

CORPORATE BANKING AND HIRE PURCHASE

Serving the middle market

One of IBA's most important principles is diversification, including revenue sources along with individual customer and industry exposure. Financial institutions that have been overly reliant on housing loans faced a dilemma in 2001 as home purchases stagnated. They had to book new loans at ever declining margins, or watch their loan portfolios shrink. IBA has maintained a solid business serving customers among Hong Kong's 300,000 SMEs, as well as a select group of larger companies with whom relationships have been built up over the years based on good service, prompt response and attention to customer needs.



SMEs require consistent support and flexible facilities to sustain their operations. Many are sole proprietor operations whose owner has invested all his resources and who devotes every waking hour to achieving sales. IBA has a long history of serving these customers, providing working capital, trade finance, equipment financing, funds for the purchase of office and production space, and cash management. Clients are involved in manufacturing of garments, toys, plastic products, electronic and electric goods, moulds and machining equipment; trading of consumer and industrial products; printing and publications;

entertainment and catering; property development; logistics; and transportation services and utility operations.

Leading position in hire purchase and leasing

IBA Credit, the bank's wholly owned hire purchase and leasing subsidiary, has achieved a leading position in providing equipment and vehicle finance, garnering 10-12% and 5% market share, respectively. Equipment ranges from machinery, metal working and plastic production equipment to construction equipment and barges. IBA credit also finances light and heavy trucks, buses and taxis and private cars. Business is sourced through dealers, direct marketing and referrals from other business divisions. Contracts range from 2 years upwards, and include both fixed and floating interest rates. Outstandings rose by 24% over the year, an impressive performance when the monthly amortization of existing contracts is taken into account.

The Corporate Banking Division concentrates on working capital and trade finance, along with term loans. IBA has also participated in a limited number of multi-bank transactions for leading Hong Kong companies. The division is organized into five teams to address differing segments such as SMEs, transnational companies and stockbrokers. Customer turnover ranges from HK\$15 million to HK\$1.5 billion, with the majority generating sales of HK\$100 to HK\$250 million. Personalized service and strong support from the Operations Division allows IBA to meet customer needs. IBA works closely with owners and financial directors to formulate facilities that match the trading patterns of the company, increasing cashflow and supporting seasonal needs. Relying on expertise from the Treasury Division and the Bills Department, the Bank helps to address key issues relating to international trade, currency movements and collection of sales proceeds. In addition to the normal corporate financing listed above, IBA provides individually designed employee packages encompassing mortgage finance, deposit and credit card facilities and investment advice, as well as Mandatory Provident Fund services.

Comprehensive corporate banking facilities

During 2001 IBA wrapped up the last major delinquencies in its PRC portfolio. The strenuous efforts paid off, with recoveries exceeding the provisions previously made, resulting in writebacks over the year. A number of well-managed PRC customers have been retained, providing the basis for a renewed portfolio. China's entry into WTO will bring major changes to the landscape in the next few years, and additional needs for financial support. IBA is pursuing a meticulous and conservative strategy.

INVESTMENT BANKING AND TREASURY

The Hong Kong public has undergone a fundamental change in the manner in which they manage their assets. Previously, property ownership created the opportunity to accumulate wealth. With the onset of the Asian financial crisis, real assets have declined in value, with residential property values down by an estimated 60% from their 1997 peaks, and very limited prospects for rapid appreciation in values. The stock market provides one alternative avenue for personal investment, but it has been subject to volatility, and more cautious individual investors have periodically reduced their purchases. IBA has recognized these trends, and deepened the scope of wealth management products offered to clients to address risk appetite. The

Hang Seng Index Chart



**Treasury products and
Ambassador Privileged Banking**

Investment Banking Division has expanded its outreach through Wealth Management Centers, and intensified its collaboration with the Treasury Division to provide true value added services. At the same time, having accumulated a substantial investment portfolio as the Bank's deposit base has grown, it was incumbent upon management to actively manage the highly liquid bond holdings in concert with the steep downward movement in interest rates over the course of the year, and the inevitable reversal of this trend at some point in 2002.



Investment Banking provides highly personalized services to select individuals through Ambassador Privileged Banking. IBA Securities, our wholly owned securities brokerage company, is also an operating arm of the division. Investment Banking also coordinates unit trust and insurance product marketing, working in conjunction with Retail and Corporate Banking as with external partners.

The IBA Ambassadors offer a complete portfolio of banking and investment services to VIP customers. During 2001 the Ambassador Professional Package, formulated to meet the needs of accountants, lawyers, doctors, dentists and architects, was introduced, taking into account the difficulty these individuals have in finding time to visit their bankers. The Ambassadors make appointments to meet their clients in their offices or outside regular business hours to handle their financial transactions.



