RISK MANAGEMENT

SYSTEM FEATURES

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

- Identify and review risks across all business units of the organisation
- Prioritise resources to manage risks
- Give management a clear view of the significant risks facing the Company
- Support decision making and project execution for better business performance

The Board, with the assistance of the Risk Committee, 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 the quarterly enterprise risk reports. Two "Blue Sky" workshops were also held in February and August 2020 adopting a "futures" thinking approach. At the February workshop, the Executives reviewed the latest challenges around Environmental, Social and Governance ("ESG") issues, which provided important input to the development of the new Corporate Strategy. As disclosed elsewhere in

this Report, the outbreak of the COVID-19 pandemic has significantly affected the Company's businesses. While the ultimate duration and scale of the COVID-19 impact remain uncertain, at the August workshop the Executives deliberated on potential medium and long-term risk scenarios arising from the pandemic, with follow-up actions formulated to mitigate the associated impacts.

The Company's risks are rigorously identified, assessed and managed. Each risk is evaluated on the basis of the likelihood of the identified risk and the consequence of the risk event, taking into consideration the control measures in place. A risk matrix is used to determine risk ratings (E1 – E4), with E1 being a very high risk and E4 being a low risk. The risk ratings reflect the required management attention and risk treatment effort, and take into account the Company's risk appetite. The highest category of risks, "E1", is subject to Board, Risk Committee and Executive Committee oversight.

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

The Company's ERM system provides an important internal control in identifying 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. The commencement of the new signaling

Board assisted by Risk Committee*

- 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

Executive Committee assisted by Enterprise Risk Committee

- 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

Business Units

- 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

*   See the Risk Committee Report (pages 130 to 131 of this Annual Report) for duties and work performed by the Committee in 2020

system and gradual introduction of nine-car trains on the East Rail Line as part of the Shatin to Central Link project, originally scheduled in mid-September 2020, has been deferred to February 2021 due to a signaling system issue which could have had a potential service impact. Investigations have been undertaken and improvement actions have been identified for implementation.

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 construction, operations, finance, treasury, safety and insurance.

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, the Executive Committee and the Risk Committee review the Company's enterprise risk profile and brainstorm emerging risks quarterly to ensure that key risks and those cutting across different areas of the business are captured.

Identify Risk* >	Evaluate Risk >	Treat Risk* >	Report and Monitor Risk

• Existing businesses
• Changing external environment
• New projects or business ventures
• New and emerging issues or trends which may pose significant risks
• List of running issues and risk drivers for brainstorming
• Change in laws and regulations
	• Evaluate risk by estimating likelihood and consequence of the risk event
	• Determine risk rating using the risk matrix (E1-E4)
		• Take into account risk appetite
		• Avoid risks where no appetite and possible to do so
		• Mitigate – review controls in place to evaluate adequacy and effectiveness and ensure owners in place to implement
		• Transfer – take out insurance to transfer risks where cost effective and efficient
		• Accept once mitigated to an appropriate level
			• Capture risks in risk registers
			• Periodic ERM reports to
			  – Enterprise Risk Committee
			  – Executive Committee
			  – Risk Committee
			  – Board

*   Areas below are not exhaustive

In 2020, the COVID-19 pandemic emerged as a key risk that is significantly affecting the Company's businesses and has required careful management to mitigate the financial, operational, human resources and societal impacts. The Infectious Disease Management Team ("IDMT") has been activated to coordinate corporate-wide strategic response actions across the Company according to the Infectious Disease Business Continuity Plan, including overseeing the stock level of Personal Protective Equipment ("PPE"), recommending work arrangements for risk reduction and issuing notices and situation reports for staff communication. The Company has made extra efforts and deployed additional resources to maintain a hygienic environment for staff and customers, including the deployment of new technology, such as the Vapourized Hydrogen Peroxide ("VHP") Robot, in disinfecting company premises, stations and trains.

