REVIEW OF OPERATIONS

RETAIL BANKING

In year 2001, the Retail Banking Group ('RBG') continued its robust pace of development, registering momentous growth in the distribution of unit trust and insurance, and establishing a brand-new credit card business. At the same time, the fundamentals in sales, distribution, product design, and operating platforms were enhanced which set a solid foundation for future expansion into the Greater China area.

Differentiating Wealth Management Focus

To capture the business opportunities of the growing needs in wealth preservation, education and retirement planning, concerted efforts had been made throughout the year to strengthen our wealth management business. A strategic alliance with Sun Life Financial was formed to launch bancassurance, establishing the Bank as a pioneer in matching wealth building and protection needs against different life stages. A brand new Wealth Management Center was opened at Taikoo Place, introducing a refreshingly different retail banking experience where our customers can enjoy the privilege to manage their wealth in comfortable and relaxed home-like surroundings.

During the year, we continuously broadened our spectrum of wealth management services. We signed up Eagle Star to provide competitive and innovative general insurance services to our customers through our branch network and direct banking channels. The bond service, which was introduced to our retail customers in April, was well received.

Through these wealth management initiatives, we have greatly enhanced our fee income generating capability. Our unit trust distribution attained over 190% growth in terms of fee income, while RBG's total fee income soared by over 100%.

Innovative Value Propositions - Customer Value Growth Strategy

We believe in differentiating the Bank through the adoption of a 'value for money' strategy to establish strong customer value. In November 2001, RBG launched the Bank's first credit card – CITIC Ka Wah VISA. Leveraging on a strategy to offer value propositions that are of high relevance to our customers' financial and lifestyle needs, the card offers two distinctive features: an unique innovative interest-free installment plan which is applicable for any choice of goods and services of any purchase amount from any place, anywhere; and a reward scheme that enables cardmembers to enjoy a broad range of quality lifestyle premiums at the upfront before meeting the spending criteria. Coupled with creative card designs and innovative marketing strategies, more than 60,000 cards were issued in three months, marking a legendary achievement in today's fiercely competitive credit card market.

The commitment of 'no monthly fee for low-balance current and savings accounts' was well received by customers as a strong value offer and we attracted over 10,000 new customers in one month. Throughout the year, value-added product programs, including 'More Money' cash card and the five-year personal installment loan, were launched. These innovative new products had not only deepened customer relationship with us but also successfully rejuvenated our customer base by bringing in more than 50% growth in target customers.

Our foothold in the SME market was also strong. An active growth strategy was pursued to serve the financial services needs of Hong Kong's small enterprises with tailor-made secured and unsecured lending products. Focusing on machinery and vehicle financing, our Hire Purchase and Leasing business registered phenomenal growth of over 120%, both in terms of customer base and asset portfolio. Through these initiatives, we had doubled our market share in the SME segment to 6%.

Dynamic People Force

To develop a customer-driven sales and service culture, we provide professional training that equip our front-line people to better serve our customers. In order to assist our people's career development, clear career paths with corresponding learning curriculum and competency models have been put in place for all our channels' staff. These represent 60% of RBG's total staff force. In addition, a lot of effort was devoted to embedding the values of Total Quality Management ('TQM') among our people.

In 2001, an extended management forum was established to foster communications for business updates at the middle management level. Business reviews at senior management level are carried out every quarter. Management development programs that foster leadership and collaboration between departments, thereby ensuring efficient and effective operation of the entire value chain, will be our next focus.

By strengthening teamwork and the willpower to succeed, all these development and communications programs add to our staff capabilities and underline our determination to establish our retail banking business as a strong franchise.

Strengthened Brand Power

RBG continued its growth strategy through innovative banking products, value-added propositions and speedy response to market trends and customer needs. At the same time, investments were made to upgrade our back-end support, such as the installation of our new core banking system. With the acquisition of The Hongkong Chinese Bank, the combined customer base and bigger distribution network will greatly facilitate the cross-selling of our new products and services. Through the continuous creation of value-added customer propositions, we aim to strengthen our brand power and achieve our vision to become the preferred financial services provider in Hong Kong and the Greater China region.

CORPORATE BANKING

Leveraging on the solid foundation established over the past few years, Corporate Banking Group ('CBG') maintained its business momentum in year 2001, achieving double-digit growth in operating income and maintaining its position as the Bank's key profit contributor.

Sharpened Customer Focus and Market Positioning

At the beginning of 2001, we realigned CBG's organization structure to reflect proper market segmentation. Our four business groups — namely PRC Corporates, Local Corporates, Trade Finance and Multinationals, and SME — now possess specialized skills to meet the needs of different types of customers.