Mei Foo Wealth Management Center

With the shift from the simple purchase of property and riding market appreciation to more differentiated and complex investment products, Hong Kong families have faced two problems: how to gain an understanding of these new instruments, and how to find the time to assess their appropriateness. If the decision-maker in the family is a housewife, it is not convenient to travel to the central business district to obtain information and execute transactions, and if the decision-maker works in an office, they do not have time to get information during daytime hours. IBA has addressed these two issues by opening

Wealth Management Centers in convenient locations around Hong Kong. Clients have access to share price information, market recommendations, and can place their orders in the centers which are electronically linked with the IBA Dealing Room in Central. Clients can also choose from equity linked notes (notes issued against an option on the price of shares comprising the Hang Seng Index), high-grade fixed income bonds such as Hong Kong Mortgage Corporation Mass Transit Railway Corporation paper, unit trusts managed by leading firms such as Schroders, Jardine Fleming and Templeton, or insurance investment products. In order to provide clients with an understanding of these products, more than 40 investment seminars were conducted during the year, featuring experts from leading fund management houses as well as IBA staff.



While stock market turnover declined by 35% in 2001 resulting in a 31% decline in securities brokerage, the sale of equity linked notes, a proxy for investing in the stock market, helped to offset some of the decline. Guaranteed funds proved to be especially popular in 2001, contributing to a 15-fold increase in unit trust commissions. IBA is in partnership with Credit Suisse Insurance, enabling Bank clients to enjoy whole life and investment products underwritten by this leading insurance firm. As deposit rates declined in Hong Kong, bonds became an attractive alternative in the second half of 2001, carrying over to the first part of 2002 as well. Sales of these quality bonds to clients have surged, providing a new source of revenues.

Range of wealth management products

IBA practices relationship banking. Our aim is to provide value to customers, and generate repeat sales. We have therefore been offering investment advice based on customer needs rather than simply promoting a product regardless of risk. We have designed a simple questionnaire to assess individual customer risk appetite, and then outlined a portfolio structure which matches the risk profile. IBA only partners with the most respected and capable financial partners, and ensures that IBA staff who advise clients are properly qualified. 89% of the division's marketing staff took and passed the requisite examinations designated by the Securities and Futures Commission and the Insurance Commissioner, one of the highest success rates in the industry. Individuals who have not passed the exams are not permitted to market products, and all staff receive continuous professional training during the year.

Professionally qualified staff



The Treasury Division functions as the Bank's banker as well as product specialist in foreign exchange and bond products. In addition to the daily quoting of deposit rates and the management of liquidity and cash flows, Treasury played a key role in the raising of HK\$1.1 billion in medium term funds. IBA completed a very successful HK\$800 million three-year FRCD in May funded by 9 banks and rated BBB by Standard & Poor's, and received HK\$260 million in private placements. The A-3 short-term, BBB long-term ratings from S&P, and the upgrade in the outlook to stable, reflect IBA's strong capital base, the diversity of revenues, the quality of the portfolio, and IBA's ability to compete in the newly deregulated environment.

Treasury provides foreign exchange services for corporate customers who wish to hedge their currency exposure or settle trade transactions. Individual clients are also able to enter into leveraged foreign exchange contracts as an investment vehicle.

Profitable investment portfolio

IBA's investment portfolio has grown from HK\$766 million in 1996 to HK\$3.4 billion in 2001. As interest rates declined over the course of the year, IBA was able to realize the increase in value of those investments, generating the HK\$132 million profit reported in the income statement. The securities sold were replaced with investments of shorter duration or floating rate instruments, reducing the future impact of an upward swing in rates. Going forward, the size of the investment portfolio clearly requires active management. By recruiting a highly respected Treasurer, acquiring the leading Value At Risk (VAR) software and the current upgrade of systems, IBA has positioned itself to generate added value in Treasury operations, taking advantage of customer transaction flows and holding in Exchange Fund paper. This rounds out IBA's product offerings, further reducing dependence on loan bookings in any particular business segment.

RISK MANAGEMENT

Strong credit culture

The weakening of the Hong Kong economy, increased competition, the rise in personal bankruptcies, industry and interest rate deregulation and the volatility of markets, all occurring at the same time could have been a prescription for deterioration in the risk profile of the Bank. The temptation exists to enter new areas of business activity without first installing the necessary management systems, and to emphasize asset growth to counter the effects of margin squeeze. However, by focusing on basic principles of banking, nurturing a strong credit culture and relying on a multi-layer approach to risk management, IBA actually improved the quality of its portfolio, reducing the percentage of non-performing loans from 6.54% to 5.01%.

