

(a) Capital adequacy and liquidity ratios

	2001	2000
	%	%
Unadjusted capital adequacy ratio at year end	19.72	18.07
Average liquidity ratio for December	47.11	42.49
Average liquidity ratio for the year ended 31 December	43.68	42.99

The unadjusted capital adequacy ratio is computed on a consolidated basis as required by the Hong Kong Monetary Authority for its regulatory purposes, and is in accordance with the Third Schedule of the Hong Kong Banking Ordinance.

The Bank meets all of the *de minimis* exemption criteria for reporting market risk as set out in the Guideline "Maintenance of Adequate Capital Against Market Risks" issued by the Hong Kong Monetary Authority and is not required to maintain capital against market risk. Hence, the Bank is exempted from disclosing the adjusted capital adequacy ratio computed in accordance with the above-mentioned Guideline.

The average liquidity ratio for the year is computed as the simple average of each calendar month's average ratio, as reported in Part I(2) of the "Return of Liquidity Position of an Authorized Institution" (MA(BS)IE) calculated in accordance with the Fourth Schedule of the Hong Kong Banking Ordinance.

(b) The components of the total capital base after deductions as reported under Part I of the banking return "Capital Adequacy Return" (MA(BS)3) calculated in accordance with the Third Schedule of the Hong Kong Banking Ordinance.

	The Group	
	As at 31 December 2001 HK\$'000	As at 31 December 2000 HK\$'000
Core capital		
Paid up ordinary share capital	1,172,160	1,172,160
Reserves	1,330,549	1,243,925
Share premium	749,778	749,778
Others	148,287	86,623
Eligible supplementary capital		
Reserves on revaluation of land and interests in land	36,868	36,868
Reserves on revaluation of holding of securities not held for trading purposes	(18,225)	(4,280)
General reserves for doubtful debts	167,362	104,216
Total capital base before deductions	3,586,779	3,389,290
Deductions from total capital base	(75,532)	(75,618)
Total capital base after deductions	3,511,247	3,313,672

(c) Major customers

Total income attributable to the Group's five largest customers combined is less than 30% of the Group's total income for both years 2000 and 2001.

(d) Overdue analysis of other assets

The Group As at 31 December 2001	Loans <i>HK\$'000</i>	Others <i>HK\$'000</i>	Total Overdue assets <i>HK\$'000</i>
Overdue for			
6 months or less but over 3 months	123,986	2,001	125,987
1 year or less but over 6 months	170,354	2,074	172,428
Over 1 year	<u>550,184</u>	<u>10,225</u>	<u>560,409</u>
	<u>844,524</u>	<u>14,300</u>	<u>858,824</u>

(e) Overdue advances to customers

	The Group			
	As at 31 December 2001	% of gross advances	As at 31 December 2000	% of gross advances
	<i>HK\$'000</i>		<i>HK\$'000</i>	
Overdue advances to customers¹				
6 months or less but over 3 months	123,986	0.74	102,197	0.57
1 year or less but over 6 months	170,354	1.02	393,417	2.20
Over 1 year	<u>550,184</u>	<u>3.29</u>	<u>678,011</u>	<u>3.78</u>
	<u>844,524</u>	<u>5.05</u>	<u>1,173,625</u>	<u>6.55</u>
Amount of collateral held in respect of overdue advances ²	<u>519,145</u>		<u>496,862</u>	
Secured overdue advances	504,170		466,336	
Unsecured overdue advances	<u>340,354</u>		<u>707,289</u>	
	<u>844,524</u>		<u>1,173,625</u>	
Amount of specific reserves made against overdue advances	<u>169,021</u>		<u>372,314</u>	

¹ Net of suspended interest.

² Including expected recoveries of HK\$16.76 million (2000: HK\$27.21 million) from companies in liquidation.

(e) Overdue advances to customers (Continued)

	The Group	
	As at 31 December 2001 HK\$'000	As at 31 December 2000 HK\$'000
Advances overdue for more than 3 months and on which interest is still being accrued ("Interest accrual overdue advances")	53,752	73,324
Advances overdue for 3 months or less and on which interest is being placed in suspense or on which interest accrued has ceased ("Interest non-accrual but not overdue advances")	46,996	70,398

(f) Reconciliation between overdue gross advances and advances to customers on which interest is placed in suspense

	The Group	
	As at 31 December 2001 HK\$'000	As at 31 December 2000 HK\$'000
Overdue advances to customers	844,524	1,173,625
Less: Interest accrual overdue advances	(53,752)	(73,324)
Add: Interest non-accrual but not overdue advances	46,996	70,398
Non-performing advances	<u>837,768</u>	<u>1,170,699</u>