As part of our commitment to delivering quality service to our customers, we also embarked on a business optimization project in the second quarter of the year, achieving marked improvements in operating efficiency.

Sustainable Growth and Quality Income Stream

Through focused customer targeting, professional relationship management, and innovative product offerings, we continued to expand our corporate customer base and to achieve further risk diversification. Our loan portfolios now comprise a much better asset mix, which in turn has created a more sustainable revenue stream for the business. More than one-third of our total income is now comprised of commission and fee income, with the interest margin on loans being maintained at a satisfactory level.

Capitalizing on our now enlarged customer portfolio, particularly in respect of corporate clients engaged in manufacturing and infrastructural businesses, we will further strengthen our capabilities in the syndication and structured finance areas in year 2002. Our initiatives will enable us to meet the more diversified financing needs of our customers, as well as to generate more off-balance sheet revenue.

China Capabilities

With our extensive and in-depth knowledge of the China market, and through close co-operation with the other members of the CITIC Group, including CITIC Industrial Bank and CITIC Securities, we are able to provide value-added services to those of our customers who are pursuing business opportunities in China. Apart from offering business advisory services, we also provide financing on projects relating to infrastructural and property development, as well as manufacturing and trading activities.

Given China's impressive economic growth and the country's entry into the WTO, we foresee an even higher level of business activities between Hong Kong and the Mainland in the times ahead. To position ourselves strategically for these new opportunities, we will further strengthen our sales and service capabilities, both in Hong Kong and in China. This will include the recruitment of additional talents from the market to fill relationship manager positions, as well as the setting up of new representative offices in China.

E-Business and New Product Offering

During the year, CBG successfully launched several e-business products, including Click2Trade Station and Internet Cash Management. These, together with the upgrade of our trade service delivery platform and the installation of our new core banking system, have placed us as at the forefront of the competition.

Going forward, we will continue to invest in product development and management, and we will co-operate closely with our strategic partners to further expand our product range. New services identified as ready for launch in 2002 include Receivable Discounting, Document Preparation Services and B2B Exchange.

The Future

The trading environment in Hong Kong is expected to remain sluggish in the short term. However, with the core strengths we have successfully built up, we are confident that our corporate banking business is well positioned to face the challenges ahead. We will continue to focus on asset quality and to pursue a growth strategy. At the same time, we will ensure that we achieve the highest customer satisfaction through the provision of professional and innovative products and services.

TREASURY AND FINANCIAL INSTITUTIONS GROUP

The Treasury and Financial Institutions Group continued its key strategies of optimizing revenue through planned and focused investments as well as prudent management of the Bank's liquidity, assets and liabilities. As part of the ongoing efforts to effectively manage capital, this year also saw the launch of the Bank's inaugural issue of US$300 million lower tier two subordinated debt notes that was welcomed by solid market interest. A strengthened market risk function, coupled with inspiring teamwork and professional expertise, have brought in innovative solutions and insightful forecasts. All these contributed to a year of optimal return.

Planned Focus

In 2001, the Bank continued to apply vigorous discipline in managing its liquidity, assets and liabilities, with added emphasis on overall control of costs of funds.

Taking advantage of liquid market conditions, we continued our key strategy of restructuring the liability mix by issuing CDs at regular intervals during the year. This boosted our long-term sources of funds as well as achieving the aim of spreading out future liability maturing profiles — the longest tenor we issued was five years CDs. Our CD investor base was enlarged, evidenced by a much larger universe of participants in each of our CD issuing syndicates. The tightening of credit spreads on financial papers also helped reduce our overall cost of funds.

Against a backdrop of a series of interest rate cuts, we were able to optimize revenue through planned and focused investments of surplus funds resulting from sluggish loan demand. Most of these investments were high credit quality fixed income securities. Through the introduction of market risk management techniques, selective hedging of investment portfolios not only enhanced returns but also controlled portfolio risks.

Prudent Financial Management

With the newly installed Treasury system, we accomplished a complete switch to market risk management orientation. While the Treasury system was in its nascent stage, every effort was made to bring the procedures in line with new workflow processes. Continuous fine-tuning is being pursued in order to ensure that proactive and sound market risk management and control are in place.

In addition to assets and liabilities, the Bank also prudently managed its capital requirements. The Bank engaged Barclays, Industrial and Commercial Bank of China ('ICBC'), and UBS Warburg as joint bookrunners and lead managers in our 10-year subordinated debt issue of US$ 300 million in July 2001. The Bank's senior management team participated in a global roadshow to broaden our investor base in Hong Kong, Singapore, New York, Boston, Frankfurt and London which attracted a strong audience of quality institutional and private investors and the results were pleasing. Not only did we manage to raise US$300 million in capital, we succeeded in establishing a benchmark and gaining efficient capital funding. The debt securities were successfully issued under S144A and listed on the Luxembourg Stock Exchange. Subordinated debt is deemed to be an efficient capital instrument that can successfully build up the Bank's capital base for potential acquisition and organic expansion.