By analyzing the impact of the Asian financial crisis on both individual and corporate borrowers, IBA was able to identify valuable indicators and to refine credit analysis to address the potential impact of an economic slowdown. The focus of our credit proposals has shifted from an examination of past performance to analysis of projected cash flows. The Credit Administration Division has also acted proactively to detect early warning signs of troubled credits. Immediately after 11 September a complete review of corporate borrowings which were not fully collateralized was conducted, followed by revaluation of collateral to ensure that risk parameters remained within acceptable levels.

Risk management requires timely receipt of data and clear analysis to determine any required action. During the course of 2001, IBA broadened the scope of automated reports and compilation of regulatory information. The completion of the data warehouse in 2002 will further enhance this capability. IBA also adopted an online property valuation procedure for popular estates, expediting the approval process and permitting regular reassessment of underlying property collateral. In order to improve the effectiveness of collection efforts, a centralized team was created to handle housing loan and corporate loan delinquencies. This resulted in a reduction of overdue loans, giving a unified and efficient approach to customers facing difficulties.

Credit Administration has no revenue responsibilities, and therefore acts as an objective and independent assessor of credit proposals. A second layer of protection is provided by the Internal Control Unit, staffed by experienced auditors and reporting directly to the Audit Committee of the Board of Directors. The Audit Committee is comprised solely of independent directors of the Bank and excludes all members of management. It ensures management recommendations are subject to independent assessment. Each meeting of the committee is attended by KPMG, our external auditors. Internal Control conducted 24 major branch and department audits during the year, issuing detailed reports which require a full response from each audited unit. Remedial action must be implemented immediately, and Internal Control will confirm if the remedial action has properly addressed their findings, ensuring that any necessary rectification steps are completed. Internal Control also performed a review of more than 2,600 loan accounts, again issuing a detailed report that requires any deficiencies to be addressed. An internal audit committee, comprised of senior management and internal auditors, meets on a quarterly basis to discuss the findings of the internal audits to propose any changes to procedures or training to prevent recurrence of the deficiencies. The Audit Committee of the Board of Directors reviews all audit findings and confirms

Faster access to data***Multi-layer management of credit risk***

that adequate action has been taken to address any deficiencies. The Head of Internal Control and the Head of Credit Administration are members of the Managing Director's Office, and actively participate in the daily morning briefing. Through this mechanism they are able to relay their concerns immediately and directly to business department heads, and to be apprised of all activities in the Bank.

Developing new procedures and products

Internal Control becomes involved in the formulation of new policies and procedures and the development of new products at an early stage. Through this process, appropriate risk management measures are incorporated in procedures and product design from the outset, minimizing the possibility of unexpected results. Internal Control collaborates with the Corporate Governance and Compliance Department in its work outlined below.

Ensuring compliance and exercising good corporate governance

The Corporate Governance and Compliance Department was established in 2000 to coordinate compliance with regulatory requirements and internal policies. The department also has the responsibility for updating existing and drafting new procedures manuals. The department head originally served as head of Internal Control and subsequently head of Credit Administration, and thus brings an unusual level of experience to this position. With the added importance of corporate governance, The Compliance Officer has taken on the added duties of Corporate Governance Officer, outlined in a separate section of this report. The Corporate Governance and Compliance Department oversees all training in the prevention of money laundering, continuous professional training mandated under SFC, Insurance Commissioner and HKMA regulations, and special programs such as preparation for the forthcoming Basel II Accords.

Value at Risk Software installed

It was noted in the Investment Banking and Treasury section that IBA acquired VAR software to assist in managing our investment portfolio. We have also introduced a new unit in Treasury, the Risk Management and Control Department, reporting directly to the Chief Financial Officer. This department will be headed by the former head of Treasury, ensuring that a fully experienced individual is maintaining independent oversight on defined limits, and conducting scenario analysis to assist the Treasurer and Asset and Liability Committee in assessing risk and refining policy.

The Legal Affairs Department straddles functions, like so many activities in the Bank. The department reviews all standard documentation used by the bank to ensure that our interests are properly protected. The department also prepares facility letter templates and simple loan

agreements, while working with outside counsel on more complex agreements. Legal Affairs also oversees cases in the court system. The opinion of the Legal Affairs Department, as well as the Internal Control Department, Corporate Governance and Compliance Department and external auditors, will overrule any proposal by a business department. Legal Affairs also fulfills the Company Secretary function of the Bank.

