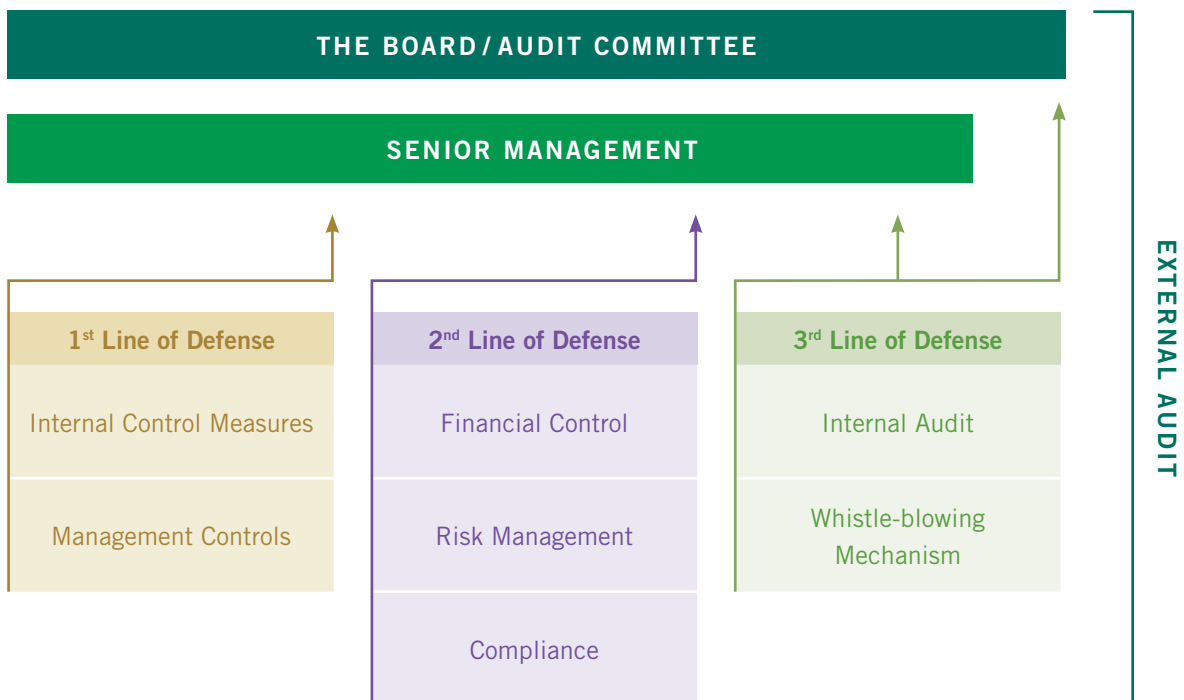


# Risk Management

## OVERALL RISK MANAGEMENT SYSTEM

Supported by the Audit Committee, the Board has the overall responsibility for risk management and the particular focus on determining the nature and extent of significant risks it is willing to take in achieving its strategic objectives. Risks are inherent in every sector of our businesses, and it is important to have a culture involving all levels of staff and a systematic approach to identify and assess risks such that they can be reduced, transferred, avoided or understood. Senior management is tasked with the design, implementation and maintenance of a sound and effective internal control system underpinning the risk management framework, which is crucial in delivering our corporate strategies and ensuring sustainability of our business. We are committed to continually enhancing our risk management framework, linking to our corporate strategies as well as integrating it into day-to-day operation decision making.



	Key Roles	Enhancements in 2014
<b>1<sup>st</sup> Line of Defense Business Operations</b>	<p>An established risk and control environment:</p> <ul style="list-style-type: none"> <li>• Involve in day-to-day risk management</li> <li>• Follow a risk process</li> <li>• Apply internal controls and risk responses</li> </ul>	<ul style="list-style-type: none"> <li>• Tightened tender process</li> <li>• Enhanced controls on variation claims made by consultants and contractors from our mainland China projects</li> <li>• Restructured property management team to dedicate resources for handover of new projects, establishment of best practices, and delivery of customer services</li> </ul>
<b>2<sup>nd</sup> Line of Defense Oversight Functions: Finance, Legal &amp; Company Secretarial, Human Resources, Cost &amp; Controls, and Other Head Office Functions</b>	<ul style="list-style-type: none"> <li>• Strategic management</li> <li>• Policy and procedure setting</li> <li>• Functional oversight</li> </ul>	<ul style="list-style-type: none"> <li>• Reinforced dual reporting line of functional heads for “check &amp; balance” in our mainland China projects to Group function heads and local management</li> <li>• Established the Central Marketing and Central Leasing teams for coordination and monitoring of strategic marketing and rental activities</li> <li>• Renewed the risk management framework and process</li> <li>• Further standardization of property development projects, e.g. design, documentation, materials and bulk purchases, inter-departmental handovers</li> <li>• Clarified roles and responsibilities amongst planning, construction and operation departments in different phases of our mainland China projects</li> <li>• Re-examined the terms of the Asset Enhancement Committee</li> </ul>
<b>3<sup>rd</sup> Line of Defense Internal Audit</b>	<ul style="list-style-type: none"> <li>• Review 1<sup>st</sup> and 2<sup>nd</sup> lines</li> <li>• Provide an independent perspective and challenge the process</li> <li>• Be objective and offer assurance</li> </ul>	<ul style="list-style-type: none"> <li>• Completed a self-assessment of activities and increased level of resources for Internal Audit</li> <li>• Re-affirmed our whistle-blowing policy to internal and external stakeholders</li> </ul>

