

Corporate Governance Report

Corporate Governance Practices

The Company firmly believes that good corporate governance is fundamental in ensuring that the Company is well managed in the interests of all of its stakeholders.

The Company's commitment to the highest standards of corporate governance is driven by the Board who, led by the Chairman, assume overall responsibility for the governance of the Company, taking into account the interests of the Company's stakeholders, the development of its business, and the changing external environment.

The Company's efforts in this regard were recognised by the Hong Kong Institute of Certified Public Accountants, who for the second year in a row awarded the 2011 Annual Report the Gold Award (Hang Seng Index Category) in the 2012 Best Corporate Governance Disclosure Awards.

This Report describes the corporate governance best practices that the Company has adopted and specifically highlights how the Company has applied the principles of the Code.

Corporate Governance Code Compliance

The Company applied the principles of the former Code on Corporate Governance Practices (the "former Code") contained in Appendix 14 of the Listing Rules and, in accordance with the commitment of the Board referred to above, adopted a number of requirements of the new Corporate Governance Code (the "new CG Code") and the associated Listing Rules announced by the Stock Exchange on 28 October 2011 in advance of their formal dates for implementation.

During the year ended 31 December 2012, the Company has complied with the Code Provisions set out in the former Code and the new CG Code contained in Appendix 14 of the Listing Rules, for the period from 1 January to 31 March 2012 and from 1 April to 31 December 2012 respectively.

The Board held seven regular Meetings in 2012, exceeding the requirement of the new CG Code which requires every listed issuer to hold Board Meetings at least four times a year.

The composition of the Board, with 11 non-executive Directors out of the 12-member Board, of whom 7 are independent non-executive Directors (the "INED(s)"), well exceeds both the requirements of the former Code (every board of directors of a listed issuer to have at least 3 INEDs), as well as the new CG Code (to have INEDs representing at least one-third of the board).

The Company has, for some time, established a Remuneration Committee, Nominations Committee and Audit Committee with written terms of reference to oversee particular aspects of the Company's affairs. In advance of the new CG Code implementation, the Board, at the January 2012 Board Meeting, adopted revised Terms of Reference for these three Committees in order to meet the requirements of the new CG Code. All these revised Terms of Reference are available on both the Company and the Stock Exchange websites.

As mentioned earlier, the Board recognises that corporate governance should be the collective responsibility of all Members of the Board. In light of the new CG Code provision on corporate governance functions and alongside the adoption of both the relevant Terms of Reference for the Board, and the revised "Protocol: Matters Reserved for the Board" (the "Protocol"), the Board confirmed at the January 2012 Board Meeting that a separate corporate governance board committee would not be established by the Company.

The Company has shown its support to the Stock Exchange's consultation on board diversity by providing a positive response in October 2012, reflecting its recognition of the benefits of diversity in the boardroom in ensuring that the board is effective and able to support the execution of a company's business strategy. Although the new provisions in the CG Code on board diversity will not become effective until 1 September 2013, the Company has already taken steps to comply with it. In this connection, the Board approved a new Board Diversity Policy (the "Policy") in March 2013, which will be posted on the Company's website. The Nominations Committee will give consideration to the Policy when identifying suitably qualified candidates to become members of the Board, although Board appointments will continue to be made on a merit basis, and the Board will review the Policy on a regular basis to ensure its effectiveness.

The Stock Exchange published consultation conclusions on environmental, social and governance ("ESG") reporting in August 2012 and revised the Listing Rules to encourage disclosure of information set out in their proposed ESG Guide in companies' annual reports or as a separate report. The Company's Sustainability Report 2012, which will continue to be published separately, will be fully compliant with the Guide and will be available on the Company's website in late May 2013.

Corporate Strategy Review

Over the first six months of 2012, the Company's Executive team undertook an exercise to review the Company's strategic direction for the next decade. Its outcome was presented to the independent non-executive Directors and other non-executive Directors in June and August 2012 respectively, and their comments have been taken into account in formulating and delivering the Company's new strategy.

The new corporate strategy was formally adopted at the October 2012 Board Meeting.

The Board of Directors

The overall management of the Company's business is vested in the Board. Pursuant to the Articles of Association and the Protocol adopted by the Board, the Board has delegated the day-to-day management of the Company's business to the Executive Committee, and focuses its attention on matters affecting the Company's overall strategic policies, corporate governance, finances and shareholders. These include financial statements, dividend policy, significant changes in accounting policy, annual operating budget, certain material contracts, strategies for future growth, major financing arrangements and major investments, corporate governance functions, risk management strategies, treasury policies and fare structures.

As outlined earlier, the Company has 7 INEDs on the 12 – member Board, and the Chief Executive Officer (“CEO”) is the only executive Director on the Board.

Dr. Raymond Ch'ien Kuo-fung, a Member of the Board and the non-executive Chairman of the Company since 1998 and 2003 respectively, was re-appointed by the Government in October 2012 as the non-executive Chairman with effect from 1 January 2013 until 31 December 2015.

Mr. Chow Chung-kong retired from the position of CEO and ceased to be a Member of the Board of Directors and a Member of the Executive Directorate on 31 December 2011.

Mr. Jay Herbert Walder was appointed as CEO for an initial term of 30 months with effect from 1 January 2012. He became both a Member of the Executive Directorate and a Member of the Board of Directors with effect from the same date. Before joining the Company, Mr. Walder was Chairman and Chief Executive Officer of the New York Metropolitan Transportation Authority, the largest passenger transportation authority in the United States.

The Chief Executive of the HKSAR may, pursuant to Section 8 of the MTR Ordinance, appoint up to three persons as “additional directors”. At present, two of the non-executive Directors (being the office of the Secretary for Transport and Housing (“S for T&H”) and the office of the Commissioner for Transport (“C for T”)) are appointed as the “additional directors” (the “2 Additional Directors”). During the year, Ms. Eva Cheng held the post of the S for T&H up to 30 June 2012, and Professor Anthony Cheung Bing-leung became S for T&H from 1 July 2012. For the post of C for T, Mr. Joseph Lai Yee-tak held it up to 27 May 2012, Ms. Carolina Yip Lai-ching (Acting C for T) held it from 28 May 2012 to 15 July 2012, Miss Susie Ho Shuk-yee held it from 16 July 2012 to 7 October 2012, and Mrs. Ingrid Yeung Ho Poi-yan has held it since 8 October 2012. Another non-executive Director, Professor Chan Ka-keung, Ceajer, is the Secretary for Financial Services & Treasury (“S for FS&T”). The Government, through The Financial Secretary Incorporated, holds approximately 76.55% of the issued share capital of the Company.

Coming from diverse business and professional backgrounds, the non-executive Directors actively bring their valuable experience to the Board for promoting the best interests of the Company and its shareholders. On the other hand, the INEDs contribute to ensuring that the interests of all shareholders of the Company are taken into account by the Board and that relevant issues are subject to objective and dispassionate consideration by the Board.

The Company's recognition of the importance and benefits of diversity in the boardroom was not only reflected in its early adoption of a Board Diversity Policy as mentioned above, but is also evidenced in the existing composition of the Board, on which both genders are represented, together with a broad range of ages, nationalities and professional backgrounds.

For the year ended 31 December 2012, the Company has received confirmation from each INED about his/her independence under the Listing Rules. As part of its duties set out in its revised Terms of Reference, the Nominations Committee has reviewed these confirmations and assessed the independence of the INEDs, and continues to consider each of them to be independent.

Each Director ensures that he/she can give sufficient time and attention to the affairs of the Company. In light of the new CG Code provision on directors' time commitments, the Chairman held a private Board Meeting (without the presence of the CEO and other Members of Executive Directorate) in April 2012 to review the contribution required from a director to perform his/her responsibilities to the Company, and whether he/she is spending sufficient time in performing them.

Regarding disclosure of the number and nature of offices held by Members of the Board in public companies or organisations and other significant commitments as well as their identity and the time involved (the "Commitments") to the issuer, all Members of the Board have, at the Board Meeting in January 2012, agreed to disclose their Commitments to the Company in a timely manner. The Company's current practice of requesting Members of the Board to make a disclosure to the Company twice a year will continue.

