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26 June 2012

Ms Anita Sit
Clerk to Panel on Financial Affairs
Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central
Hong Kong

Dear Ms Sit,

Panel on Financial Affairs

Follow-up to meeting on 4 June 2012

I refer to your letter of 6 June 2012 to the Financial Secretary. The Administration has followed up with the Securities and Futures Commission on the issue raised. The information in relation to Hong Kong Exchanges and Clearing Limited's proposed acquisition of the London Metal Exchange is at Annex for Members' reference.

Yours sincerely,

A handwritten signature in blue ink, consisting of a large loop followed by a series of smaller loops and a trailing line.

(Jerry Cheung)
for Secretary for Financial Services
and the Treasury

c.c. Securities and Futures Commission (Attn: Ms Christine Kung)
 Hong Kong Exchanges and Clearing Limited (Attn: Mr Charles Li)
 Financial Secretary's Private Office (Attn: Mr Arthur Au)
 Financial Services and the Treasury Bureau (Attn: Mr Raymond Sy)

**Hong Kong Exchanges and Clearing Limited("HKEx")'s response to
Legislative Council Panel on Financial Affairs
Follow-up actions arising from the meeting on 4 June 2012
In relation to HKEx's proposed acquisition of the London Metal Exchange (the "LME")**

We refer to the question raised by the Panel on Financial Affairs of the Legislative Council (the "Panel") in relation to HKEx's proposed acquisition of the LME (the "Transaction"). We welcome this opportunity to respond to the Panel on the Transaction, which we believe will provide long-term strategic and financial benefits, not only to HKEx, but to the Hong Kong SAR community as a whole.

Background and strategic rationale

HKEx has developed as the leading operator of exchanges and clearing houses in Asia and a key player globally. Our success has in large part been based on having exploited our proximity to the China market and acting as a bridge between China and international capital markets. For our long-term development, it is important that we continue to exploit opportunities to enhance our value proposition to both China and international market participants. A key strategic priority for HKEx, therefore, is to expand and diversify our current equity-based business into commodities, currency and interest rate products.

Following over a year of extensive market research and analysis beginning in early 2011, HKEx identified a particular demand for commodities trading, focused around metals, to support the large and growing metals consumption in Asia and, particularly, China. Given the difficulties of developing a commodities trading platform organically, it was determined that HKEx should explore partnerships or other inorganic means of entering the market.

The LME is the world's leading exchange for the trading of base metal futures and options contracts¹, with a global market share estimated to be approximately 80 per cent. It achieved record volumes during 2011, with 146.6 million lots traded, equivalent to USD 15.4 trillion in notional contract value. Over the past five years, trading volumes have grown by 12.1 per cent per annum (2007-2011, compound annual growth rate), despite the difficult global economic environment.

¹ In terms of tonnes traded.

The LME's unique business model and global network of approved warehouses link it directly to the real economy and, when combined with the high levels of liquidity on the LME, mean that the prices discovered there are recognised and relied upon by the metals industry worldwide. Crucially, the LME plays a vital role in providing risk management solutions to consumers and producers of metals globally.

Given the LME's global leadership in metals trading and the unique opportunity provided by its decision in late 2011 to explore a sale, HKEx decided to participate in the auction process.

HKEx's due diligence and analysis showed that, while the LME is a global exchange, it has yet to realise fully the growth opportunity in Asia and China, in particular. The Transaction therefore combines two highly complementary businesses, bringing together the world's leading base metals exchange and Asia's leading financial market operator. Furthermore, the Transaction provides a platform for significant revenue growth as the LME's business and operations are expanded in Asia using HKEx's regional resources, infrastructure and network.

The combination of the LME with HKEx also offers significant opportunities for the expansion of HKEx's businesses. The LME provides HKEx with a platform for entry into other commodity asset classes, synergies relating to the development of RMB denominated products in fixed income and currencies that are attached to commodity flows, and opportunities for further expansion of our geographical reach. These developments all increase the relevance of HKEx and Hong Kong in global markets, supporting the enhancement of Hong Kong as a leading global financial services centre.

Financial impact on HKEx

HKEx believes that the addition of a strong commodities component to its existing businesses will support and enhance its growth prospects while diversifying its earnings base. The Transaction is expected to be earnings enhancing for HKEx in the third year following completion².

² This statement regarding earnings enhancement is not intended to be a profit forecast and should not be interpreted to mean that the earnings per HKEx share for the current or future financial periods will necessarily be greater than those for the relevant preceding financial periods.

The Transaction will be financed from existing cash resources and new bank facilities. Short and long-term loan facilities totalling at least GBP 1,100 million (HKD 13,214 million) have been secured from a group of banks, which HKEx expects to refinance part or all of at a later date through a combination of equity and bond issuance.

Following the Transaction HKEx will have sufficient funds and resources to operate existing operations, and will continue to maintain a high level of liquidity to support the risk management needs of our clearing operations. Further, it is not expected that HKEx's current dividend policy will be changed as a result of the Transaction.

Regulation and governance

The LME will continue to be regulated by the Financial Services Authority ("FSA") as a Recognised Investment Exchange based in London. The Transaction is not expected to result in the direct regulation of the LME by any regulatory body other than those which already have jurisdiction over it. However, as part of the ongoing regulatory monitoring process, it is expected that the FSA and the Securities & Futures Commission ("SFC") will closely cooperate and establish regulatory information sharing to provide appropriate regulatory oversight of the combined group.

HKEx views the expertise and experience of the LME's management team and employees as an essential part of the integration and future operation of the LME within the HKEx Group. Therefore, HKEx expects to retain employees of the LME as part of the enlarged HKEx group. As part of our planned expansion into commodities markets, HKEx has already recruited senior personnel with extensive commodities trading experience to supplement the expertise at our senior management levels.

Expected timetable

The Transaction will be effected by way of a scheme of arrangement under Part 26 of the Companies Act 2006 (the "Scheme"). An extraordinary general meeting of the LME's Ordinary Shareholders (the "EGM") is required to be convened in connection with the Scheme to consider and approve the Transaction.

The EGM is expected to take place before the end of July 2012. Subject to shareholder approval, a regulatory approval application for the Transaction will then be reviewed by the FSA. During this review, it is expected that the FSA will liaise with the SFC to establish HKEx's fit and proper status, and to agree regulatory protocols going forward. Subject to FSA approval, the Transaction is expected to close during the fourth quarter of 2012.

Conclusion

HKEx believes the Transaction to be in the long-term interests of our shareholders, employees, other stakeholders and the wider Hong Kong community. We welcome the interest of the Panel in this matter and look forward to the continuing support of the Panel and the SFC for us in this historic opportunity.

Hong Kong Exchanges and Clearing Limited
June 2012