## INTERNAL CONTROL ENVIRONMENT

We adhere to a stringent set of internal controls using well-established guidelines for regular management reviews, segregation of duties, budgetary controls, limits for various levels of authority, a whistle-blowing mechanism, Code of Conduct for both staff and trading partners, and training for staff development.

Our internal control systems are developed with reference to the COSO (Committee of Sponsoring Organizations of the Treadway Commission) principles. Details are covered in the Corporate Governance Report on page 91.

## MANAGING KEY RISKS

We take measures to manage the risks arising from our existing and growing businesses. Key risks currently being managed are:

### Land Bank Acquisition and Property Development Risk

Hang Lung Group has a long-term expansion strategy for mainland China to minimize the effects of short-term market fluctuations and government policies. Under this strategy, we have established and continued to maintain a solid land bank for property development. When the right opportunities arise which typically have the competitive advantages of top location and adequate size, we carefully scrutinize each project or parcel of land for related risks and returns. These include design and quality construction considerations, and assessment of relevant government policies, the level of local government support, market demand and conditions, and economic data as well as infrastructure support in the neighboring area. If these requirements are met, we will present a proposal to the Board for their final approval.

When a project is underway, our project team closely monitors its progress and evaluates and approves any necessary changes to the design or construction works. Roles and responsibilities are clearly defined for different departments in the Project Planning Department, Project Construction Department and Leasing & Management Department at various stages of handover during the project. Our management also takes part in supervising projects and conducts regular progress reviews. If changes are required, management is thus able to make prompt decisions.

Our skilled and professional project team is also responsible for keeping the Board fully informed through regular and comprehensive reports.

As is the case with any development, cost and quality controls are essential to a project's success. This is particularly important when several large development projects are in the pipeline. Throughout different stages of a project, management will maintain tight controls over its cost and the selection of contractors and material suppliers in order to maintain the high standards of excellence.

## Treasury Risk

We have made every effort through our treasury policies to mitigate the various treasury risks to which we are exposed.

### *(a) Interest Rates and Foreign Exchange*

Most of the Group's borrowings are floating-rate bank loans, which expose us to movements in interest rates. We closely monitor the interest rate risks and when appropriate will adopt measures to manage the associated risks – including but not limited to the issuance of fixed rate bonds and the use of derivatives such as interest rate swaps.

As our business and investments in mainland China are conducted primarily in Renminbi, we manage our Renminbi exchange rate risks prudently for maximum protection. Our recurring rental turnover in Renminbi provides a natural hedge for these investments. We also maintain an appropriate level of Renminbi resources to meet the Group's capital requirements for our ongoing projects in mainland China.

The US Dollar exchange rate risk is considered not significant as our net exposure to the US Dollar is moderate and the HK Dollar is pegged to the US Dollar under the prevailing pegged exchange rate regime in Hong Kong.

### *(b) Cash Management, Funding and Liquidity*

The Group's cash and financing are managed and controlled at the corporate level. This enables us to negotiate better borrowing terms and practice coherent financial risk management.

To meet our obligations as and when needed, the Group maintains sufficient funds, banking facilities and multiple fund raising channels. The maturity of deposits and loans is carefully planned and managed to reduce liquidity risk. During the year, we lengthened the average debt maturity of the Group through the arrangement of medium/long-term loan facilities and issuance of long-dated bonds. Our Medium Term Note Program gives us the flexibility to tap the bond market if necessary. The Group closely monitors the markets to manage the refinancing risks in a prudent manner.