Save as disclosed in this Annual Report, none of the Members of the Board and the Executive Directorate has any relationship (including financial, business, family or other material or relevant relationships) between each other, although the two Additional Directors were both appointed by the Chief Executive of the HKSAR, Professor Chan Ka-keung, Ceajer is the S for FS&T of the Government, and Ms. Christine Fang Meng-sang, Mr. Vincent Cheng Hoi-chuen and Mr. Alasdair George Morrison sit on various government advisory committees.

A list of Members of the Board and the Executive Directorate and their roles and functions is available on both the Company and the Stock Exchange websites. Biographies of the Members of the Board and the Executive Directorate, and the other Member of the Executive Committee are set out on pages 116 to 123.

As permitted under its Articles of Association, it has been the practice of the Company to arrange Directors' and Officers' ("D&O") Liability Insurance for which Members of the Board and officers of the Company do not have to bear any excess. To ensure sufficient cover is provided, the Company's Insurance and Risk Strategy Committee undertook a detailed review of the Company's D&O insurance policy in September 2012 in light of recent trends in the insurance market. The review benchmarked the amount of cover against other similar companies and considered whether separate cover was required for Members of the Executive Directorate or Members

of the Board. The conclusion of the review was that the level of cover was adequate and, given this limit, together with the indemnity provided by the Company to Members of the Board, the broad policy wording and the financial strength of the insurance panel, no additional cover was required.

In January 2012, a questionnaire was sent to all Members of the Board in order to enable the performance of the Board to be evaluated. The questionnaire sought their views on, for example, the overall performance of the Board, the composition of the Board, conduct of Board Meetings and provision of information to the Board. The responses to the questionnaire were thoroughly analysed and discussed at the Private Board Meeting held in April 2012 and any suggestions made by Members of the Board have been incorporated as further improvements to the overall corporate governance regime.

The Board has conducted an annual review of its Corporate Governance duties in accordance with its Terms of Reference on Corporate Governance Functions, and considered that the Company's (i) policies and practices on corporate governance; (ii) approach to the continuous professional development of Directors and senior management; (iii) policies and practices on compliance with legal and regulatory requirements; and (iv) Code of Conduct and Directors' manual, are adequate and appropriate for the Company in light of its current corporate strategy. They will be kept under review in light of the changing legal and regulatory environment and any changes to the Company's business.

Chairman and Chief Executive Officer

The posts of Chairman and CEO are distinct and separate (please also refer to their appointments on page 95). The non-executive Chairman is responsible for chairing and managing the operations of the Board, as well as monitoring the performance of the CEO and other Members of the Executive Directorate. Apart from making sure that adequate information about the Company's business is provided to the Board on a timely basis, the Chairman provides leadership for the Board, and ensures views on all principal and appropriate issues are exchanged by all Directors (including the non-executive Directors) in a timely manner, by encouraging them to make a full and effective contribution to the discussion. Under the Chairman's guidance, all decisions have reflected the consensus of the Board.

As head of the Executive Directorate and chairman of the Executive Committee (which comprises seven other Members of the Executive Directorate, and General Manager – Corporate Relations), the CEO is responsible to the Board for managing the business of the Company.

Board Proceedings

The Board meets in person regularly, and all Members of the Board have full and timely access to relevant information and may take independent professional advice at the Company's expense, if necessary, in accordance with the approved procedures.

The draft agenda for regular Board Meetings is prepared by the Legal Director & Secretary ("LD&S") and approved by the Chairman of the Company. Members of the Board are advised to inform the Chairman or LD&S not less than one week before the relevant Board Meeting if they wish to include a matter in the agenda of the Meeting. The agenda together with Board Papers are sent at least three days before the intended date of the Board Meeting.

The Board Meeting dates for the following year are usually fixed by LD&S and agreed by the Chairman, before communicating with other Members of the Board in the third quarter of each year.

At regular Board Meetings, Members of the Executive Directorate together with senior managers report to the Board on their respective areas of business, including the railway operations, station commercial and retail related business, progress of projects, property and other businesses, financial performance, legal issues, safety governance, risk management, corporate governance, human resources, sustainability, corporate responsibility and outlook. The CEO also submits his Executive Summary ("CEO Executive Summary") which focuses on the overall strategies and principal issues of the Company, to the Board. These reports, together with the discussions at Board Meetings, ensure that Members of the Board have a general understanding of the Company's business and provide information to enable them to make informed decisions for the benefit of the Company.

The CEO Executive Summary has been made available to Members of the Board on a monthly basis since April 2012.

All Members of the Board have access to the advice and services of LD&S, who is responsible for ensuring that the correct Board procedures are followed and advises the Board on all corporate governance matters. The Members of the Board also have full access to Members of the Executive Directorate as and when they consider necessary.

All Directors are required to comply with their common law duty to act in the best interests of the Company and have particular regard to the interest of the shareholders as a whole. Amongst others, all Directors are required to declare their interests, if any, in any transaction, arrangement or other proposal to be considered by the Board at Board Meetings.

Unless specifically permitted by the Articles of Association, a Director cannot cast a vote on any contract, transaction, arrangement or any other kind of proposal in which he has an interest and which he knows is material. For this purpose, interests of a person who is connected with a Director (including any of his associates) are treated as the interests of the Director himself. Interests purely as a result of an interest in the Company's shares, debentures or other securities are disregarded. A Director may not be included in the quorum for such part of a meeting that relates to a resolution he is not allowed to vote on but he shall be included in the quorum for all other parts of that Meeting. This reduces potential conflicts which might otherwise arise between the Company's business and an individual Director's other interests or appointments. The removal by the Stock Exchange of the 5% threshold exemption for voting on a resolution in which a director has an interest and its implications have been brought to the attention of Members of the Board at the January 2012 Board Meeting.

(Please also refer to the "Material Interests and Voting" section on page 100.)

Matters to be decided at Board Meetings are decided by a majority of votes from Directors allowed to vote, although the usual practice is that decisions reflect the consensus of the Board.

Board Meetings

The Board held seven regular Meetings in 2012.

During 2012 and in addition to the regular reports on the business and financial performance, examples of other key matters discussed at Board Meetings included Hong Kong's train service (including the Listening & Responding Programme of service enhancement initiatives and the operation of the Fare Adjustment Mechanism), railway projects (such as South Island Line (East), Kwun Tong Line Extension and Shatin-Central Link), contract awards relating to railway projects (e.g. Hong Kong Section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link, South Island Line (East), Kwun Tong Line Extension and Shatin-Central Link), Mainland of China's railway projects (e.g. Shenzhen Metro Line 4 and Beijing Metro Line 4's operations), overseas train operations (e.g. London Overground, Stockholm's Metro and Melbourne's Metropolitan train system), 2013 Budget and Longer Term Forecast, shareholders' analysis and investors' feedback, corporate governance, enterprise risk management, safety governance, internal control system, corporate responsibility, sustainability and pay review.

The minutes of regular Board Meetings are prepared by LD&S or her delegate with details of the matters considered by the Board and decisions reached, including any concerns raised by Members of the Board or dissenting views expressed. The draft minutes are circulated to all Members of the Board for their comment within a reasonable time after the Meeting. The approval procedure is that the Board formally adopts the draft minutes at the subsequent Meeting. If Members of the Board have any comment on the draft minutes, they will discuss it at that Meeting, followed by a report on what has been agreed in the minutes of that Meeting. Minutes of Board Meetings are kept by LD&S and open for inspection by all Members of the Board at the Company's registered office.

The matters in relation to (i) US\$3 Billion Debt Issuance Programme – Supplemental Prospectus, (ii) Tender Submission of an Overseas Franchise, and (iii) Intercity Fare Arrangement, were approved by Members of the Board by circulation because the timing of approval did not meet the scheduled regular Board Meetings. Neither the substantial shareholder nor a Member of the Board has any interest in these three matters.

