

RISK MANAGEMENT

SYSTEM FEATURES

Business units across the Company embrace the Company's Enterprise Risk Management ("ERM") framework which underpins their day-to-day business activities. The framework provides a simple and effective management process to:

- Identify, assess, and effectively manage operational, functional, and enterprise risks across the Company
- Prioritise resources to manage risks
- Give management a clear view of significant risks facing the Company
- Support decision making and project execution for better business performance

The Board, with the assistance of the Risk Committee (up to 31 January 2022 and the Audit & Risk Committee thereafter), oversees the Company's ERM framework and top risks, whereas the Executive Committee, with the support of the Enterprise Risk Committee ("ERC"), is overall accountable for the ERM policy and system implementation and continuous improvement.

The Executives provide top-down views on the key risks of the Company through discussions on quarterly enterprise risk reports, receive technical input and analysis, make informed decisions and take decisive tactical and strategic actions on the key risks that the Company faces. Three "Blue Sky" (brainstorming) workshops were held in March, June and September 2021. At the March and June workshops, the Executives examined risk scenarios arising



* See the Risk Committee Report (pages 140 to 141 of this Annual Report) for duties and work performed by the Committee in 2021

from the new business normal during and in the post-COVID environment. At the September workshop, the Executives looked into the latest trend of cyber-attacks on critical infrastructure, including state-sponsored attacks, and also examined risks associated with talent management, retention and competence gaps.

The Company's risks are rigorously identified, assessed and managed. Each risk is evaluated on the likelihood of occurrence as well as potential consequence while taking existing controls into consideration. A risk matrix is used to determine a risk rating (E1 – E4), with E1 being a relatively high risk and E4 being a relatively low risk. The risk rating determines the required level of management attention and risk treatment effort while considering the Company's risk appetite. The highest category of risk, "E1", is subject to Board, Board Committee and Executive Committee oversight.

While encountering risk is inevitable in the course of business, the Company's appetite for risk varies and is particularly low in certain areas such as in relation to public and employee safety and the provision of a reliable transport service.

The Company's ERM system provides an important internal control in identifying, assessing and managing risks affecting the Company. As a learning organisation, the Company constantly looks for improvement opportunities through internal and external reviews and studies, as well as learning from incidents encountered during its operations. On 2 December 2021, our Island

- Exercise ongoing risk oversight
- Establish appropriate risk management strategies
- Oversee the ERM framework
- Review top risks and emerging risks
- Conduct annual review of ERM system effectiveness

- Implement and continuously improve ERM framework
- Enterprise Risk Committee
 - Chaired by Legal and Governance Director
 - Comprises representatives from key business functions
 - Steers framework implementation and improvement
 - Reviews Company's top risks and key emerging risks
 - Reports to Executive Committee and Risk Committee quarterly, and to Board every six months

- Establish arrangements and implement risk management process consistent with the Company's ERM framework and policy
- Capture identified risks in risk registers for regular review and monitoring

Line service in Hong Kong was temporarily interrupted when an advertisement panel access door came into contact with a carriage door of a passing train. A comprehensive incident investigation was immediately initiated and corrective and preventative actions, including completion of a fleet-wide check of advertising panels followed by the removal of all advertising panels of a similar design, were undertaken.

MANAGEMENT PROCESS FOR SIGNIFICANT RISKS

The Company takes proactive measures to identify, evaluate and manage significant risks arising from its recurrent and growth businesses and from the constantly changing business environment. Risk management strategies are developed for different areas including

but not limited to operations, construction, finance, and environment, social and governance (“ESG”). ESG risks identified through the ERM framework are further mapped against relevant issues under ISO 26000 for materiality assessment purposes.

The ERM Team within the Legal and Governance Function maintains a list of running issues and risk drivers pertinent to the changing business and external environments, which is used to assist the ERC in identifying potential risks that may emerge.

In addition, the ERC and the Executive Committee review the Company’s enterprise risk profile and brainstorm emerging risks quarterly to ensure key risks are captured, assessed and controlled. The Board also reviews these on a six-monthly basis.