Inspiring Teamwork

Market risk management functions were further strengthened in 2001. This was demonstrated by the segregation of risk management from front office trading. Front office trading is effectively supported by risk management techniques applied by the middle office to achieve optimal return within pre-determined risk appetite. Besides strengthening our risk management functions, concerted efforts by our professional experts, who brought in innovative solutions and insightful forecasts in response to the dynamic market environment, proved to be successful in risk mitigation as well as in improving the efficiency of execution.

During the year, new initiatives for bolstering co-operation between the Bank's business units were adopted. These measures led to a better control of the overall cost of funds of the Bank. During 2001, a fixed income securities warehousing infrastructure with focus on household names was set up to facilitate bond distribution to retail customers as well as to build investor relations.

In addition, relationship with interbank counterparties improved significantly during the year, and these in combination with the resulting counterparty limits extended to our Bank greatly facilitated our hedging activities. Re-purchase facilities established with premier financial institutions also provided access to market liquidity.

Optimal Return

To achieve optimal return in today's market, building teamwork among various expertise as well as picking the right strategy are essential. With the help of the newly installed Treasury system, as well as dedicated analysis, precise forecasting, focused investment, selective but prudent hedging applied to our portfolio and professional application of market risk management techniques, we successfully rode the tailwinds of severe interest rate cuts in 2001, producing remarkable and encouraging results.

In view of the uncertainty that lies ahead in 2002, the challenge lies in building hedges that will minimize the impact of interest rate fluctuation as well as preparing for possible interest rate reversal. Lastly but not least, we shall continue to exercise prudent liquidity management and capital management.

INVESTMENT BANKING

Ka Wah Capital

2001 was a challenging year for Ka Wah Capital Limited ('Ka Wah Capital'). Owing to the global economic downturn and the September 11 disaster in the US, the economic situation in Hong Kong deteriorated significantly. It was inevitable that our business was affected to a certain extent. However, with our senior management's leadership and through our team members' efforts, Ka Wah Capital remained competitive in the market. Our positioning is to become a leading local investment bank, assisting middle-market and PRC-related companies to raise funds in Hong Kong and other international capital markets.

During the year, the Debt Capital Markets Team continued to raise our profile in the capital market through arranging a number of major transactions in loan syndication and debt issuance. We raised over HK$4.5 billion (2000: HK$6 billion and 1999: HK$1.9 billion) in debt capital for our clients by way of syndicated loans, floating/fixed rate notes ('FRNs') and floating/fixed rate certificates of deposits ('FRCDs'). In particular, we were the joint arranger for HK$1 billion FRCDs issued by the Bank, the joint mandated arranger for Road King Infrastructure Limited's US$75 million term loan facility and the joint coordinating arranger for US$200 million FRNs and transferable loans certificates ('TLC') issued by China Merchants Holdings Company Limited. We were also the sole mandated arranger for US$34.35 million convertible notes issued by Asia Television Limited and the sole mandated arranger for term loan facility of DeMat TransAsia Holdings Limited, Orient Power Holdings Limited and China Aerospace International Holdings Limited. In addition, we were the financial advisor to China National Offshore Oil Corporation on its US$4 billion joint-venture project with the Dutch Shell Group.

As a result of poor stock market sentiment, the amount of monies raised by equity offerings in Hong Kong decreased by more than 70% in 2001. Nevertheless, our Equity Corporate Finance Team successfully participated in numerous Initial Public Offering ('IPO') transactions in Hong Kong including, but not limited to, Wealthmark International (Holdings) Limited, Convenience Retail Asia Limited, China National Offshore Oil Corporation Limited, TeleEye Holdings Limited, and Aluminum Corporation of China Limited. In addition, we were the independent financial advisor of Lamex Holdings Limited and Top Glory International Holdings Limited. Leveraging our strong parental background, we further co-operated with the Bank, CITIC Industrial Bank and CITIC Securities to expand our PRC-related business in both Hong Kong and mainland China.

Our Ka Wah Five Arrows China Hong Kong Fund, through prudent management, continues to provide shareholders with favourable returns. In 2001, the Manager made a positive contribution to the Fund through new investments in fixed income and Hong Kong-listed stocks despite volatile market conditions.