Private/Other Board Meetings

In addition to the above regular Board Meetings which dealt with the business of the Company, the Chairman held three private/other Board Meetings during the year.

The first Meeting was held on 26 April 2012 with all non-executive Directors to: (i) discuss the summary of responses to the Board Evaluation Questionnaire, (ii) review the contribution required from a Director to perform his/her responsibilities to the Company, and whether he/she was spending sufficient time in performing them, and (iii) discuss Executive Directorate performance and succession. LD&S assisted the Chairman in facilitating the discussion. The CEO attended the meeting for item (iii), but there were no other Executive Directors or staff present at the meeting.

The second Meeting was a Special Board Meeting held on 30 May 2012 with Members of the Board and the Executive Directorate to discuss a property development project in the Mainland of China.

The third Meeting was held on 9 July 2012 with non-executive Directors and the CEO to discuss the appointment of the Deputy CEO.

The attendance record of each Member of the Board (and relevant Members of the Executive Directorate) is set out below:

Meetings Held in 2012

| | Board | Private/ Other Board | Audit Committee | Remuneration Committee | Nominations Committee | Corporate Responsibility Committee | Annual General Meeting |
|--|-----------------|----------------------------|--------------------|---------------------------|--------------------------|--|------------------------------|
| Number of Meetings | 7 | 3 | 4 | 2 | 2 | 2 | 1 |
| MEMBERS OF THE BOARD | | | | | | | |
| Non-executive Directors | | | | | | | |
| Dr. Raymond Ch'ien Kuo-fung (Chairman) | 7/7 | 3/3 | | | 2/2 | 2/2 | 1/1 |
| Commissioner for Transport (Joseph Lai Yee-tak up to 27 May 2012) | 3/3 | 1/1 | 2/2 | | | | 1/1 |
| (Carolina Yip Lai-ching (Acting Commissioner for Transport) from 28 May 2012 to 15 July 2012) | 1/1 | 2/2 | | | | | |
| (Susie Ho Shuk-ye from 16 July 2012 to 7 October 2012) | 1/1 | | 1/1 | | | | |
| (Ingrid Yeung Ho Poi-yan since 8 October 2012) | 2/2 | | 1/1 | | | | |
| Secretary for Transport and Housing (Eva Cheng up to 30 June 2012) | 3/3 | 1/2 (Note 1) | | | 2/2 | 1/1 | 0/1 |
| (Professor Anthony Cheung Bing-leung from 1 July 2012) | 3/4 (Note 2) | 1/1 | | | | 0/1 (Note 2) | |
| Professor Chan Ka-keung, Ceajer | 4/7 (Note 3) | 2/3 (Note 3) | | 1/2 (Note 3) | 2/2 | | 1/1 |
| Independent Non-executive Directors | | | | | | | |
| Vincent Cheng Hoi-chuen | 6/7 (Note 4) | 3/3 | | 2/2 (Note 4) | | 1/2 | 1/1 |
| Christine Fang Meng-sang | 7/7 | 2/3 | | | 2/2 | 2/2 | 1/1 |
| Edward Ho Sing-tin | 6/7 | 3/3 | | 2/2 | 2/2 | | 1/1 |
| T. Brian Stevenson | 6/7 | 3/3 | 4/4 (Note 5) | 1/2 | | | 1/1 |
| Ng Leung-sing | 6/7 | 2/3 | 4/4 | | 1/2 | | 1/1 |
| Abraham Shek Lai-him | 6/7 | 3/3 (Note 6) | | | 2/2 | 2/2 | 1/1 |
| Alasdair George Morrison | 6/7 (Note 7) | 3/3 | 4/4 (Note 7) | 1/2 | | | 1/1 |
| Executive Director | | | | | | | |
| Jay Herbert Walder (CEO) | 7/7 | 3/3 | | | | 1/1 (Note 8) | 1/1 |
| MEMBERS OF THE EXECUTIVE DIRECTORATE | | | | | | | |
| Gillian Elizabeth Meller (Legal Director & Secretary) | | | | | | 2/2 | |
| Morris Cheung Siu-wa (Human Resources Director since 17 July 2012) | | | | | | 2/2 (Note 9) | |

Notes

- 1 The alternate director of Ms. Eva Cheng attended the other Private/Other Board Meeting.
- 2 The alternate directors of Professor Anthony Cheung Bing-leung attended the other Board Meeting and Corporate Responsibility Committee Meeting.
- 3 The alternate directors of Professor Chan Ka-keung, Ceajer attended the other Board Meetings, Private/Other Board Meeting, and the other Remuneration Committee Meeting.
- 4 Mr. Vincent Cheng Hoi-chuen attended two Board Meetings and the two Remuneration Committee Meetings by teleconference.
- 5 Mr. T. Brian Stevenson attended one Audit Committee Meeting by teleconference.
- 6 Mr. Abraham Shek Lai-him attended one Private/Other Board Meeting by teleconference.
- 7 Mr. Alasdair George Morrison attended one Board Meeting and one Audit Committee Meeting by teleconference.
- 8 Mr. Jay Herbert Walder was invited to attend the October 2012 Corporate Responsibility Committee Meeting and appointed as a member of the Corporate Responsibility Committee at the October 2012 Board Meeting.
- 9 Mr. Morris Cheung Siu-wa was appointed as a member of the Corporate Responsibility Committee at the October 2011 Board Meeting.

Material Interests and Voting

Please refer to the “Board Proceedings” section on page 97 regarding the common law duty of the Directors to act in the best interests of the Company and the prohibition on them to vote on any contract, transaction, arrangement or any other kind of proposal in which they have a material interest.

Government’s Representatives on the Board

The Government is a substantial shareholder of the Company and has nominated three representatives (the two Additional Directors and Professor Chan Ka-keung, Ceajer) as Members of the Board and, like any other Director, they are obliged to act in the best interests of the Company.

On appointment to the Board and, as for any other Director, each Government-nominated Director is given a comprehensive, formal and tailored induction programme highlighting, among other things, his/her duties under general law, statutes and the Listing Rules (including the fiduciary duty to act in good faith in the best interests of the Company as a whole, considering the interests of all its shareholders, majority or minority, present and future).

If a conflict arises between the interests of the Company and those of the Government, each Government-nominated Director would not be included in the quorum of part of a Meeting that relates to the transaction, arrangement or other proposal being considered by the Board and would not be allowed to vote on the related resolution.

There are a number of contractual arrangements that have been entered into between the Company and the Government (and its related entities), some of which are continuing in nature. As the Government is a substantial shareholder of the Company, such contractual arrangements are connected transactions (and in some cases continuing connected transactions) for the purposes of the Listing Rules. The section headed “Continuing Connected Transactions” on pages 136 to 152 explains how, in accordance with the Listing Rules, these transactions are treated.

(Please also refer to the “Board Proceedings” section on page 97 regarding Directors’ declarations of interest and voting.)

Appointment, Re-election and Removal of Members of the Board

A person may be appointed as a Member of the Board at any time either by the shareholders in general meeting or by the Board upon the recommendation of the Nominations Committee of the Company. For appointment to be made by shareholders, please refer to the procedures available on the Company and the Stock Exchange websites.

Directors who are appointed by the Board must retire at the first annual general meeting after their appointment. A Director who retires in this way is eligible for election at that annual general meeting, but is not taken into account when deciding which and how many Directors should retire by rotation. In either case, the Directors so elected and appointed are eligible for re-election and re-appointment.

At each annual general meeting of the Company, one third of the Directors (or, if the number of Directors is not divisible by three, such number as is nearest to and less than one third) must retire as Directors by rotation.

Additional Directors may not be removed from office except by the Chief Executive of the HKSAR. These Directors are not subject to any requirement to retire by rotation nor will they be counted in the calculation of the number of Directors who must retire by rotation. In all other respects, the Additional Directors are treated for all purposes in the same way as other Directors and are, therefore, subject to the normal common law duties of directors, including to act in the best interests of the Company. Please refer to the “Material Interest and Voting” section on this page.