* Areas below are not exhaustive

Since 2020, the COVID-19 pandemic has emerged as a key enterprise risk which has and continues to significantly affect the Company’s businesses and has required careful management to mitigate the financial, operational, staff, customer and societal impacts. The pandemic situation remains fluid as new variants emerge and continue to pose an ongoing threat which the Company will continue to monitor and respond to. The Infectious Disease Management Team (“IDMT”) coordinates corporate-wide strategic response actions according to the Infectious Disease Business Continuity Plan. This includes overseeing the stock level of Personal Protective Equipment, recommending work arrangements with a view to reducing risk and issuing notices and situation reports for

staff communication. The IDMT also undertakes a regular review of the risks to the Company’s business continuity arising from any Government control measures, the COVID-19 situation outside Hong Kong, the reported efficacy of vaccines and the vaccination take-up rate of staff and contractors. The Company continues to deploy resources to maintain a hygienic environment for staff and customers, including the deployment of technology, such as the Vapourised Hydrogen Peroxide (“VHP”) Robot, to disinfect company premises, stations, and trains. The Company implements social distancing measures proportionate to the prevailing risk levels in organising meetings, training and events.

The long-term financial sustainability of the Company is continuously monitored by the Board and the Executive Committee. The prolonged COVID-19 pandemic has caused short-term financial impacts on the Group's businesses. With the emergence of COVID-19 variants, in particular the highly transmissible Omicron variant, the pandemic is still yet to subside globally. To mitigate the financial impacts on the Company, various cost control initiatives, including a recruitment freeze and reductions

in discretionary spending, have been put in place. Further, the Group continues to maintain low gearing, even under the current difficult situation. Overall, the financial position of the Group remains sound. The Group has also been implementing transformation initiatives with a view to further improving the Group's profitability in the longer term, while the new railway and other projects in the pipeline may further contribute to the Group's long-term financial sustainability.

Key risk management focus areas for the Company include:

Effective and Balanced Relationship with Key Stakeholders	
Key Challenges	<ul style="list-style-type: none"> Challenging political landscape and diverse stakeholder expectations Uphold public confidence in light of operational incidents Building relationships with communities and stakeholders around the new projects
Key Controls	<ul style="list-style-type: none"> Implement tailored engagement plans for different stakeholders to maintain effective communication and understanding Observe the Company's operating obligations and maintain good performance of the Company Proactive approach to stakeholder engagement during the planning, design and construction of the new projects
People	
Key Challenges	<ul style="list-style-type: none"> Talent recruitment and retention for specific disciplines, new projects and growth business Having sufficient workforce amidst reduced headcount and staff turnover More challenging employee relations environment due to more diverse and polarised views Health threat to the workforce, loss of productivity and potential impact on normal operations arising from the COVID-19 pandemic
Key Controls	<ul style="list-style-type: none"> Succession planning, forward manpower planning and resourcing strategies and onboarding process Management decision to contain staff headcount but monitor closely to mitigate risks of business disruption and staff negative sentiment Employee Engagement Survey to gauge more accurately staff sentiment Proactive employee engagement through various communication channels Enhanced cleaning and sterilisation at workplaces, including offices, depots, stations and trains, provision of face masks and personal protective equipment for staff, special work arrangements and implementation of business continuity arrangements Encouraged staff to take vaccines through arrangement of an outreach programme and granting of leave resulting in an increased percentage of vaccinated staff Robust tracking and management protocol for confirmed or close-contact cases in the workforce
New Projects Quality, Programme and Cost	
Key Challenges	<ul style="list-style-type: none"> Adherence to quality, programme and cost of projects Meeting stakeholder programme expectations on new railway projects due to insufficient Non-Traffic Hours ("NTH") possessions to facilitate the high levels of operations interface, recognising the ongoing need for asset replacement and regular maintenance on the operating railway Negotiation of the Tung Chung Line Extension Project Agreement with Government, being the first of the new projects
Key Controls	<ul style="list-style-type: none"> Establishment of the Three Lines of Defence approach to provide project assurance, including audits and assurance to ensure compliance with processes and procedures Introduction of the new digital revamped Capital Works Project Integrated Management System Monitoring project quality and progress against Key Performance Indicators Stringent control of change and contingency funds Introduction of competency and resource management framework in the Capital Works Business Unit to ensure sufficient staff with the right skills and competencies are employed on the projects Development of a digital strategy in the Capital Works Business Unit, increasing the use of technology to deliver and manage projects, including the use of Building Information Modelling ("BIM") and digital supervision and record keeping NTH Office established to coordinate supply and demand for track possessions across business units and to develop initiatives and procure resources to improve possession management Proactive engagement with Government to establish the future way of delivering railway projects, including negotiation of the Tung Chung Line Extension Project Agreement