OPERATIONS, SUPPORT AND INFORMATION TECHNOLOGY

Behind the scenes all of our marketing efforts are sustained by the efforts of a highly professional team that ensures that transactions are processed, business units are staffed, accounts are maintained, and our physical plant is in proper condition.

The Loan Administration Department, Bills Department, Cash, Communications and Clearing, and Treasury Settlements service all the business units of the Bank, and also interface with IBA customers. Their timely execution of transactions is part of our pledge to satisfy our customers. In an effort to achieve greater efficiency and increase the amount of time available for business promotion in branches, overseas funds transfers have been centralized in operations, easing a heavy burden on branch staff. Branch Operations has responsibility to ensure that staffing, systems, forms and reporting as well as the physical condition of branches are all handled smoothly.

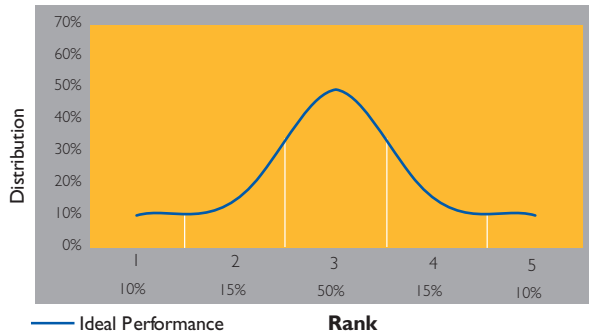
Operational efficiency has become ever more important as loan demand has stagnated and margins have come under pressure. It is vital to reduce costs in this environment. Two initiatives were taken in 2001 to increase efficiency. Cross training and pooling of operations staff has provided more flexibility in meeting changes in transaction volume. Under this new system it is not necessary to hire temporary staff or new permanent staff; rather, personnel are redeployed from other departments which are not experiencing the increased volume at that time. The second initiative was the engagement of PWC to review transaction processing in branches, credit processing and Operations Department procedures. (IBA is cognizant of the conflict of interest in asking external auditors to act as consultants when the same firm will evaluate the suitability of recommendations of the consultant). This survey identified a number of areas which could result in reduced costs. A Process Engineering Execution Committee has been formed to oversee the implementation of the recommendations. Going forward, this committee will have the authority to approve changes in procedures in conjunction with Internal Control Department and Corporate Governance and Compliance Department. The committee will also have leading role in proposals to increase headcount in the future.

Timely execution of transactions

Increasing operating efficiency

Vitality Curve performance assessment

Performance Distribution



The Human Resources Department is charged with recruitment, selection, retention, compensation and evaluation policies. In reviewing the requirements of banking in the new economy and the personnel who will implement our returns driven strategy, the Bank concluded that an entirely new evaluation system was necessary. Patterned after the Vitality Curve concept developed by Jack Welch as chairman of GE, the system focuses on Energy, Execution, Energizing and Edge, rating all staff on a standard bell curve. The top 10% of staff are rated 1, the second 15% rated 2, the middle 50% rated 3, the next 15% rated 4 and the bottom 10% rated 5. The Ones will receive substantial rewards through a combination of pay increases, bonuses, shadow stock options and additional leave. Twos and Threes will selectively receive such awards. The Fives will be given a specified period to meet performance standards, failing which they will be replaced. This rigorous process provides all staff with a clear set of goals and an unambiguous measure of their performance. Managers and employees are stimulated to perform, and compensation is directly related to increasing shareholder value.

Caring for staff

An Employee Relations Officer acts as a conduit for employee comments on various issues within the Bank. This officer also provides professional advice not only on career matters but also family issues such as developing a healthy relationship with teenage children. This concern for the welfare of the staff is appreciated. Another aspect of this staff support program is the IBA Fitness Center, a fully equipped training room in which professional staff advise employees on health matters and design training programs to improve physical and mental health. A staff bulletin, IBA Care, provides information on nutritional and emotional issues.



The Bank has a responsibility to provide each employee with the tools to do his or her job. This is not limited to equipment or forms, but also to the skills necessary to excel. The Training Department conducts in-house programs and coordinates participation in external courses offered by the Institute of Bankers and the Vocational Training Council, as well as other institutions. In 2001 this totaled 3,133 man-days, an average of 5.4 man-days per employee. IBA continued its groundbreaking partnership with DePaul University, offering both MBA and BA degrees to staff and to the public. The MBA program consists of 16 courses in marketing and finance conducted over a 24-month period, each course lasting 4 weeks with 11 hours of class per week. The BA program extends over a period of approximately 30 months, covering a range of courses in business, science and the humanities. A joint graduation ceremony of the second MBA program and the first BA program was held in May.