Ahead of the new CG Code requiring an issuer to have formal letters of appointment for directors, the Company had a service contract with each of the non-executive Directors (including Dr. Raymond Ch’ien Kuo-fung (non-executive Chairman) and Professor Chan Ka-keung, Ceajer (S for FS&T) but excluding the two Additional Directors) specifying the terms of his/her continuous appointment as a non-executive Director and a Member of the relevant Board Committees, for a period not exceeding three years.

At the 2012 Annual General Meeting held on 3 May 2012 (the “2012 AGM”), Mr. Jay Herbert Walder retired from office pursuant to Article 85 of the Articles of Association and was

elected as a Member of the Board. In addition, Dr. Raymond Ch'ien Kuo-fung, Professor Chan Ka-keung, Ceajer, and Mr. T. Brian Stevenson retired from office by rotation pursuant to Articles 87 and 88, and were re-elected as Members of the Board at the 2012 AGM.

For details of the Members of the Board who will retire from office at the 2013 Annual General Meeting pursuant to the relevant Articles of Association, please refer to the Circular dated 9 April 2013 to shareholders – Proposed General Mandates to Issue and Repurchase Shares, Re-election of Directors and Notice of Annual General Meeting.

Induction Programme and Other Training

Induction Programme

On appointment to the Board, each Member of the Board (including alternate directors) is given a comprehensive, formal and tailored induction programme on key areas of business operations and practices of the Company, as well as the general and specific duties of directors under general law (common law and legislation) and the Listing Rules.

A tailor-made training programme covering the roles of a director from the strategic, planning and management perspective, as well as the essence of corporate governance and the trends in these areas, was therefore arranged for new Members of the Board (Professor Anthony Cheung Bing-leung, Miss Susie Ho Shuk-yee, Mrs. Ingrid Yeung Ho Poi-yan and Mr. Jay Herbert Walder (CEO)), new Alternate Directors (Mr. Andy Chan Shui-fu, Ms. Mable Chan and Ms. Elizabeth Tse Man-yee) and Mr. Morris Cheung Siu-wa (Human Resources Director), all of whom were appointed in 2012.

A Familiarization Programme to understand key areas of the Company's business operations was also provided to the above new Board Members and Alternate Directors.

All Members of the Board (including their alternate directors) are also given a Directors' Manual on their appointment which sets out, amongst other things, directors' duties, and the Terms of Reference of the Board on its Corporate

Governance Functions and of its Board Committees. The Directors' Manual is updated from time to time to reflect developments in those areas, following a report on the same at relevant Board Meeting(s). The latest update to the Directors' Manual was in January 2013 following the implementation of the new legislation on disclosure of inside information under the Securities and Futures Ordinance ("SFO") and the associated changes to the Listing Rules, both effective from 1 January 2013.

Training and Continuous Professional Development – Members of the Board and the Executive Directorate

To assist Members of the Board and the Executive Directorate in continuing their professional development, LD&S recommends them to attend relevant seminars and courses. The costs for such training are borne by the Company.

In June 2012, a site visit was held for Members of the Board to the Hong Kong Section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link to allow them to obtain a better understanding of the construction progress of the project, including the West Kowloon Terminus. The tour was followed by a visit to a tunnel boring machine launching shaft and bored tunnel.

Briefings on the new CG Code, the new statutory disclosure obligations on inside information, and associated Listing Rules were given in January and December 2012 respectively to Members of the Board and the Executive Directorate by the Company's external legal advisor jointly with LD&S.

Detailed guidelines on how to ensure compliance with the new statutory disclosure obligations on inside information were also established and copied to Members of the Board and the Executive Directorate.

Each Member of the Board and the Executive Directorate has also provided a record of training he/she received to the Company.

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During 2012, the current Members of the Board and the Executive Directorate received training in the following areas:

| Directors | Induction Training* | Board Briefings on Company's Businesses/Site Visits | Reading Regulatory Updates and/or attending relevant training sessions |
|---|---------------------|---|--|
| Non-executive Directors | | | |
| Dr. Raymond Ch'ien Kuo-fung (Chairman) | N/A | √ | √ |
| Professor Chan Ka-keung, Ceajer (Secretary for Financial Services and the Treasury) | N/A | √ | √ |
| Secretary for Transport and Housing (Professor Anthony Cheung Bing- leung) | √ | √ | √ |
| Commissioner for Transport (Ingrid Yeung Ho Poi-yan) | √ | √ | √ |
| Independent Non-executive Directors | | | |
| Vincent Cheng Hoi-chuen | N/A | √ | √ |
| Christine Fang Meng-sang | N/A | √ | √ |
| Edward Ho Sing-tin | N/A | √ | √ |
| Alasdair George Morrison | N/A | √ | √ |
| Ng Leung-sing | N/A | √ | √ |
| Abraham Shek Lai-him | N/A | √ | √ |
| T. Brian Stevenson | N/A | √ | √ |
| Executive Director | | | |
| Jay Herbert Walder (Chief Executive Officer) | √ | √ | √ |
| Other Members of the Executive Directorate | | | |
| Lincoln Leong Kwok-kuen (Deputy Chief Executive Officer) | N/A | √ | √ |
| Morris Cheung Siu-wa (Human Resources Director) | √ | √ | √ |
| Chew Tai Chong (Projects Director) | N/A | √ | √ |
| Jacob Kam Chak-pui (Operations Director) | N/A | √ | √ |
| Gillian Elizabeth Meller (Legal Director and Secretary) | N/A | √ | √ |
| David Tang Chi-fai (Property Director) | N/A | √ | √ |
| Jeny Yeung Mei-chun (Commercial Director) | N/A | √ | √ |

* Applicable to new Directors who were appointed in 2012.

Training and Continuous Professional Development – Senior Executives

A comprehensive and tailored training programme has been arranged for Senior Executives of the Company. This programme consists of a series of workshops, seminars and benchmarking visits which are organised on an on-going basis.

This training programme serves to further enhance the business acumen, leadership and management skills of the Senior Executives.

To benchmark and learn from other leading businesses in Hong Kong, an Executive Excellence Consortium was established with other five founding organisations, which provides Senior Executives a platform for cross-organisational learning and benchmarking of best business practices.

In light of the new disclosure obligations on inside information, a “Corporation Notice – Disclosure of Inside Information under the Securities and Futures Ordinance” was issued to all Managers and above in January 2013. In addition, briefings by the Company’s external legal advisor were organised for the Company’s Officers for them to understand and discuss the new legislation. They can also refresh their memory by accessing the Company’s intranet for a video of the briefing.

Accountability

The Members of the Board are responsible for preparing the accounts of the Company and of the Group. The accounts are prepared on a going concern basis and give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2012, and of the Group’s profit and cash flow for the year then ended. In preparing the accounts for the year ended 31 December 2012, the Members of the Board have selected appropriate accounting policies and, apart from those new and amended accounting policies as disclosed in the notes to the accounts for the year ended 31 December 2012, have applied them consistently with previous financial periods. Judgments and estimates have been made that are prudent and reasonable. The reporting responsibilities of the External Auditor are set out on page 110.

In support of the above, the accounts presented to the Board have been reviewed by the Members of the Executive Directorate. For both the annual and interim reports and accounts, the Finance Division is responsible for clearing them with the External Auditor and then the Audit Committee. In addition, all new and amended accounting standards and requirements, as well as changes in accounting policies adopted by the Company have been discussed and approved at the Audit Committee before adoption by the Company.

Board Committees

As an integral part of good corporate governance, the Board has established a total of four Board Committees to oversee particular aspects of the Company’s affairs. Each of these Committees is governed by its respective Terms of Reference which are available on the websites of both the Company and the Stock Exchange.

All Committees are provided with sufficient resources to discharge their duties and can seek independent professional advice, at the Company’s expense, to perform their responsibilities.