The long-term financial sustainability of the Company is continuously monitored by the Executive Committee and the Board. The impact of the Public Order Events in 2019 and the prolonged COVID-19 pandemic have caused short-term financial impacts on the Company's businesses, as previously disclosed. To mitigate the impacts, cost control initiatives, include service adjustments, a recruitment freeze as well as a reduction in discretionary spending, have been put in place. Further, the Company continues to maintain low gearing, even under the current difficult situation. Overall, the financial position of the Company remains sound. The Company has also started implementing transformation initiatives with a view to further improving the Company's profitability in the longer term and ensuring long-term financial sustainability.
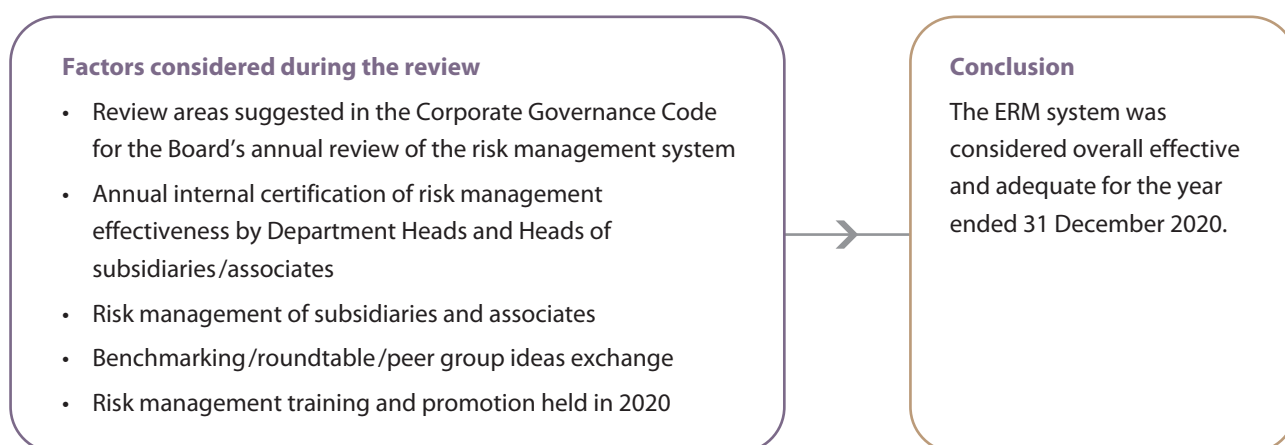
RISK MANAGEMENT

Key focus areas for risk management of the Company include:

Effective and Balanced Relationship with Key Stakeholders	
Key Challenges	• Challenging political landscape and diverse stakeholders' expectations • Uphold trust and public confidence in light of the earlier Shatin to Central Link incident, the Public Order Events and operational incidents
Key Controls	• 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

People and Operations Safety	
Key Challenges	• Health threat to the workforce, loss of productivity and potential impact on normal operations arising from the COVID-19 pandemic • More challenging employee relations environment due to more diverse and polarised views • Safety and security threats associated with potential further Public Order Events
Key Controls	• 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 such as fixed team, split team and work-from-home arrangements • Robust tracking and management protocol for confirmed or close-contact cases in the workforce • Implementation of business continuity arrangements • Proactive employee engagement through various communication channels including virtual meetings and close communication with staff bodies • Enhanced security arrangements • Review of asset and design standards

New Projects Quality, Delivery and Cost	
Key Challenges	• Adherence to programme, cost and quality of projects
Key Controls	• Periodic audits and assurance to ensure compliance with processes and procedures • Monitoring project quality and progress against Key Performance Indicators • Familiarization of staff with the processes and procedures relevant to their work and encouraging lessons learned to be shared • Adoption of technology to strengthen supervision and record keeping • Stringent control of contingency funds

New Business Model/Technological Disruption/Competition	
Key Challenges	• Current business model disrupted by new technology • Manage competition from other transport modes
Key Controls	• 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	• Challenging 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 risk
Key Controls	• Formulate innovative 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 environmental scan for new business opportunities • Formulate and implement business plans for underperforming businesses for improvement and monitoring

Security Threat (Cyber/Physical)	
Key Challenges	• Threat of cyber-attack on Operations and IT systems • Threats associated with Public Order Events • Terrorist attack threat, in particular for railway operations of the Company outside Hong Kong
Key Controls	• Enhanced IT network resilience to protect the Company 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 ended 31 December 2020 to the Executive Committee, which confirmed the review results, on 11 February 2021, and to the Risk Committee on 26 February 2021.

For the year ended 31 December 2020, the Risk Committee, with delegated authority from the Board, has evaluated the effectiveness and adequacy of the Company's ERM system and considers that it is 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 2020

Conclusion

The ERM system was considered overall effective and adequate for the year ended 31 December 2020.

CONTINUOUS PROCESS IMPROVEMENT

Key initiatives undertaken in relation to the ERM system in 2020 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.

- A series of 3 bite-sized animated videos, which form a story to promote risk management principles and application, has also been developed. The last of the three videos was launched in March 2020. The fun and innovative approach has received a good response with the series receiving over 6,000 views by staff.

- In November 2020, a Risk Awareness Webinar adopting the theme "Forward Looking Risk Management" was held covering topics such as the use of contactless technology for new travel norms and futuristic thinking tools. The Webinar was attended by about 150 senior managers and was well received.

- Acting through the Risk Committee and the Audit Committee, the Board has mandated a review of the Company's internal control and risk management systems for Hong Kong operations. Following the first phase review conducted in 2019, an external consultant, Arthur D Little, was appointed to conduct a deep-dive assessment of the Company's existing Three Lines of Defence framework, with a view to identifying any gaps in the framework and making recommendations for improvement. The results of this assessment were presented to and endorsed by the Risk Committee and the Audit Committee in late 2020. The next phase of the project will be to strengthen the Company's Second Line of Defence (in particular) in certain key risk areas through the establishment of new technical and engineering Centres of Excellence and the adoption of a new assurance framework. A further update on progress will be presented to the Risk Committee and the Audit Committee in mid-2021.

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 and the HK ERM Roundtable meetings.