(g) Rescheduled advances to customers

	The Group			
	As at 31 December 2001	% of gross advances	As at 31 December 2000	% of gross advances
Rescheduled advances to customers¹	HK\$'000		HK\$'000	
Interest accrual rescheduled advances	164,440	0.98	301,824	1.68
Interest non-accrual rescheduled advances	33,550	0.20	30,833	0.17
	<u>197,990</u>	1.18	<u>332,657</u>	1.86
Amount of collateral held in respect of rescheduled advances	<u>186,445</u>		<u>256,688</u>	
Secured rescheduled advances	172,445		231,773	
Unsecured rescheduled advances	<u>25,545</u>		<u>100,884</u>	
	<u>197,990</u>		<u>332,657</u>	
Amount of specific reserves made against rescheduled advances	<u>6,760</u>		<u>24,692</u>	

¹ Net of rescheduled advances which have been overdue for over three months and were reported in Note (e) Overdue Advances to Customers.

(h) Advances to customers – by industry sectors

The information concerning advances to customers by industry sectors has been classified in accordance with the industry categories contained in the banking returns on “Quarterly Analysis of Loans and Advances and Provisions” (MA(BS)2A) and “Assets and Liabilities of an Authorized Institution” (MA(BS)I) submitted to the Hong Kong Monetary Authority.

	The Group	
	As at 31 December 2001 HK\$'000	As at 31 December 2000 HK\$'000
Loans for use in Hong Kong		
Industrial, commercial and financial		
– Property development	241,497	362,082
– Property investment	3,139,063	3,055,633
– Financial concerns	397,587	444,592
– Stockbrokers	7,046	18,893
– Wholesale and retail trade	129,840	120,749
– Manufacturing	1,289,023	1,122,447
– Transport and transport equipment	482,106	554,220
– Others	2,111,705	2,526,555
Individuals		
– Loans for the purchase of flats in the Home Ownership Scheme and Private Sector Participation Scheme	34,378	170,191
– Loans for the purchase of other residential properties	6,964,612	5,926,151
– Credit card advances	724,364	695,143
– Others	899,703	2,123,877
Trade finance	181,918	468,379
Loans for use outside Hong Kong	127,239	324,839
	<u>16,730,081</u>	<u>17,913,751</u>

(i) Cross-border claims

As at 31 December 2001 <i>Figures in HK\$Million</i>	The Group			Total
	Banks and other financial institutions	Public sector entities	Others	
Asia Pacific excluding Hong Kong				
– Australia	582	0	0	582
– China	0	75	76	151
– Others	44	0	63	107
North America				
– Canada	410	0	0	410
– United States	2	203	116	321
Caribbean				
– Bermuda	0	0	554	554
– Cayman Islands	0	0	438	438
– Others	0	0	363	363
Middle East – Bahrain	3	0	0	3
Western Europe				
– Belgium	538	0	0	538
– Germany	2,300	0	0	2,300
– France	596	0	0	596
– Netherlands	705	0	0	705
– United Kingdom	607	0	4	611
– Others	150	0	38	188
	<u>5,937</u>	<u>278</u>	<u>1,652</u>	<u>7,867</u>

(j) Currency risk

The information concerning the foreign currency exposures of the Group arising from trading, non-trading and structural positions are disclosed as follows. The net options position reported is calculated in accordance with the methods set out in the banking return "Foreign Currency Position" (MA(BS)6) submitted to the Hong Kong Monetary Authority.

<i>Equivalent in HK\$'Millions</i>	The Group					Total
	As at 31 December 2001					
	US Dollars	Euro	Japanese Yen	Pound Sterling	Australian Dollars	
Spot assets	3,315	280	291	190	624	4,700
Spot liabilities	(3,895)	(311)	(348)	(197)	(502)	(5,253)
Forward purchases	780	100	138	11	51	1,080
Forward sales	(215)	(69)	(81)	(4)	(174)	(543)
Net option position	15	0	0	0	0	15
Net long/(short) position	0	0	0	0	(1)	(1)
Net structural position	0	0	0	0	0	0

<i>Equivalent in HK\$'Millions</i>	The Group					Total
	As at 31 December 2000					
	US Dollars	Euro	Japanese Yen	Pound Sterling	Australian Dollars	
Spot assets	4,536	233	281	322	388	5,760
Spot liabilities	(5,102)	(197)	(291)	(302)	(386)	(6,278)
Forward purchases	1,163	26	220	0	487	1,896
Forward sales	(746)	(45)	(208)	(20)	(490)	(1,509)
Net option position	0	0	0	0	0	0
Net long/(short) position	(149)	17	2	0	(1)	(131)
Net structural position	0	0	0	0	0	0

The US dollar net short position of HK\$149 million as at 31 December 2000 was the result of the charging-off of US dollar loans at the end of December 2000. The open positions had been hedged in January 2000.