Audit Committee

The Audit Committee consists of four non-executive Directors, three of whom are INEDs. The Members of the Committee are Mr. T. Brian Stevenson (chairman), Mr. Ng Leung-sing, the C for T (being Mr. Joseph Lai Yee-tak up to 27 May 2012, Ms. Carolina Yip Lai-ching (Acting C for T) from 28 May 2012 to 15 July 2012, Miss Susie Ho Shuk-yee from 16 July 2012 to 7 October 2012 and Mrs. Ingrid Yeung Ho Poi-yan from 8 October 2012), and Mr. Alasdair George Morrison. Mr. Stevenson, Mr. Ng and Mr. Morrison are INEDs. None of the Committee Members is a partner or former partner of KPMG, the Company’s External Auditor. The Deputy CEO, the Head of Internal Audit and representatives of the External Auditor of the Company are expected to attend Meetings of the Committee. At the discretion of the Committee, others may also be invited to attend Meetings. The Committee meets regularly, and the External Auditor or the Deputy CEO may request a Meeting if they consider it necessary. During 2012, the Committee met four times.

Duties of Audit Committee

Under its Terms of Reference, the duties of the Audit Committee include financial and efficiency aspects as described below. Amongst other things, the Committee is required to oversee the relationship with the External Auditor, to review the financial information of the Company, and to oversee the Company’s financial reporting system and internal control procedures. The Committee discusses with the External Auditor the nature and scope of audit and reporting obligations before the audit commences. Apart from giving pre-approval of all audit services, the Committee also pre-approves any non-audit services for complying with relevant legal requirements. The Committee is primarily responsible for making recommendations to the Board on the appointment, re-appointment and removal of the External Auditor, and approving the remuneration and terms of such engagement.

With respect to financial information of the Company, the Committee monitors the integrity of financial statements,

annual and interim reports and accounts, together with the preliminary announcement of results and other announcements regarding the Company's financial information to be made public. In dealing with the financial information, the Committee liaises with the Board and the Executive Directorate (including the Deputy CEO), and the chairman of the Committee further meets on an ad hoc basis with the Head of Internal Audit, representatives of the External Auditor, and Management. Apart from considering issues arising from the audit, the Committee discusses any matters that auditor(s) may wish to raise either privately or together with executive Director(s) and any other person.

The Committee is required to review, at least annually, the effectiveness of the Company's financial controls, internal control and risk management systems and to report to the Board that such a review has been carried out. These controls and systems allow the Board to monitor the Company's overall financial position and to protect its assets. The Committee's review for 2012 also covered its role in overseeing the Management's review of the adequacy of resources, qualifications and experience of staff of the Company's accounting and financial reporting function, and their training programmes and budget. Please refer to the section headed "Internal Controls" below. The Committee reviews and approves the annual Internal Audit Plan which includes audits on the efficiency of chosen activities or operations of the Company. In addition, the Committee reviews periodic reports from the Head of Internal Audit and the follow-up of major action plans recommended, and puts forward recommendations to the Board where appropriate.

In line with the new CG Code, the Terms of Reference of the Committee have been revised and were approved at the January 2012 Board Meeting.

The chairman of the Committee summarises the activities of the Committee and highlights issues arising therefrom by a report to the Board after each Audit Committee Meeting.

The minutes of the Audit Committee Meetings are prepared by the secretary of the meeting with details of the matters considered by the Committee Members and decisions reached, including any concerns raised by the Committee Members and dissenting views expressed. The draft minutes are circulated to the Committee Members for comments and the final version of the minutes is sent to the Committee Members for their records within a reasonable time after the Meeting and the minutes are open for inspection by the Committee Members at the Company's registered office. With reference to the Agenda Framework, the chairman of the Committee makes final determination on the agenda for the regular Committee Meetings.

Work Performed by Audit Committee

In 2012, the Audit Committee held four Meetings and, based on the Agenda Framework pre-agreed with the chairman of the Committee, a total of four Meetings have been scheduled for 2013. Among the four Meetings held in 2012, the Audit Committee had two separate Meetings for reviewing the annual results for the year ended 31 December 2011. The first Meeting concentrated on the business operations, internal control and internal audit related items, as well as outstanding litigation, compliance and enterprise risk management issues, while the second Meeting focused on the accounting and financial reporting matters.

The major work performed by the Committee in 2012 included:

- Review of and recommendation for the Board's approval the draft 2011 Annual Report and Accounts and 2012 Interim Report and Accounts;
- Review of Management Letter, tax issues, compliance and salient features of 2011 Annual Accounts and 2012 Interim Accounts presented by KPMG, the External Auditor;
- Review of two Half-yearly Reports prepared by the Internal Audit Department;
- Approval of the 2013 Internal Audit Plan;
- Pre-approval of the audit and non-audit services provided by KPMG, the External Auditor;
- Review of KPMG's fees proposal for the 2012 audit;
- Preview of 2012 annual accounting and financial reporting issues;
- Review of an Update on Quality Assessment Review on Internal Audit;
- Review of an Update on the Management Governance Framework;
- Review of a Whistle-blowing Framework;
- Review of the Report on Internal Control system for the year ended 31 December 2011;
- Review of the Report on Evaluation of Effectiveness of Internal Audit Department for 2011;
- Review of the Report on Staff Complaints for 2011;
- Review of the Enterprise Risk Management Report for 2011;
- Review of the outstanding litigation and compliance issues regarding Operating Agreement and Rail Merger Transaction Agreements, statutes and regulations relevant to the business of the Company;

- Confirmation of the financial figures for the 2011 payout under “2008 Variable Incentive Scheme”;
- Review key issues from the Audit/Governance Committees Minutes of wholly owned subsidiaries;
- Review of the Report on a Review of the Internal Audit Charter; and
- Holding of private sessions with Head of Internal Audit and the External Auditor without the presence of Management.

Representatives of the External Auditor, the Deputy CEO and the Head of Internal Audit attended all those Meetings for reporting and answering questions about their work. Further to that and by invitation, the Operations Director, the Commercial Director, the Projects Director, the Property Director and LD&S (or their representatives) had respectively provided an overview of the Company’s railway operations, non-fare businesses, new railway projects, property business as well as outstanding litigation, compliance and enterprise risk management matters to the Members at the Meetings. The Deputy CEO also provided an overview of the business development and expansion outside of Hong Kong.

The attendance record of each Committee Member is shown on page 99 under the section “Board Proceedings”.

Remuneration Committee

The Remuneration Committee consists of five non-executive Directors, four of whom are INEDs. The Members of the Remuneration Committee are Mr. Edward Ho Sing-tin (chairman), Mr. T. Brian Stevenson, Mr. Vincent Cheng Hoi-chuen, Professor Chan Ka-keung, Ceajer and Mr. Alasdair George Morrison. Mr. Ho, Mr. Stevenson, Mr. Cheng and Mr. Morrison are INEDs.

Duties of Remuneration Committee

The principal responsibilities of the Remuneration Committee include formulating a remuneration policy and practices that facilitate the employment of top quality personnel, recommending to the Board the remuneration of the Members of the Board who are non-executive Directors, determining with delegated responsibility the remuneration packages of the Members of the Board who are executive Directors and other Members of the Executive Directorate, and reviewing and approving performance-based remuneration by reference to the Board’s corporate goals and objectives.

This model which the Committee has adopted is set out in its Terms of Reference and is consistent with the new CG Code.

As mentioned earlier, the Terms of Reference were approved at the January 2012 Board Meeting.

Work Performed by Remuneration Committee

In 2012, the Remuneration Committee held two Meetings. In accordance with its Terms of Reference, the Committee performed the following work during the year:

- Approved the 2011 Remuneration Report as incorporated in the 2011 Annual Report;
- Reviewed and approved payouts under the Company’s performance-based variable incentive scheme for the 2011 performance period;
- Reviewed and approved share option awards for Members of the Executive Directorate and other eligible employees;
- Conducted an annual review of the remuneration packages for Members of the Executive Directorate, which took effect in July 2012; and
- Determined and approved the remuneration packages for the following Members of the Executive Directorate:
 - Mr. Lincoln Leong Kwok-kuen as Deputy CEO (from 16 July 2012), and
 - Mr. Morris Cheung Siu-wa as Human Resources Director (from 17 July 2012).