In November a special ceremony was held at the IBA/ DePaul Auditorium in the IBA Headquarters to present an Honorary Doctorate of Humane Letters to the Honorable George Bush, 41st President of the United States, in recognition of his record of service to people around the world. President Bush requested that the degree be presented at IBA because of his strong support for this program which enhances international understanding as well as providing tremendous career opportunities for each graduate. A third MBA program and second BA program are underway. The intellectual skills and the self-confidence gained by the staff through these programs have translated into greater contributions to the bank and a highly motivated staff.



The Accounting and Management Information Systems Department has responsibility for managing the general ledger, completing regulatory reports, preparing management reports, and payment of invoices. As the volume of transactions and the scope of business have grown, the demands on this department have increased. The department is benefiting from the upgrade of systems, with greater automation assisting in completing their tasks.



General Administration has responsibility for maintaining all offices of the Bank, managing vendor relationships, providing security and all messenger and mail services. Adhering to a strict standard for supplies purchasing and construction contracts, this department plays a key role in controlling expenses. General Administration has not limited itself to a purchasing relationship with vendors, but has taken the initiative to conduct joint calls with business units to obtain lending and deposit business as well as credit card services. The security aspect of banking has gained additional prominence as counterfeit currency has increased and individuals attempt to exploit loopholes in bankruptcy regulations to defraud banks. Staff training and alerts from the Security Department have effectively addressed these trends.



President George Bush visits IBA

Technology has become a driving force in the banking industry, and it functions in both a business development and business support mode. Thirteen years ago IBA management concluded that the demands of technology could outstrip the abilities and financial capacity of a bank our size, and elected to outsource data processing and IT functions to take advantage of the expertise and efficiencies of EDS, perhaps the largest IT service provider in the world. This decision has proven to be an effective means of both achieving continuous

Exploiting technology to enhance business performance

upgrades of technology and controlling operating costs. Instead of being the only bank in Hong Kong to outsource, IBA is now one of several institutions making use of outside providers. IBA's agreements with EDS fully comply with the new HKMA guidelines on outsourcing. In 2001 IBA signed a new extension with EDS, as well as agreements covering the installation of an advanced call center, data warehouse and customer relationship management (CRM) system. New terminals were installed in IBA branches in 2001, along with upgraded software.



Call Center

The Electronic Banking Team is another example of a unit which straddles functions. It provides operational support for the IBA website and IBA's participation in Net Alliance, our joint venture with Asia Commercial Bank, Chekiang First Bank and Liu Chong Hing Bank as well as iMerchants, an Internet service provider. IBA delivers Internet banking through the Net Alliance platform. The Electronic Banking Team participates in all Net Alliance Working Group meetings, providing IBA's input on new product development. The team is also the interface with EDS on the development of the Call Center, data warehouse and CRM. The Call

Center is designed to handle incoming calls, but its major function is to conduct intelligent telemarketing. Linked to the CRM, it will permit highly effective segmentation of the customer base, with each Call Center customer service operator provided with predesigned scripts and full relationship details on their computer screen.

BUSINESS PROMOTION AND PUBLIC RELATIONS

Serving our constituencies

The Bank serves four constituencies. Shareholders have created the bank, investing capital and deserve a reasonable return on their investment. Customers provide the business of the bank, paying interest and fees and providing funding through their deposits, and deserve quality services, fair costs and convenience. Staff deploy the shareholders' capital and provide the service create the revenues of the bank; they deserve fair compensation and career opportunities. The community provides the economic environment for the bank's activity, and deserves employment, tax revenues and good corporate citizenship.

Business promotions bring new revenues to the bank. They require thorough planning to determine the specific target segments for each promotion, the financial objectives to be attained and the monitoring of progress toward

those objectives. Bank Product Marketing has responsibility for these functions, working in conjunction with Financial Control. Due to the specialized nature of its business, the Credit Card and Consumer Finance Division also has a marketing team to design its promotional activities. Bank Product Marketing works with advertising agencies and business units to develop its marketing themes. Promotions include television and radio commercials, print advertising, direct mail and posters and pamphlets in IBA networks. The advent of Internet banking and the Call Center provide additional channels for promotions.

Promoting products and generating new reverses

During 2001 a digital message board and an arena size LCD screen were installed on the facade of the IBA Building, providing yet another channel for business promotions. In addition to promoting IBA products, the LCD screen displays Bloomberg Television under a special agreement with the leading financial information broadcaster. IBA also broadcasts videos advertising client products, supporting their business through this highly visible medium. IBA is the only bank in Hong Kong to utilize this technology to provide information, promote the bank's products and assist customers.