New Business Model/Technological Disruption/Competition	
Key Challenges	<ul style="list-style-type: none"> • Current business model disrupted by new technology • Manage competition from other transport modes
Key Controls	<ul style="list-style-type: none"> • Invest in technology and digital solutions to strengthen business model • Monitor competition from other transport modes and implement initiatives to maintain market share
Delivery of Growth Strategy	
Key Challenges	<ul style="list-style-type: none"> • Uncertain business model for future new lines in Hong Kong • Keen competition for business opportunities outside Hong Kong • Business performance below the bid models and assumptions • Heightened geopolitical/isolationist risk
Key Controls	<ul style="list-style-type: none"> • Ongoing engagement with Government to establish business models for new lines in Hong Kong • Maximise branding effect of the Company and stakeholder engagement • Diversify the Company's businesses in locations outside Hong Kong and conduct regular scans for new business opportunities • Formulate and implement business improvement plans for underperforming businesses
Security Threat (cyber/physical)	
Key Challenges	<ul style="list-style-type: none"> • Threat of cyber-attack on Operations and IT systems • Terrorist attack threat
Key Controls	<ul style="list-style-type: none"> • Enhanced IT network resilience to protect against cyber attacks • Implementation of cyber security protection systems for IT and railway operations systems • Enhanced security measures • Enhanced corporate security governance framework

Process of System Effectiveness Review

On behalf of the Executive Committee, the ERC evaluates the effectiveness of the ERM system at least annually. The Legal and Governance Director, who chairs the ERC, presented the ERM system effectiveness review results for the year ending 31 December 2021 to the Executive Committee, which confirmed its agreement with the review results on 10 February 2022 and to the Audit & Risk Committee on 28 February 2022, who likewise confirmed their agreement with the review results.

The Audit & Risk Committee, with delegated authority from the Board, has evaluated the effectiveness and adequacy of the Company's ERM system and considers it to be overall "effective and adequate", based on a number of review areas.

Factors considered during the review

- Review areas suggested in the Corporate Governance Code for the Board's annual review of the risk management system
- Annual internal certification of risk management effectiveness by Department Heads and Heads of subsidiaries/associates
- Risk management of subsidiaries and associates
- Benchmarking/roundtable/peer group ideas exchange
- Risk management training and promotion held in 2021

Conclusion

The ERM system was considered overall effective and adequate for the year ended 31 December 2021.

CONTINUOUS PROCESS IMPROVEMENT

Key initiatives undertaken in relation to the ERM system in 2021 include the following:

- The ERM Team continued to produce ERM Newsletters for dissemination to all staff focusing on topical issues in risk management, aiming to raise risk awareness and share good risk management practices.
- In October 2021, the Company launched its annual Risk Awareness Week “RAW” event to promote risk awareness across all levels of the organisation, including holding a hybrid seminar which emphasised the importance of managing ESG issues as business risks, a webinar on risk assessment tools, and a quiz on managing ESG-related risks and performance. The RAW events and activities were well received with over 1,600 participations.
- Acting through the Risk Committee and the Audit Committee, in 2019 the Board mandated a review of the Company’s internal control and risk management systems. In 2020, an external consultant was appointed to conduct a deep-dive assessment of the Company’s existing Three Lines of Defence (“3LoD”) framework, with a view to identifying any gaps or improvements in the framework. The results of this assessment were presented to and endorsed by the Risk Committee and the Audit Committee in late 2020. Over the course of 2021, the Company has strengthened its Second Line of Defence (“2LoD”) through the establishment of an independent Assurance Management Department, which has been complemented by new technical and engineering Centres of Excellence, and a new Strategic Assurance Review Board (“SARB”), which serves to coordinate and focus assurance activities as well as to highlight any insights or concerns to relevant Executives. The new 3LoD model and framework was successfully piloted within the Capital Works Business Unit in late 2021 and will be rolled out in a phased manner to other business units starting in early 2022.
- We keep ourselves abreast of the latest developments in risk management through reviews with users, cross-industry benchmarking and experience sharing, including through participation in the UK ERM Roundtable meetings.