The Remuneration Committee also met on 5 March 2013 to approve the 2012 Remuneration Report, which is set out on pages 112 to 115 and includes a description of the remuneration policy of the Company.

Attendance record of each Committee Member is shown on page 99 under the section “Board Proceedings”.

Nominations Committee

The Nominations Committee consists of seven non-executive Directors, four of whom are INEDs. The Members of the Nominations Committee are Mr. Edward Ho Sing-tin (chairman), Dr. Raymond Ch’ien Kuo-fung, Ms. Christine Fang Meng-sang, Mr. Abraham Shek Lai-him, Mr. Ng Leung-sing, Professor Chan Ka-keung, Ceajer and the S for T&H (being Ms. Eva Cheng up to 30 June 2012, and Professor Anthony Cheung Bing-leung from 1 July 2012). Mr. Ho, Ms. Fang, Mr. Shek and Mr. Ng are INEDs.

Duties of Nominations Committee

The Nominations Committee nominates and recommends to the Board candidates for filling vacancies on the Board, and the positions of CEO, Finance Director (the “FD”) and Chief Operating Officer (the “COO”) (provided that the COO position exists). For the positions of FD and COO, the Committee may consider candidates recommended by the CEO, or any other candidates (provided that the CEO shall have the right to first agree to such other candidates).

Corporate Governance Report

In line with the new CG Code, the Terms of Reference of the Nominations Committee have been revised and were approved at the January 2012 Board Meeting to include additional duties to review the structure, size and composition of the Board and to identify individuals suitably qualified to become Members of the Board.

In addition, the Nominations Committee will give consideration to the Board Diversity Policy which was recently approved at the March 2013 Board Meeting.

Work Performed by Nominations Committee

In 2012, the Nominations Committee held two Meetings. In accordance with its Terms of Reference, the Committee performed the following work during the year:

- Recommendation to the Board for the purpose of 2012 AGM:
 - The appointment/re-appointment of Directors who stood for election/re-election at the AGM, and
 - The independence of the independent non-executive Directors who stood for re-election at the AGM; and
- Annual review of the size, structure and composition of the Board.

The attendance record of each Committee Member is shown on page 99 under the section “Board Proceedings”.

Corporate Responsibility Committee

The Corporate Responsibility Committee includes two non-executive Directors (i.e. Dr. Raymond Ch'ien Kuo-fung (Chairman) and the S for T&H (being Ms. Eva Cheng up to 30 June 2012, and Professor Anthony Cheung Bing-leung from 1 July 2012)), three INEDs (i.e. Ms. Christine Fang Meng-sang, Mr. Abraham Shek Lai-him and Mr. Vincent Cheng Hoi-chuen) and three Executive Directors (i.e. Mr. Jay Herbert Walder * (CEO), Ms. Gillian Elizabeth Meller (LD&S) and Mr. Morris Cheung Siu-wa (Human Resources Director)).

* At the October 2012 Board Meeting, the Board appointed Mr. Jay Herbert Walder (CEO) as a Member of the Committee.

Duties of Corporate Responsibility Committee

The duties of the Committee are to recommend a corporate responsibility policy to the Board for approval, monitor and oversee the implementation of the Company's corporate responsibility policy and initiatives, identify emerging corporate responsibility issues arising from external trends, review the Company's annual Sustainability Report and recommend endorsement by the Board, and provide updates to the Board as required. Please also refer to the “Corporate Responsibility” section on pages 92 to 93 of this Annual Report.

Work Performed by Corporate Responsibility Committee

In 2012, the Corporate Responsibility Committee held two Meetings. The major work performed by the Committee in 2012 included:

- Review of the implementation of the Company's community and staff engagement and communication programmes;
- Review of the sustainability development and environmental management of the Company;
- Review of corporate responsibility development of the Company; and
- Review of and recommendation for the Board's approval of the scope for the draft 2011 Sustainability Report.

Company Secretary

Ms. Gillian Elizabeth Meller has been LD&S and a Member of the Executive Directorate since 1 September 2011. As LD&S, Ms. Meller reports to the CEO. All Members of the Board have access to the advice and services of LD&S, who is responsible for ensuring that the correct Board procedures are followed and advises the Board on all corporate governance matters. On appointment to the Board, LD&S has arranged for each of the Directors (including alternate directors) to receive a comprehensive, formal and tailored induction programme on key areas of business operations and practices of the Company, as well as the general and specific duties of directors under general law (common law and legislation) and the Listing Rules. To assist Directors' continuing professional development, LD&S recommends Directors to attend relevant seminars and courses and arranges for training on relevant new or amended legislation or other regulations to be provided at Board Meetings. The costs for such training are borne by the Company. During 2012, the Company Secretary undertook over 15 hours of professional training to update her skills and knowledge.

Internal Controls

The Board is responsible for the internal control systems of the Company and its subsidiaries, setting appropriate policies and reviewing the effectiveness of the internal control systems. Internal control is defined as a process effected by the Board, Management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following areas:

- effectiveness and efficiency of operations
- reliability of financial reporting
- compliance with applicable laws and regulations
- effectiveness of risk management functions

Pursuant to the Protocol adopted by the Board, the Board has delegated the day-to-day management of the Company's business to the Executive Committee, and focuses its attention on matters affecting the Company's overall strategic policies, finances and shareholders.

Supported by members of the Executive Committee, the CEO who chairs the Executive Committee is responsible to the Board for the conduct of the business of the Company.

A number of committees have been established to assist the Executive Committee in the management and control of the Company's various core businesses and functions. Key committees include:

- Operations Executive Management Committee
- Property Executive Management Committee
- Project Control Group
- Investment Committee
- International Business Executive Committee
- China Business Executive Committee
- Consultancy Services Management Committee
- Information Technology Executive Management Committee
- Financial Planning Committee
- Corporate Safety Management Committee
- Enterprise Risk Committee
- Executive Tender Panel/ Tender Board
- Corporate Responsibility Steering Committee
- Crisis Management Team

The Executive Committee is responsible for implementing the Board's policies on risk and control. In fulfilling its responsibilities, the Executive Committee identifies and evaluates the risks faced by the Company for consideration by the Board, and designs, operates and monitors suitable internal control systems which implement the policies adopted by the Board. The Executive Committee is accountable to the Board for monitoring the internal control systems and providing assurance to the Board that it has done so. Additionally, all employees have responsibility for internal controls within their areas of accountability.

Various risk management strategies have been established by the Board as advised by the Executive Committee to identify, assess and reduce risks, including construction, business operations, finance, treasury, safety and enterprise risks as well as to ensure appropriate insurance coverage.

Risk Assessment and Management

The Company's Enterprise Risk Management framework is an essential and integral part of corporate governance to help in sustaining business success and creating value for stakeholders. It is a corporate-wide systematic risk management process which aims to assist the Executive Committee and individual business areas to manage the key risks and support the Board in discharging its corporate governance responsibilities.

More details of the framework and process are given in the section headed Risk Management on page 88.

Control Activities and Processes

To ensure the efficient and effective operation of business units and functions, and safety of operating railway and construction works in railway projects, Corporate General Instructions ("CGIs"), divisional/departmental procedures and manuals, committees, working groups and quality assurance units are established to achieve, monitor and enforce internal controls and evaluate their effectiveness.

CGIs and various departmental procedures and manuals are established for preventing or detecting unauthorised expenditures/payments, safeguarding the Company's assets, ensuring the accuracy and completeness of accounting records and timely preparation of reliable financial information.

All Department Heads, including Business and Project Managers for overseas projects, are responsible for ensuring the compliance with statutes and regulations applicable to their own functional units. They are required to identify any new or updated statutes, to assess their impact on the Company's operations, and to review at least once a year that relevant statutes/regulations are complied with. Potential and actual non-compliances are also reported and followed up by Department Heads and significant cases are reported to the respective Divisional Directors and the Executive Committee. Issues relating to compliance with statutes and regulations including potential and actual non-compliances, and the status of rectification and actions taken to prevent recurrence are reported annually to the Executive Committee and Audit Committee.