IBA Headquarters

IBA places a high value on investor relations. The Bank's internal analyst, who analyzes the local banking industry and benchmarks IBA's performance against these standards, provides regular reports that are shared with investors, securities analysts and the public through the media and the IBA website. The analyst also has responsibility for tracking brokerage reports and media articles to ensure that these reports are accurate, contacting the relevant individuals to correct errors. Corporate Communications maintains contact with the media and arranges interviews to provide the public with up-to-date information on new products and the business direction of the Bank. This department also works with Financial Control to arrange the publication of statutory financial reports and the printing and distribution of the annual and interim reports.

Investors relations and industry analysis

Corporate Communications also has responsibility for responding to customer complaints to ensure that an objective examination of the issue is conducted and customer satisfaction is achieved. It is gratifying that we also receive frequent letters of praise for service quality. The responsible staff member receives recognition for these compliments.

Internal communication is an important aspect of management, especially in a rapidly changing industry. Corporate Communications coordinates all such communication. This would include ad hoc distribution of memos, the internal IBA Ambassador bulletin, and special briefings.



IBA enjoys playing a positive role in the community. The IBA Staff Club arranges participation in public events. During Chinese New Year IBA staff make visits to homes for the elderly to share good cheer. IBA participated in competition among members of the Bank Consortium to raise money for the Community Chest, and joined in the Po Leung Kok fundraising walk from Hong Kong Stadium to Aberdeen.



The Regional Advisory Council, described in the Retail Banking section, provides another channel to educate the public not only about IBA's products and sound financial state, but also to discuss issues of importance to the community. There was much confusion about the role of deposit insurance, a serious shortcoming of the Hong Kong banking system. IBA provided its advisors with a concise and informative description of the function of deposit insurance and the contributions it can make to financial stability. IBA is pleased to offer such information to the public so that informed choices can be made.

Community Chest event (top);
Charity Walk (bottom)

FINANCIAL CONTROL AND STRATEGIC PLANNING

IBA is engaged in a wide range of activities and participates in constantly changing markets. Shareholders have entrusted us with their capital, and customers have entrusted us with their deposits. Business activities have to be planned and evaluated, not run on the whim of an individual. Rigorous financial planning and analysis is absolutely vital to effective management of the Bank.

Financial analysis to guide business decisions

The Chief Financial Officer is responsible for reporting financial results, both under statutory regulations and for management planning purposes. Projections are a critical part of this management reporting process. The projections serve as the basis for allocating resources. A team of financial analysts and former auditors, comprising Strategic Planning and Control, report to the Chief Financial Officer. This team was enlarged in 2001 to

enhance its capabilities and increase the sophistication of the analytical work.

Daily reports on lending activity, cost of funds and loan yields, and balance sheet statistics are produced and discussed at the MDO meeting. Mid-month forecasts of full month results are produced to enable managers to make rapid adjustments in their business plans. Mid-year and full year forecasts are prepared and updated on an ongoing basis. Profitability reports for divisions, branches, business teams and individual account officers are used to measure performance. All business promotion campaigns must have an approved budget. Daily reports of the progress of the campaigns are delivered to managers, and a final assessment is prepared by Strategic Planning and Control to permit planning of future campaigns. All new products are approved on the basis of a financial analysis prepared by this department.

Stress tests on the balance sheet are prepared biweekly to project the impact of declines in Prime without a corresponding decrease in funding costs, and an increase in funding costs without a corresponding increase in Prime. The results are used by the Asset and Liability Committee to evaluate alternatives in business plans and to take any recommended steps to hedge the impact of such changes.

Strategic Planning and Control also prepares ad hoc reports at the request of business units so that they can have a better understanding of their business.

MANAGEMENT COMMITTEES

Banking is a complex business made more difficult by the impact of globalization. Given the complexity of our activities and the risks inherent in having a single person make decisions, IBA brings together individuals with different backgrounds and experience to evaluate issues and propose well considered solutions.

The Managing Director’s Office (MDO) is comprised of the Chief Executive, the Executive Vice Presidents and the heads of key departments, currently including Retail banking, Corporate Banking, Investment Banking, Hire Purchase and Leasing, Credit Card and Consumer Finance, Operations, Treasury, Treasury Risk Management and Control, Internal Control, Corporate Governance and Compliance, Industry Analysis and

IBA Share Price (HK\$)



Interest rates stress test

Exploring the full range of managerial talent

Credit Administration. The MDO meets each morning to review activities and discuss market conditions. This ensures that all senior managers are aware of the current status of all major departments and the immediate task to be accomplished under our business strategy. This meeting often covers broader issues, and may assign these issues to the Strategy Committee, a working group of the MDO. Each Saturday the MDO and assorted other managers meet to discuss strategic issues, and receive presentations from internal staff and outside experts. This has allowed the bank to refine its strategy through a group effort.

