

SUPPLEMENTARY FINANCIAL INFORMATION

Gross advances to customers by industry sectors

	At 30 June 2001 (Unaudited) HK\$'000	At 31 December 2000 (Audited) HK\$'000
Loans for use in Hong Kong		
Industrial, commercial and financial:		
Property development	163,152	156,069
Property investment	1,200,840	1,186,515
Financial concerns	198,796	380,564
Stockbrokers	162,381	131,437
Wholesale and retail trade	51,349	53,201
Manufacturing	237,103	228,454
Transport and transport equipment	248,359	227,306
Others	945,407	1,234,570
Individuals:		
Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	631,005	280,728
Loans for the purchase of other residential properties	3,337,805	2,684,654
Credit Card advances	28,514	–
Others	467,102	485,107
Trade finance	892,692	951,700
Loans for use outside Hong Kong	<u>305,003</u>	<u>297,794</u>
	<u>8,869,508</u>	<u>8,298,099</u>

Over 90% of gross advances to customers were extended to customers located in Hong Kong.

SUPPLEMENTARY FINANCIAL INFORMATION (continued)

Risk Management

The Group has established policies and procedures for identifying, evaluating, monitoring and controlling various types of risks pertaining to the Group's business. The key risks include credit risk, liquidity risk, capital management risk, market risk, interest rate risk, foreign exchange risk and operational risk.

The overall internal control environment and the management policies for major types of risks are as follows:

(1) Internal Control Environment

The internal control framework of the Group comprises of comprehensive control policies and standards. Area of responsibilities of each business and operational unit are clearly defined. Internal control procedures have been established based on the risk inherent in the individual business unit.

The internal audit plays an important role in the Group's internal control framework. It monitors the effectiveness of internal control procedures and ensures compliance with the policies and standards across the whole Group. A direct reporting line to the Audit Committee under the Board of Directors safeguards its independence. The Audit Committee meets periodically to review and discuss financial performance, internal control and compliance issues and matters raised by the external auditors and ensure that all audit recommendations are implemented.

(2) Credit Risk Management

Credit risk arises from the possibility that the counterparty in a transaction may default. It arises from the lending, trade finance, treasury, securities margin finance, insurance premium collection and claim recovery and other activities undertaken by the Group.

Business units within the Group have a specific credit policy applicable to their operations. The policy defines the credit extension criteria, the credit approval and monitoring processes, the loan classification system and provisioning policy. It also takes into account the statutory credit management requirements that are appropriate to that business unit.

In principle the Group manages its credit risk within a conservative framework by evaluating its credit worthiness of counterparties, setting credit limits for counterparties, countries and industry sectors, and obtaining collateral where appropriate. Actual credit exposures, limits utilization and asset quality are regularly monitored and controlled by the Credit Committee and the Executive Committee.

(3) Liquidity Risk Management

Liquidity risk is the risk that the Group cannot meet its current obligations as they fall due. To manage liquidity risk, the Group has established liquidity management policies that are pertinent to the operations of the major business units. The policies are reviewed by the Asset Liability Committee ("ALCO") and approved by the Directors.

The Group measures and monitors its liquidity through maintenance of prudent ratios and limits that are laid down in the liquidity policies. These include the liquidity structure of the Group's assets, liabilities and commitments, statutory liquidity ratios, loan-to-deposit ratios, interest rate gaps, maturity mismatch positions and net assets positions.

The Group also maintains a prudent level of high quality liquid assets to ensure the availability of sufficient cash flow to meet any unexpected and material cash requirements in the course of ordinary business. In addition, standby facilities are established to provide contingency liquidity support.



SUPPLEMENTARY FINANCIAL INFORMATION (continued)

Risk Management (continued)

(4) Capital Management Risk

The Group's policy is to maintain a strong capital base to support the development of the Group's business and to meet the statutory capital or solvency margin requirements. Capital is allocated to the various activities of the Group depending on the risk reward criteria and regulatory capital requirements.

For the banking subsidiary, it is required to maintain minimum capital subject to the Hong Kong Monetary Authority's capital requirements for its regulatory supervision process. As for the securities and investment services subsidiaries, they are regulated by the Securities and Futures Commission ("SFC") and are required to maintain the minimum capital according to the rules of the SFC.

(5) Market Risk Management

Market risk is the risk to the Group's earnings and capital due to changes in the market level of interest rates, foreign exchange rates, securities and equities as well as the volatilities of those prices. The Group's market risk arises from customer-related business, structural positions and investment portfolios.

The Group monitors market risk principally by establishing limits for transactions and open positions. These limits are approved by the ALCO and Directors and are monitored on a daily basis. The daily risk monitoring process measures the actual risk exposures against approved limits and triggers specific action to ensure the overall market risk is managed within an acceptable level.

(6) Interest Rate Risk Management

Interest rate risk is the risk that the Group's position may be adversely affected by a change of market interest rates. The Group's interest rate risk arises primarily from the timing difference in the maturity and the repricing of the Group's interest-bearing assets, liabilities and off-balance sheet commitments.

The Group manages the interest rate risk by limiting the potentially adverse effects of interest rate movement on net interest income by closely monitoring the net repricing gap of the assets and liabilities. The interest rate sensitive positions are managed by the Treasury Department of each business unit within the limits approved by the ALCO and Directors.

(7) Foreign Exchange Risk Management

Foreign exchange risk is the risk that the holding of foreign currencies will affect the Group's position as a result of a change in foreign currency exchange rates. The Group's foreign exchange risk primarily arises from foreign exchange dealing, commercial banking operations and structural foreign currency exposures.

Foreign exchange positions are managed by the Treasury Department of each business unit within the limits approved by the ALCO and Directors. Limit excesses, if any, are reported to the ALCO for necessary action.

SUPPLEMENTARY FINANCIAL INFORMATION (continued)

Risk Management (continued)

(8) Operational Risk Management

Operational risk is the financial loss resulting from procedural errors, system failures, frauds and other event risk.

The Group manages the operational risk by maintaining adequate documentation of its operating procedures to facilitate training and quality performance. A well-established internal control environment also minimises the risk of losses caused by human error. To reduce the interruptions to business activities caused by system failure or natural disaster, back-up systems and contingency business resumption plans are in place for critical business and back-office functions. Detailed recovery procedures are properly documented, with periodic drills conducted to ensure the procedures are current and correct.