A whistle-blowing policy has been put in place to deal with concerns related to fraudulent, unethical acts or non-compliances with laws and Company's policies that have or could have significant adverse financial, legal or reputational impact on the Company. The policy applies to all staff, parties who deal with the Company as well as the general public.

The Internal Audit Department plays a major role, independent of the Company's management, in assessing and monitoring the internal control systems of the Company. The Head of Internal Audit reports to the CEO and has

direct access to the Audit Committee. The Department has unrestricted access to information that allows it to review all aspects of the Company's risk management, control and governance processes. On a regular basis, it conducts audits on financial, operational and compliance controls, and effectiveness of risk management functions of all business and functional units as well as the subsidiaries. Management is responsible for ensuring that control deficiencies highlighted in internal audits are rectified within a reasonable period. The Department produces an annual internal audit plan for the Audit Committee's approval. The audits are selected based on risk assessment to ensure that business activities with high risk are covered. On a half-yearly basis, the Head of Internal Audit reports to the Audit Committee her opinion on the adequacy and effectiveness of the internal control systems.

On behalf of the Board, the Audit Committee evaluates the effectiveness of the internal control systems of the Company, including the reliability of financial reporting, effectiveness and efficiency of operations, compliance with applicable laws and regulations, effectiveness of risk management functions and the adequacy of resources, staff qualifications and experience, training programmes and budget of the Company's accounting and financial reporting function. This is achieved primarily through approving the scope of the annual internal audit plan, reviewing the findings of internal audit work, the annual and interim financial statements, and the nature, scope of work, and report of the external auditors, and consideration of the following:

- the changes in the nature and extent of significant risks since the previous review and the Company's ability to respond to changes in its business and external environment;
- the scope and quality of management's ongoing monitoring of risks and the internal control systems, the work of the Internal Audit Department, and the assurance provided by the Executive Committee;
- the extent and frequency with which the results of monitoring are communicated, enabling the Audit Committee to build up a cumulative assessment of the state of control in the Company and the effectiveness with which risk is being managed;
- the incidence of any significant control failings or weaknesses that have been identified during the period and the extent to which they have resulted in unforeseen outcomes or contingencies that have had, could have had, or may in the future have, a material impact on the Company's financial performance or condition; and
- the effectiveness of the Company's processes in relation to financial reporting and statutory and regulatory compliance.

The processes for assessing internal controls by the Audit Committee included: regular interviews with members of the Executive Committee in relation to key business operations, internal control and compliance issues, both financial and non-financial; review of significant issues arising from internal audit reports and external audit report, private sessions with internal and external auditors, and review of annual assessment and certification of internal controls from members of the Executive Committee, management of overseas subsidiaries and department heads in their areas of responsibility. The Audit Committee has also reviewed the papers prepared by the Executive Committee and Internal Audit Department covering: 2011 Annual Report and Accounts, Preview of 2012 Annual Accounting issues, 2012 Interim Accounts, 2013 Internal Audit Plan, Internal Audit Department's Half-yearly Reports, Report on Whistle-blowing, Report on the Company's Internal Control System, Reporting of Outstanding Litigation and Compliance Issues, Enterprise Risk Management Report and Evaluation of Effectiveness of Internal Audit Department. The chairman of the Committee meets on an ad hoc basis with the Head of Internal Audit, representatives of the External Auditor and Management of the Company as appropriate. He summarizes activities of the Committee and highlights issues arising therefrom by a report to the Board after each Audit Committee Meeting.

The Company is committed to recruit, train and develop a team of qualified and competent accountants in order to oversee its financial reporting and other accounting-related matters. A process to capture and update relevant laws, rules and regulations applicable to the reporting and accounting function is in place. Designated officers will ensure relevant standards and ordinances including Hong Kong Financial Reporting Standards, the Listing Rules and the Companies Ordinance under their responsibility are complied with. Resources and provisions required to deliver accounting and financial reporting function are critically reviewed during the annual budgeting exercise. Company-wide recruitment process and staff development programmes are in place to address the competency, qualifications and experience required. Adherence to the process is confirmed on an annual basis by the designated officers to the Deputy CEO who will conduct a formalized annual review and report to the Audit Committee for the review results. Confirmation of the process is also monitored by the Internal Audit Department. Based on the above, the Audit Committee considered the resources, qualifications and experience of staff of the Company's accounting and financial reporting function, and their training programmes and budget were adequate.

The Board has, through the Audit Committee, conducted the review of the effectiveness of the Company's internal control systems for the year ended 31 December 2012, covering all material financial, operational and compliance controls, and the risk management function, and concluded that adequate and effective internal controls are maintained to safeguard the shareholders' investment and the Company's assets. There were no significant control failings, weaknesses or significant areas of concern identified during the year which might affect shareholders.

Crisis Management Team

To uphold the reputation of being one of the best companies in Hong Kong and in order to help ensure that the Company will respond to and recover from crises in an organised and highly effective manner, including timely communication with principal stakeholders such as shareholders, the Company has an established mechanism since 1995 to activate the formation of the Crisis Management Team in the event of a crisis. The Crisis Management Team comprises relevant Members of the Executive Directorate and Executive Managers, and its operation is governed by a Crisis Management Plan which, among other things, sets out the duties of respective members. The Crisis Management Plan is kept in line with world-class standards and up-to-date through regular reviews. The Crisis Management Team conducts regular exercises to validate the crisis management organisation and arrangements and to provide practices for members. An exercise was conducted in the first quarter of 2012.

Continuous Disclosure Obligations Regarding Inside Information

The Company has developed a system with established policies, processes and procedures across all relevant Division(s) and Department(s) for complying with the disclosure obligations regarding price sensitive information. The system was reviewed by a cross-departmental task force in late 2008 and was considered effective in dealing with the relevant disclosure obligations.

As the disclosure obligations relating to price sensitive information (formerly governed by the Listing Rules) are now governed by the SFO, with effect from 1 January 2013, (the "Legislation") in which the term "price sensitive information" was replaced by "Inside Information", the Board has approved, at the December 2012 Board Meeting, the following additional measures to enhance the existing system:

1. Issuance of a set of guidelines setting out:
 - (i) the processes for identifying, assessing and escalating potential Inside Information to the Executive Committee and the Board; and

- (ii) the responsibilities of officers in preserving the confidentiality of Inside Information, escalating upwards any such potential information and cascading down the message and responsibilities to relevant staff;

2. Providing training sessions to all Members of the Board and the Executive Directorate and officers who are likely to be in possession of the Company's Inside Information. On-going training sessions on the latest developments/requirements of the SFO will also be arranged when appropriate;
3. Updating the Company's Code of Conduct to take account of the Legislation; and
4. Conducting an annual review of compliance with the Legislation by the Executive Committee, with a report to the Board.

The Board considered that the Company's existing system and the additional measures are effective and appropriate compliance mechanisms to safeguard the Company and its officers in discharging their disclosure obligations in respect of Inside Information.

Governance of Subsidiaries and Affiliated Companies

The Company has a number of subsidiaries and affiliated companies which operate independent businesses in Hong Kong, the Mainland of China and overseas. Notwithstanding these subsidiaries and affiliated companies are separate legal entities, the Company has implemented a management governance framework ("Governance Framework") to ensure that it exercises an appropriate level of control and oversight as a shareholder of these subsidiaries and affiliated companies.

Pursuant to the Governance Framework, the Company exercises its control and oversight in a number of forms: imposition of internal controls, requirements for consent or consultation, reporting requirements and assurance. The management of each subsidiary or affiliated company is responsible for the adoption of management practices and policies that are appropriate to the business nature and local situation, taking into account the management governance requirements of the Company, and developing a corporate governance manual for the entity which reflects both such management practices and policies as well as management governance requirements, for approval by the relevant board of directors. Ongoing compliance with the manuals is reported by all subsidiaries and affiliated companies on a regular basis.

