professions, and also the Consumer Council. The Corporation encourages Directors to attend meetings to ensure that issues are properly discussed. During 2011, the Board held four meetings.

Directors are requested to declare their direct or indirect interests, if any, in any transactions to be considered at Board meetings and to withdraw from the meetings, as appropriate. Any Director who may have a conflict of interest in a matter to be considered by the Board

will abstain from voting on such matter. In respect of each financial reporting period, the Corporation will seek confirmation from the directors in respect of their material interests in transactions involving the Corporation or its subsidiaries. Material related party transactions between the Corporation and its counterparties where a Director is involved will be identified and disclosed in the notes to the financial statements.

As at 31 December 2011, there were 18 Directors, all of whom were duly appointed by the Financial Secretary in his capacity as shareholder of the Corporation. Information about the Directors is set out in the Report of the Directors published in the Annual Report and on the Corporation's website (www.hkmc.com.hk). All Directors other than the four Executive Directors are non-executive and are not actively involved in the day-to-day management of the Corporation. Non-Executive Directors, however, do play an important role in bringing their independent judgment and considerable knowledge and diverse expertise to the Board's deliberations, which in turn provide effective steer to Management in pursuit of the Corporation's policies. The Corporation does not remunerate its Directors.

For newly appointed Directors, the Corporation will provide an induction briefing on the business activities, strategies and objectives of the Corporation. Board meetings are held on a regular basis so that the Corporation's business is reported to the Board regularly. Directors are provided with appropriate information before such Board meetings to enable them to be updated on the affairs of the Corporation and make informed decisions at the Board meetings.

The term of a Non-Executive Director is one year, and Non-Executive Directors are typically appointed at an Annual General Meeting. Under the Articles of Association of the Corporation, all Non-Executive Directors will retire at the next Annual General Meeting following their appointment but are eligible for re-election.

The Corporation maintains a directors' and officers' liability insurance policy for its Directors and officers against legal proceedings and other claims arising in the course of discharge of their duties.

Chairman and Chief Executive Officer

In 2011, the post of Chairman was held by Mr. John C. Tsang. The post of Chief Executive Officer was held by Mr. James H. Lau Jr. The segregation of the posts of Chairman and Chief Executive Officer ensures a clear division of responsibilities between the Board and the executive functions of the Corporation's Management. The Board is responsible for laying down strategic direction and business guidelines, approving financial objectives and closely monitoring the Corporation's performance on an on-going basis. The Chief Executive Officer, who is accountable to the Board, is responsible for leading Management in implementing the Board's decisions in a proper and efficient manner. The Chief Executive Officer ensures that adequate information relating to the Corporation's business are reported to the Board on a regular basis.

Company Secretary

The Company Secretary is accountable to the Board and her main duty is to ensure that all company secretarial procedures are followed by the Corporation and the Board. In addition, the Company Secretary also ensures that Board papers are provided to Directors in a timely and comprehensive manner prior to each Board meeting and the Annual General Meeting of the Corporation. Directors have free access to the advice and services of the Company Secretary concerning corporate governance matters, and she provides guidance to Directors to make appropriate declarations to avoid conflicts of interest.

The Board meeting schedule for 2011 was provided to Directors in advance to facilitate Directors' attendance at Board meetings. Board papers are generally sent to Directors at least seven days before the relevant Board meeting so that Directors could be properly

briefed before the Board meeting. Board papers typically contained comprehensive background and/or explanatory information about the subject matters and included supporting documents, analyses, research findings, projections, budgets and forecasts, where appropriate. However, any Director adjudged to have a conflict of interest in the subject matter under discussion in a Board paper would not be provided with the relevant Board paper.

All the minutes of Board meetings are generally taken in sufficient detail, including the matters considered, decisions reached, concerns raised by Directors and dissenting views expressed at the meetings. All minutes of Board meetings and Audit Committee meetings are kept by the Company Secretary and made available for inspection by any Director, except as regards any materials with respect to an agenda item in which that Director is perceived to have a conflict of interest, in such case, the relevant Board papers and Board minutes would be withheld from such Director.

Audit Committee

The Audit Committee members during the year were:

- Dr. David Li, Chairman, Non-Executive Director
- Mr. Peter Pang, Executive Director
- Mr. Eddie Yue, Executive Director
- Mr. Eddy Fong, Non-Executive Director
- Mr. Andrew Leung, Non-Executive Director
- Mr. Abraham Shek, Non-Executive Director

The Audit Committee is responsible for reviewing the Corporation's financial statements, the composition and accounting principles adopted in such statements, the results of the financial audits and the Corporation's management procedures to ensure the adequacy and effectiveness of internal control systems. The Terms of Reference of the Audit Committee are published on the Corporation's website.

The Audit Committee holds regular meetings with Management, the Chief Internal Auditor and external auditor. The Audit Committee also meets on an ad hoc basis to consider special issues requiring its attention. The Chairman of the Audit Committee summarises the reviews conducted by the Audit Committee and highlights the major issues in a report for submission to the Board for consideration by Directors. During 2011, the Committee met on two occasions.