Debt Capital Market

	2001	2000	1999
Amount Arranged (HK$ billion)	**4.5**	6.0	1.9
Number of Mandates	**10**	9	2

Equity Corporate Finance

	2001	2000	1999
Number of IPOs Participated	**4**	13	N/A
Number of Financial Advisory Mandates	**2**	7	N/A

Cargary Securities

Since 1988, the securities broking business of the Bank had been managed by Cargary Securities Limited ('Cargary'). The primary function of this subsidiary is to provide clients with securities trading and margin financing services. All transactions are processed through a sophisticated and fully automated securities trading and settlement system, which is designed to offer customers an efficient, reliable and secure securities trading platform.

2001 was a difficult year for the entire brokerage industry. The global economic slowdown, regulatory developments, and fierce competition all contributed to a challenging operating environment. That transpired, Cargary recorded reductions both in the value transacted and profitability by approximately 47.6% and 70.5% respectively.

During the year, Cargary placed high priority on staff training with a view to providing more professional services to customers. To enhance trading efficiency and reduce transaction costs, continuous investment had been made in system upgrades. The third-generation Automated Matching and Execution System was successfully launched in February 2001. The more efficient execution capability has helped to attract and retain clients. In June, Cargary opened its second branch in Kwai Chung and succeeded in enlarging its client base by 15.5%. With this enlarged customer base, Cargary aims to achieve a higher growth in turnover and market share.

	2001	2000	% Change
Total Value of Transactions (HK$ million)	**10,927.6**	20,856.9	(47.6)
Profit after tax (HK$ million)	**11.1**	37.8*	(70.5)
Number of Transactions	**182,550**	242,422	(24.7)
Number of Customers	**31,952**	27,665	15.5

*excluding the gain from disposal of shares in Hong Kong Exchanges and Clearing Limited

In 2002, Cargary will focus on enhancing its distribution capabilities and further enlarging its customer base through establishing new branch outlets and developing multi-channel capabilities for order placement, such as Internet stock trading. The margin financing service will be further promoted, with prudent management of related risk exposures. Furthermore, a new range of products and services, such as the trading of futures, China B-shares and Equity Linked Notes are under development or consideration which will eventually lead to wider investment options for customers. Through these initiatives, Cargary aims to further diversify its scope of businesses and to achieve a higher ranking among Exchange participants in the brokerage industry.

OVERSEAS OPERATIONS

US Operations

The Bank operates two branches in the United States, one in New York City, New York, the other in Los Angeles, California. For regulatory purposes, both branches are governed by the Office of the Comptroller of the Currency. The New York Branch, located in Manhattan's 'Chinatown District', operates as a full service branch with deposits insured by the Federal Deposit Insurance Corporation. The Los Angeles Branch is located in a densely Asian populated area within the State of California.

A comprehensive range of commercial and/or retail banking products is provided by at least one, if not both, of our US branches, including loans, deposits, funds transfer, letters of credit, foreign exchange, and safe deposit box. Both US branches actively participate in loan syndications, and both provide a suite of international banking services encompassing offshore deposits, international payments and trade-finance related products to the Bank's customers located in the Asian region. While capitalizing on our competitive strengths in these areas, the two branches will further diversify their foreign business risks through expanding their businesses and customer bases in the domestic market.

While the Los Angeles Branch had another record year in 2001 in terms of profitability, the New York Branch recorded a decline. Similar to many other US banks, the New York Branch was negatively affected by the narrowing of net interest margins as a result of falling US interest rates. Nevertheless, its financial performance continued to exceed US banking industry norms, registering a Return on Assets in excess of 1.0%. Other financial ratios of both branches continued to improve and/or exceed US banking industry norms, reflecting the capability of their individual management teams.

During the year, the two branches continued to work closely to achieve common business goals under a more centralized and co-ordinated management structure. Both branches placed high priority on risk management, in particular the strengthening of credit risk and operational controls; both these measures received positive regulatory assessments. To enhance operational efficiency and to improve on its management information system, the New York Branch replaced its core banking system with a fully-integrated on-line system. The conversion was successfully completed on 30 June 2001. The new system will be implemented by the Los Angeles Branch in 2002 so that both branches will be operating on a common system platform.

In 2002, both branches will aim to increase the level of correspondent banking services provided to other banks based in the Asian region. The branches will strive towards achieving healthy growth rates, while emphasis will be placed on quality growth in assets and earnings.

	2001	2000	1999	% Change
Loans (US$ million)	**175.4**	181.0	130.6	-3.1
Number of Loan Accounts	**385**	380	415	1.3
Deposits (US$ million)	**300.9**	318.0	336.2	-5.4
Number of Deposit Accounts	**3,578**	3,216	2,990	11.3

China Operations

The Bank established a representative office in Beijing in March 2001 to develop PRC business opportunities by working closely with CITIC and its subsidiaries. Our presence in the mainland was further strengthened by the takeover of The Hongkong Chinese Bank's representative office in Shanghai in January 2002.