The Executive Committee reviews the Governance Framework and compliance by the subsidiaries and affiliated companies with it on an annual basis. The progress made in the implementation of the Governance Framework is reported to the Audit Committee annually.

Model Code for Securities Transactions by Directors of Listed Issuers

The Company has adopted the Model Code set out in Appendix 10 of the Listing Rules ("Model Code"). After having made specific enquiry, the Company confirms that Members of the Board and the Executive Directorate complied throughout the year with the Model Code. Senior managers, other nominated managers and staff who, because of their office in the Company, are likely to be in possession of unpublished price sensitive/Inside Information, have been requested to comply with the provisions of the Model Code. In addition, every employee is bound by the Code of Conduct issued by the Company, amongst other things, to keep unpublished price sensitive/Inside Information in strict confidence.

Business Ethics

The Company's continued success depends on unwavering adherence to a high standard of business ethics and integrity. To help employees understand and comply with our requirements on ethical practices, the Company has developed the Code of Conduct, Corporate Guidebook for All Staff and Corporate Guidebook for Managers (the "Guidebooks"). Every two years, we review and update the Code of Conduct and the Guidebooks to ensure appropriateness and compliance with the law. All employees are required to acknowledge their understanding and acceptance of the relevant documents. Staff members are encouraged to report existing or perceived violations and malpractices. If they have genuine suspicions about wrongdoings, there are proper procedures pursuant to the Whistle-blowing policy of the Company, through which they can raise their concerns in a safe environment and in complete confidence.

To ensure new recruits understand our ethical commitments, the Code of Conduct and the Guidebooks are briefed to them in staff induction programmes. In addition, the Code of Conduct is uploaded onto the Company's website.

The Company has extended the scope of the Code of Conduct to cover subsidiaries in the Mainland of China and a simplified Chinese-language version of the Code of Conduct has been made available to staff there. Under the Code of Conduct, all subsidiaries are required to observe the relevant local laws and regulations. At the same time, the Company has been promoting a comparable ethical culture in joint venture companies. Guidelines on business ethics for staff have also been published.

External Auditor

The Company engages KPMG as its External Auditor. In order to maintain KPMG's independence and objectivity and the effectiveness of the audit process in accordance with applicable standards, the Audit Committee, under its Terms of Reference, pre-approves all audit services to be provided by KPMG and discusses with KPMG the nature and scope of their audit and reporting obligations before the audit commences.

The Audit Committee also reviews and pre-approves the engagement of KPMG to provide any non-audit services for complying with relevant legal requirements and seeks to balance the maintenance of objectivity with value for money.

The nature of audit and non-audit services provided by KPMG and fees paid to KPMG (including any entity that is under common control, ownership or management with the audit firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as part of the audit firm nationally or internationally) are set out in note 9D to the accounts on page 175.

For maintaining integrity and objectivity as the External Auditor of the Company, KPMG implements policies and procedures to comply with professional ethics and independence policies and requirements applicable to the work it performs. In addition, KPMG requires its audit partner serving the Group to rotate off the audit engagement with the Company at least once every seven years.

Communication with Shareholders

Annual General Meeting ("AGM")

The Company's AGM is one of the principal channels of communication with its shareholders. It provides an opportunity for shareholders to communicate face to face with the Directors about the Company's performance and operations. It has been the practice for the Chairman of the Company, the chairmen of the Board Committees, all Members of the Executive Committee and the External Auditor of the Company to attend AGMs to answer shareholders' questions.

The 2012 AGM was held on 3 May 2012 at Rotunda 3 (6/F), Kowloonbay International Trade & Exhibition Centre, Kowloon Bay, Hong Kong. To facilitate Shareholders who did not attend the Meeting, the whole proceeding was webcast and posted on the Company's website in the same evening.

The 2013 AGM has been scheduled for 9 May and it is planned to continue providing simultaneous interpretation to facilitate smooth and direct communication between Shareholders and the Company's Directors and Management.

Resolutions passed at the 2012 AGM

The Chairman proposed separate resolutions for each substantially separate issue at that AGM. Before the resolutions were considered, the Chairman exercised his right as the Chairman of the Meeting under Article 67 of the Articles of Association to call a poll on all resolutions conducted by electronic means.

A total of ten resolutions were passed at the 2012 AGM (with resolution no. 3 comprising four separate resolutions), each by over 94% of the votes cast at the Meeting. The full text of the resolutions is set out in the AGM Circular (which comprised Notice of the AGM) to shareholders dated 29 March 2012. For the benefit of those shareholders who did not attend the AGM, below is a succinct summary of the resolutions passed:

- (1) Adoption of the audited Statement of Accounts and the Reports of the Directors and the Auditors of the Company for the year ended 31 December 2011;
- (2) Declaration of a final dividend of HK\$0.51 per share for the year ended 31 December 2011;
- (3) (a) Re-election of Dr. Raymond Ch'ien Kuo-fung as a Member of the Board of Directors of the Company;
(b) Re-election of Professor Chan Ka-keung, Ceajer as a Member of the Board of Directors of the Company;
(c) Re-election of Mr. T. Brian Stevenson as a Member of the Board of Directors of the Company; and
(d) Election of Mr. Jay Herbert Walder as a Member of the Board of Directors of the Company.
- (4) Re-appointment of KPMG as Auditors of the Company and authorisation of the Board of Directors to determine their remuneration;
- (5) Grant of a general mandate to the Board of Directors to allot, issue, grant, distribute and otherwise deal with additional shares in the Company, not exceeding ten per cent. of the Company's issued share capital as at the date of this resolution*;
- (6) Grant of a general mandate to the Board of Directors to purchase shares in the Company, not exceeding ten per cent. of the Company's issued share capital as at the date of this resolution*; and
- (7) Conditional on the passing of resolutions 5 and 6, authorisation of the Board of Directors to exercise the powers to allot, issue, grant, distribute and otherwise deal with additional shares in the Company under resolution 5 in respect of the aggregate nominal amount of share capital in the Company purchased by the Company*.

* (The full text of the resolution is set out in the Notice of the 2012 AGM.)

The poll results were posted on the websites of both the Company and the Stock Exchange on the same day after the AGM.

Extraordinary General Meeting ("EGM")

The Company may also communicate with its shareholders through EGMs if and when appropriate.

If shareholders want to convene an EGM of the Company, those shareholders may requisition the Directors of the Company to do so, provided that at the date of requisition they hold, in aggregate, not less than one-twentieth of the paid-up capital of the Company. The shareholders' requisition must state the objects of the meeting requested and must be deposited at the registered office of the Company. The requisition may consist of several documents in like form, each signed by one or more of the shareholders concerned.

If, within 21 days from the date of the deposit of the requisition, the Directors of the Company do not proceed duly to convene an EGM for a day not more than 28 days after the date on which the notice convening the EGM is given, the relevant shareholders, or any of them representing more than one-half of the total voting rights of all of them, may themselves convene an EGM, provided that any EGM so convened is held within three months from the date of the original requisition.

Procedures for Shareholders Putting Forward Proposals

Shareholders may put forward proposals for consideration at a general meeting according to the Companies Ordinance and the Company's Articles of Association.

As regards proposing a person for election as a director, please refer to the procedures available on the websites of the Company and the Stock Exchange.

Enquiries from Shareholders

The Company has a Shareholders' Communication Policy to provide shareholders with information about the Company to enable them to engage actively with the Company and exercise their rights as shareholders in an informed manner.

The Company's Shareholders Communication Policy available on both the websites of the Company and the Stock Exchange, has set out, amongst other things, a channel for shareholders' access to the Board and Management by writing to the Company Secretary of the Company.

Please also refer to the Investor Relations section on pages 86 to 87 on other means of communication with shareholders.

Constitutional Documents

The Company's Memorandum and Articles of Association (in both English and Chinese) is available on both the websites of the Company and the Stock Exchange. During 2012, there is no change to the Company's Memorandum and Articles of Association.