Internal Auditor

The Corporation has an Internal Audit Department which operates independently of Management and plays a major role in monitoring the internal control systems of the Corporation. The Internal Audit Department is led by the Chief Internal Auditor who reports directly to the Chairman of the Audit Committee on all matters relating to the internal control systems. The Chief Internal Auditor also reports to the Chief Executive Officer on the day-to-day administrative functions of the Internal Audit Department, and is entitled to communicate freely with



Audit Committee Meeting

the Chairman of the Audit Committee without reference to Management.

Each year, the Audit Committee formally approves the annual Internal Audit Plan drawn up by the Chief Internal Auditor based on his independent risk assessment and other risk management issues observed by him at the regular Operational Risk Committee meetings. In accordance with the annual Internal Audit Plan, the Internal Audit Department adopts a risk-based audit approach in conducting its periodic independent reviews of the Corporation's internal control systems. After each review, the Internal Audit Department discusses the audit findings and recommendations with the relevant department heads and Senior Management. Regular internal audit reports are first submitted to the Internal Audit Committee which is chaired by an Executive Director. The membership composition of the Internal Audit Committee comprises two Executive Directors, the Chief Executive Officer, the Senior Vice Presidents, General Counsel and the Chief Internal Auditor. The internal audit reports and meeting minutes prepared for the Internal Audit Committee are then submitted to the Audit Committee for further review and, thereafter, to the Board of Directors for information.

Over the years, Management has taken an active approach in considering the audit findings and recommendations made by the Chief Internal Auditor and monitors closely their implementation. In 2011, the Internal Audit Department conducted 13 reviews and two consultancy projects.

External Auditor

The Corporation's external auditor is PricewaterhouseCoopers. Detailed information in respect of the auditor's remuneration is disclosed in the Corporation's financial statements. The auditor is allowed to communicate freely with the Chief Internal Auditor and the Audit Committee.

To ensure its independence with respect to the Corporation, the auditor would issue a confirmation letter of its independence, on an annual basis, to the Audit Committee to confirm its independence based on the requirements set out in Section 290 of the Code of Ethics for Professional Accountants of the Hong Kong Institute of Certified Public Accountants. For the purpose of the audit of the Corporation's financial statements for the year ended 31 December 2011, PricewaterhouseCoopers has confirmed its independence to the Audit Committee.

Financial Reporting

The Corporation aims to present a clear, balanced and comprehensible assessment of its performance, financial position and prospects to its stakeholders and the general public. Directors are responsible for the preparation of the financial statements, and there is a statement by the auditor about its reporting responsibilities in the Auditor's Report on the Financial Statements. The Directors are to ensure that financial statements are prepared so as to give a true and fair view of the financial status of the Corporation. The annual and interim results of the Corporation are announced in a timely manner after the end of each relevant period.

Internal Control

The Board has the overall responsibility for the Corporation's internal control systems and, through the Audit Committee, conducts periodic review on the effectiveness and efficiency of the systems.

There are various committees set up by the Board to ensure the efficient operation and prudent risk management of the Corporation. Those committees include the Corporate Risk Management Committee which is chaired by an Executive Director to oversee the financial and non-financial risks of the Corporation from an enterprise-wide perspective; whilst the Operational

Risk Committee, the Credit Committee, the Transaction Approval Committee and the Asset and Liability Committee are executive committees chaired by the Chief Executive Officer. Detailed description of these four executive committees and the risk management framework of the Corporation are set out in the section on Business Overview in the Annual Report. The internal control systems are designed to provide reasonable assurance against material misstatement or loss, manage risks of failure in the operational systems and the achievement of business objectives, safeguard assets against unauthorised use, ensure the maintenance of proper accounting records for internal use and publication and assure compliance with applicable legislation and regulations.

In February 2012, the Chief Internal Auditor duly conducted an independent review of the Self-assessment Forms provided by each Department in relation to compliance with the Code for 2011. Based on the audit findings on the Corporation's internal control systems and the Self-assessment Forms for the year, the Chief Internal Auditor was of the opinion that there was no material breach of the Code in 2011.

Code of Conduct

The Corporation requires the highest standards of integrity and conduct from its staff members. The requirements and the relevant legal obligations are clearly set out in a code of conduct ("Code of Conduct") incorporated into the Staff Handbook. The Code of Conduct also sets out, in particular, provisions as regards potential conflicts of interest which may arise between staff members and the Corporation in respect of which staff members should be aware, and other provisions designed to ensure that they carry out their work properly, ethically, impartially and free from any suggestion of improper influence.

A copy of the Code of Conduct is posted on the Corporation's intranet to make it readily accessible by all staff members.

Staff members are required to give written confirmation of their compliance with the Code of Conduct on an annual basis. Based on the confirmation received from the staff members, Management was satisfied that staff members have complied with the Code of Conduct during 2011.

Communication

The Corporation attaches great importance to communications with the public at large. The Annual Report of the Corporation contains comprehensive information on its business strategies and developments. The Corporation's website (www.hkmc.com.hk) offers timely access to the Corporation's press releases and its other business information. The Corporation also maintains a hotline telephone system to service enquiries from the public.

Conclusion

The Board was satisfied with the corporate governance practices of the Corporation during 2011. In 2012, the Corporation will continue to review its corporate governance framework and improve those practices in light of ongoing experience, regulatory changes, international trends and developments in order to enhance the Corporation's efficiency and effective management in pursuit of its business objectives.