Managing the balance sheet under changing conditions

The Asset and Liability Committee (ALCO) meets weekly to discuss specific topics related to the balance sheet and earnings statement. Detailed reports are reviewed, and adjustments in the business plan taking into account changing market conditions are decided upon. ALCO must approve all new products and campaigns, as well as exceptions to standard pricing. ALCO also directs Treasury on funding issues, including the raising of medium term funding.

Obtaining product investment returns within equity parameters

The Investment Committee administers the investment portfolio comprising debt securities, equities, fund investments and direct investments. Using the VAR report and outside commentary on market trends, it directs Treasury on the execution of purchases and sales.

Independent assessment of credit proposals

The Credit Committee meets twice weekly to approve credit proposals. All credit proposals are first vetted by Credit Administration. If they endorse the proposal, it will be added to the agenda, and any questions or comments from Credit Administration will be addressed by the account officer at the Credit Committee meeting. The account officer will also respond to questions raised by the members of the committee. The Credit Policy Committee regularly reviews the credit policy and authorities to ensure they properly address risk issues, and recommends additions or amendments. Credit policy issues arising from the introduction of new products must be approved before the formal launch of any new product.

Updating credit policies

Increasing productivity

The Process Engineering Execution Committee was set up in 2001 to expedite the implementation of transaction streamlining. This is a priority in improving the Bank's cost/income ratio.

Developing human resources

The Personnel Management Committee oversees the operations of the Human Resources Department, and conducts the final review of the top and bottom rated individuals in the staff performance evaluation program. It reviews staff expense statistics, overtime, turnover and exit interviews. It also recommends changes in staff benefit programs and staff policy.

The Technology Committee oversees the status of systems, implementation of upgrades and installation of new equipment, and staff satisfaction with the performance of EDS. A subcommittee reviews service requests from departments to prioritize tasks in a manner consistent with overall Bank requirements.

Coordinating technology activities

The Classified Loans Committee reviews portfolio status and individual borrowers to ensure that credit quality remains high. Account officers are quizzed on the status of specific customers. If patterns are detected, the committee will recommend appropriate action. A subcommittee comprised only of the Head of Internal Control, the Head of Corporate Governance and Compliance, the Head of Credit Administration and the Chief Financial Officer will set provisions on a monthly basis, subject to approval of the Audit Committee, as well as the external auditors and the HKMA.

Managing credit quality

CORPORATE GOVERNANCE

Corporate governance has gained increasing prominence as Hong Kong moves to solidify its position as a leading international financial center, and as events such as the collapse of Enron focus attention on the actions of directors and management in protecting the rights of all shareholders. It is the practice of IBA to ensure that all shareholders are treated fairly and equitably. This is especially true in the banking industry because our one true asset is public trust. IBA has three highly capable independent directors serving on the Board. In addition, the Bank has taken the initiative to appoint a Corporate Governance Officer to ensure that we comply with best practice. Specific aspects of our corporate governance practice are discussed in the following paragraphs.

Equitable treatment for all shareholders

All shareholders and potential investors are fully aware of the ownership structure of IBA through our annual report, website and frequent public announcements which highlight the 55% ownership of ABC, 20% ownership of China Everbright and 25% freely traded on the Hong Kong stock exchange. The list of shareholders is available through Central Registration H.K. Ltd, which serves as share registrar.

Transparency of ownership

As noted above, the holdings of the two major shareholders are public knowledge, and no director can own shares in their own name, primarily due to the need to insure that 25% of the bank's shares are in free float in order to meet the requirements of the stock exchange.

Concentration and influence of ownership

Regularity of, ease of access to, and information on shareholders' meetings

IBA informs shareholders of upcoming meetings at least 21 days in advance, with notice of such meetings being sent individually to shareholders and being posted on the IBA website. Meetings are held in Hong Kong and hence easily accessible for the minority shareholders, although this requires representatives of the majority shareholders to travel considerable distance to attend. All shareholders are entitled to appoint a proxy to attend and vote at shareholder meetings.

Voting and shareholder meeting procedures

There is a clearly articulated set of voting procedures at shareholder meetings. Voting is conducted in a simple, transparent and cheap procedure for voting by those present or by those unable to attend the meeting but voting by proxy.