### *(c) Credit/Counterparty*

Credit/counterparty risk exposure is primarily in the areas of rents receivable, installments receivable relating to property sales, and deposits placed with banks.

We undertake careful credit assessments of prospective tenants, collect rental deposits and closely monitor outstanding rents in order to mitigate rents receivable risk. We also protect receivables related to property sales by using properties as collateral. Bank exposure limits are assigned so that we can mitigate concentration risks on our deposits, which are only made with banks that have sound financial strength and/or good credit ratings.

*(d) Use of Derivatives*

We use derivative instruments for hedging purpose only; the Group's policies do not permit derivative transactions for speculative purposes.

**Business and Operational Risk**

We ensure our properties remain competitive and up to the highest standards by closely monitoring market trends and the business environment. Regular maintenance and enhancement help us uphold the safety and quality of our properties. To protect the Group's assets, we employ seasoned professionals who oversee the design, progress and capital expenditures of major maintenance and enhancement projects. They report to an Asset Enhancement Committee of senior management representatives from different departments. Together with appropriate insurance coverage against accidental losses and/or other hazards, we have established internal controls to safeguard our assets and reputation against any potential liabilities.

In addition to these controls, we have an independent internal audit team who reviews key activities of the Group and ensures all material controls, including financial and operational, are functioning effectively. As part of the Group's crisis management plan, precautionary and contingency measures are also in place to ensure the Group is protected against major potential loss, damage or impact to our operations.

As a global corporate citizen, we have a duty to act responsibly. We place a high priority on sustainability in design and construction of new buildings. Guided by our We Do It Right principle, we not only meet minimal regulatory requirements but go beyond them to ensure our properties meet higher level of environmental standards.

**People Risk**

Through our Nomination and Remuneration Committee, we ensure the Group's remuneration levels for Directors and senior management are competitive in the market. This Committee has also established a management succession plan to ensure the continuity of our operations.

Our success as a business depends on the caliber of our people. In order to attract, motivate and retain talented employees, we evaluate our employee remuneration packages and monitor them against market trends. We also provide training or financial support for additional training through recognized professional programs to help our staff reach their full potential. To encourage two-way staff dialogue, we have clearly-established channels of communication and a grievance reporting system in place for all levels of staff. When staff depart, we conduct exit interviews to gather feedback and suggestions for future improvement.

## SUMMARY OF PRINCIPAL RISKS AND KEY CONTROLS

<p><b>Land Bank Acquisition and Property Development Risk</b></p> <ul style="list-style-type: none"> <li>• Close monitoring on market fluctuations and changes in government policies in mainland China</li> <li>• A solid land bank</li> <li>• Risk-and-return assessments</li> <li>• Periodic reviews of project costs and progress</li> <li>• Controls over variations/changes during construction</li> <li>• Quality assurance reviews on projects under development</li> <li>• Tight tendering procedures</li> <li>• Regular reporting to the Board</li> </ul>	<p><b>Business and Operational Risk</b></p> <ul style="list-style-type: none"> <li>• Close monitoring on market trends and business environment</li> <li>• Regular maintenance and renovation of facilities</li> <li>• Oversight by Asset Enhancement Committee and professionals</li> <li>• Appropriate insurance coverage</li> <li>• Internal Audit</li> <li>• Crisis management plan</li> </ul>
<p><b>Treasury Risk</b></p> <p>(i) Interest rates and foreign exchange</p> <ul style="list-style-type: none"> <li>• Management of fixed/floating debt ratio against interest rate fluctuations</li> <li>• Use of recurring rental turnover in Renminbi as a natural hedge against loans</li> <li>• Appropriate level of Renminbi reserves to meet capital requirements for ongoing projects in mainland China</li> </ul> <p>(ii) Cash management, funding and liquidity</p> <ul style="list-style-type: none"> <li>• Central treasury management</li> <li>• Manage and plan maturity of deposits and loans</li> </ul> <p>(iii) Credit/Counterparty</p> <ul style="list-style-type: none"> <li>• Credit assessments</li> <li>• Rental deposits</li> <li>• Close monitoring of outstanding receivables</li> <li>• Use of banks with good financial strength and credit ratings</li> </ul> <p>(iv) Derivatives</p> <ul style="list-style-type: none"> <li>• Prohibition of use of derivatives for speculation</li> </ul>	<p><b>People Risk</b></p> <ul style="list-style-type: none"> <li>• Periodic remuneration package evaluation and benchmarking</li> <li>• Management succession plan</li> <li>• Staff training program and support</li> <li>• Grievance reporting system</li> </ul>