(k) Risk management

The Group has established policies and procedures for risk management which are reviewed regularly by the Management and various management committees including the Asset and Liability Committee, Credit Committee, Credit Policy Committee, Classified Loan Committee and Audit Committee.

(i) Credit Risk Management

Credit risk arises from the potential that a borrower or counterparty will fail to perform on an obligation. It arises from the trade finance, lending, derivatives, treasury and other normal banking activities undertaken by the Group. The Group has established policies to ensure that credit risk is properly managed at both the transaction and portfolio levels. The Credit Committee, chaired by the Chief Executive Officer, formulates credit policies and together with the Group's Chief Corporate Governance and Compliance Officer and the Internal Control Department, monitors the compliance of statutory and internal limits on credit exposures.

The credit risk management function is independent of business units. It oversees the implementation of credit policies and ensures the quality of credit evaluation and approval. Credit approval is conducted in accordance with the Group's credit policy which defines the credit extension criteria, the credit approval and monitoring processes, the loan classification system and provisioning policy. The credit policy also takes into account the requirements of the Hong Kong Banking Ordinance and the guidelines issued by the Hong Kong Monetary Authority with respect to large exposures and provisioning requirements.

The Executive Committee of the Board has been delegated the power to approve credits on behalf of the Board. The Chief Executive Officer, who has been delegated by the Board a lower credit approval authority than the Executive Committee, has in turn delegated lower authorities to the Credit Committee. Approval takes into account the type of loans, the tenor of the loan, repayment ability of the prospective borrower and available security.

The Group has established guidelines to ensure that each new product is designed and reviewed by a Product Development Committee. All relevant internal departments are required that they have put in place the appropriate processes, systems and controls before the product is approved.

Performance of loans is monitored through regular reviews and management reports submitted to the Chief Executive Officer as well as the Internal Control Department and the external auditors. To avoid concentration risk, credit exposures to individual customer groups and advances to industry sectors are carefully managed to achieve a balanced loan portfolio.

(ii) Liquidity Risk Management

Liquidity risk is the risk that not enough cash will be generated from either assets or liabilities to meet deposit withdrawals or contractual loan funding. To manage liquidity risk, the Group has established the liquidity management policy which is reviewed by the Management and approved by the Board of Directors as well as the Hong Kong Monetary Authority. The Group measures the liquidity of the Group through statutory liquidity ratio, loan-to-deposit ratio and the currency/maturity mismatch portfolio.

The Asset and Liability Committee closely monitors the liquidity position of the Group to ensure that the liquidity structure of the Group's assets, liabilities and commitments can meet its funding needs and that the statutory liquidity is always complied with. As disclosed in Note (a) above, the Group's consolidated liquidity ratio of 47.11% for December 2001 and the average liquidity ratio of 43.68% for the year of 2001 was well above the statutory minimum ratio of 25%.

(k) Risk management (Continued)
(iii) Capital Management

The Group's intention is to maintain a strong capital base to support the development of the Group's operations prudently, with the aim of diversifying its business activities, including the future expansion of branch network, increasing the customer base, introducing new financial products and meeting the statutory capital adequacy ratio. As disclosed in Note (a) above, the Group's unadjusted consolidated capital adequacy ratio of 19.72% as at 31 December 2001 was already well above the statutory minimum ratio of 8%.

(iv) Market Risk

Market risk is the risk arising from the net effect of changes in market rates and prices, such as interest rates and foreign exchange rates on the Bank's assets, liabilities and commitments, thus causing profits or losses.

Interest rate risk is the risk that changes in prevailing interest rates will adversely affect assets, liabilities, capital, income, and/or expense at different times or in different amounts. Interest rate risk can further decimate into repricing risk, basis risk, yield curve risk and option risk.

The Bank's market risk originates from its open position in foreign exchange. The Bank's trading activities on derivative instruments mainly arise from the execution of trade orders from customers and positions taken in order to hedge the Bank's opened position. The Bank does not engage in proprietary trading of foreign exchange, but merely executes customer orders.