Ownership rights

Secure ownership rights exist via a transparent and independent registrar system, with Central Registration H.K. Ltd. acting as share registrar; Central Registration H.K. Ltd. has no connection financial or otherwise with shareholders or management of IBA other than their contractual obligations as registrar. There is one class of common share that has clearly articulated rights. The charter clearly establishes the concept of one share, one vote. At the time of listing the listing prospectus stated the intention of paying out approximately 40% of net earnings as dividends, and that policy has been adhered to. During the economic downturn the percentage of earnings paid out in dividends exceeded 40% because the directors wished to provide shareholders with a reasonable cash return, supported by the fact that IBA enjoys a high level of capital adequacy and therefore could afford to pay out a higher percentage without endangering the ongoing value of the bank. All declared dividend payments are made on the dates announced for such payments. There are no anti-takeover provisions, although it is the stated intention of the two major shareholders to retain their current ownership percentages, as demonstrated by their pro-rata participation in each of the capital increases subsequent to the original listing of the bank.

Commitment of major shareholders

The bank's financial statements (both annual report and interim reports) are prepared in compliance with the requirements of the Companies Ordinance, Listing Rules, Statements of Standard Accounting Practices of the Hong Kong Society of Accountants and the Guideline on Financial Disclosure by Locally Incorporated Authorized Financial Institutions of the Hong Kong Monetary Authority. Details of investments and holdings in subsidiaries are disclosed in adequate detail and there is adequate disclosure of related party and internal connected party transactions. Records of all shareholder meetings are properly maintained by the company secretary and are accessible at IBA headquarters. Shareholders are notified of all major events through the IBA website, publication of annual and interim results in the English and Chinese press along with press releases to all major newspaper publishers in Hong Kong, and press conferences from time to time and always after the release of the annual results. IBA occasionally issues circulars in line with listing requirements to explain certain issues to shareholders.

Quality and content of public disclosure

Public reports are always filed on time, and public information is available to shareholders in a timely manner. To this end, IBA will be making greater use of its website to supplement the normal distribution of statutory announcements. Publicly filed financial statements are sent to all registered shareholders. Records of shareholder meetings, and other public and statutory information are available on request by any shareholder at IBA's head office.

Timing and access to public disclosure

The auditor is a reputable and experienced audit company, KPMG, which audits a significant number of banks operating in Hong Kong. IBA takes particular pride that the Audit Committee of the Board of Directors is solely comprised of independent, non-executive directors who are highly experienced in the review of business operations. KPMG, as external auditor, attends all Audit Committee meetings.

Independence and standing of auditor

The Board is comprised of highly capable, experienced and well-informed directors. Three independent directors serve among a total of ten directors. The Chairman is a non-executive director, and is separate from the Chief Executive. Only two management executives serve on the Board, ensuring a healthy basis of independence vis-à-vis the bank's management. Remuneration and Nominating committees have been established.

Board structure and composition

Role and effectiveness of the Board

The Board sets broad policy and delegates authority to implement that policy to professional management. Monitoring compliance with this policy is carried out by the Internal Control Department, headed by an experienced former bank auditor, reporting directly to the Audit Committee of the Board of Directors. In addition, the Audit Committee and the Board of Directors have full access to all reports and correspondence of the Hong Kong Monetary Authority and the risk asset review conducted by the internal auditors of ABC as parent bank. In addition to quarterly meetings of the Board, directors receive frequent written and oral communication about the performance of IBA, trends in the banking industry and general economic conditions from management. Credit authority above a specified limit is reserved for the Executive Committee of the Board, ensuring that significant credit facilities are subject to proper scrutiny.

Role and independence of Non-Executive Directors

All monetary, financial and commercial relationships between non-executive directors and IBA are reported to the full Board to ensure there is no conflict of interest. External directorships held by Board members do not interfere with the quality of their involvement.

Board/Executive compensation, evaluation and succession policies

Compensation of the Chief Executive and the executive vice presidents is determined by the Remuneration Committee, and is reported in the annual report in accord with the relevant regulatory requirements. Compensation is cash based (and therefore is clearly reflected in the financial statements) because the requirements for minimum free float of the bank's shares prevent the implementation of a true stock option scheme. A shadow stock option scheme which links a cash payment to the performance of the bank's share price has been instituted. Under a new staff performance evaluation scheme, compensation for senior executives has been more strictly aligned with the net profit reported by the bank with variable compensation being a primary component and increases in basic salary reduced. The senior management structure of IBA, and the existence of a Managing Director's Office comprised of the 16 executives is designed to create a team capable of providing the necessary leadership irrespective of the presence of any single individual, and training multiple candidates for the role of chief executive.