

Report of the directors

The directors have pleasure in presenting their annual report together with the audited financial statements for the year ended 31 December 2001.

Principal activities

The principal activities of the Group and the Bank are the provision of general banking and related financial services, primarily in Hong Kong. The Bank also operates two branches in the United States of America. Particulars of the Bank's principal subsidiaries as at 31 December 2001 are set out in note 20 on the financial statements.

Financial statements

The profit of the Group for the year ended 31 December 2001 and the state of the Bank's and the Group's affairs as at that date are set out in the financial statements on pages 10 to 62.

Dividends

An interim dividend of HK\$0.03 (2000: HK\$0.02) per share was paid on 12 September 2001. The directors recommend the payment of a final dividend of HK\$0.025 (2000: HK\$0.05) per share in respect of the year ended 31 December 2001.

Charitable donations

Charitable donations made by the Group during the year amounted to HK\$57,571 (2000: HK\$986,129).

Fixed assets

Movements in fixed assets are set out in note 23 on the financial statements.

Reserves

Movements in the reserves of the Group and the Bank during the year are set out in note 30 on the financial statements.

Share capital

Movements in the share capital of the Bank are set out in note 29 on the financial statements.

Directors

The directors during the financial year and up to the date of this report are as follows (arranged in the order of number of strokes of the directors' Chinese surnames):

Mr Yu Baozhong
(Independent Non-executive Director)
Mr Kong Dan (appointed on 2 January 2001)
(Chairman)
Mr Kong Siu Chee Kenneth (appointed on 4 May 2001)
(Executive Vice President and Alternate Chief Executive Officer)
Mr Li Hengxun
Dr Daniel H Lam
(Independent Non-executive Director)
Mr Lam Kwong Siu
(Independent Non-executive Director)
Mr Ju Weimin (appointed on 12 July 2001)
Mr Chang Zhenming (appointed on 4 May 2001)
(President and Chief Executive Officer)
Mr Zhang En Zhao (appointed on 4 May 2001)
Mrs Chan Hui Dor Lam Doreen (appointed on 4 May 2001)
(Executive Vice President and Alternate Chief Executive Officer)
Mr Zhuang Shoucang
Mr Yang Chao (appointed on 2 January 2001)
Mr Zhao Shengbiao
(Executive Vice President and Country Head, USA)
Mr Lo Wing Yat Kelvin
(Executive Vice President)
Mr Dou Jianzhong

Mr Wang Xianzhang (resigned on 2 January 2001)
Mr Hong Yuncheng (retired by rotation on 3 May 2001)
Mr Zhang Mingqian (retired by rotation on 3 May 2001)
Mr Tang See King Brian (retired by rotation on 3 May 2001)
Mr Zhou Hanrong (resigned on 4 May 2001)
Mr Cai Zhongzhi (resigned on 6 July 2001)

In accordance with Article 111(1) of the Bank's Articles of Association, Mr Chang Zhenming, Mr Zhang En Zhao, Mrs Chan Hui Dor Lam Doreen, Mr Kong Siu Chee Kenneth and Mr Ju Weimin retire from the Board at the forthcoming Ordinary Yearly Meeting and, being eligible, offer themselves for re-election.

In accordance with Article 118 of the Bank's Articles of Association, Dr Daniel H Lam, Mr Zhuang Shoucang and Mr Yu Baozhong retire from the Board by rotation at the forthcoming Ordinary Yearly Meeting and, being eligible, offer themselves for re-election.

None of the directors has a service contract with the Bank or any of its subsidiaries which is not determinable by the Bank within one year without payment of compensation, other than normal statutory obligations.

Directors' interests

At 31 December 2001, the beneficial interests of the directors in the share capital of the Bank as recorded in the register maintained under section 29 of the Hong Kong Securities (Disclosure of Interests) Ordinance were as follows:

	<i>Ordinary shares of HK\$1 each</i>			
Name of director	<i>Personal interests</i>	<i>Family interests</i>	<i>Other interests</i>	<i>Total interests</i>
Dr Daniel H Lam	183,970	118,089	-	302,059
Mrs Chan Hui Dor Lam Doreen	-	-	2,000,000	2,000,000
Mr Kong Siu Chee Kenneth	-	-	2,000,000	2,000,000
Mr Lo Wing Yat Kelvin	-	-	2,000,000	2,000,000
Mr Zhao Shengbiao	1,200,000	-	614,114	1,814,114

Senior Executive Share Option Scheme

A Senior Executive Share Option Scheme (the "Option Scheme") is maintained by the Bank, under which eligible senior executives (including executive directors) of the Bank were granted share options for subscription of shares of the Bank. The Option Scheme was adopted on 30 March 1995. The exercise price of options was determined by the Board and was the higher of the nominal value of the shares and 80% of the average of the closing prices of the shares on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") for the five business days immediately preceding the date of the grant.

The maximum number of shares in respect of which options may be granted under the Option Scheme may not exceed 10% of the issued share capital of the Bank from time to time, excluding any shares which have been duly allotted and issued pursuant to the exercise of any option granted under the Option Scheme.

At 31 December 2001, the directors and employees of the Bank had the following interests in options to subscribe for shares of the Bank (market value per share at 31 December 2001 was HK\$1.98) granted pursuant to the Option Scheme of the Bank. Each option gives the holder the right to subscribe for one share.

Directors' interests (continued)

Senior Executive Share Option Scheme (continued)

Directors	<i>No. of options outstanding at the beginning of the year</i>	<i>No. of options outstanding at the year end</i>	<i>Date granted</i>	<i>Period during which options exercisable</i>	<i>No. of shares acquired on exercise of options during the year</i>	<i>No. of options lapsed during the year</i>	<i>Price per share on exercise of options</i>	<i>Weighted average closing price (note 2)</i>
Mrs Chan Hui Dor Lam Doreen	2,000,000	2,000,000	17 August 1999	20 April 2000 to 29 March 2005	-	-	HK\$2.30	-
Mr Kong Siu Chee Kenneth	2,000,000	2,000,000	17 August 1999	18 May 2001 to 29 March 2005	-	-	HK\$2.30	-
Mr Lo Wing Yat Kelvin	2,000,000	2,000,000	17 August 1999	31 October 1999 to 29 March 2005	-	-	HK\$2.30	-
Mr Zhao Shengbiao	87,000	87,000	10 April 1996	11 April 1996 to 29 March 2005	-	-	HK\$1.00	-
	210,875	210,875	8 May 1997	9 May 1997 to 29 March 2005	-	-	HK\$1.00	-
	316,239	316,239	6 May 1998	7 May 1998 to 29 March 2005	-	-	HK\$1.00	-
Mr Hong Yuncheng	3,000,000	2,700,000	17 August 1999	24 February 2000 to 31 March 2002	300,000	-	HK\$2.30	HK\$2.7
Mr Cai Zhongzhi	3,000,000	3,000,000	17 August 1999	24 February 2000 to 5 January 2002	-	-	HK\$2.30	-
Mr Zhang Mingqian	2,000,000	-	17 August 1999	10 May 2000 to 3 July 2001	-	2,000,000	HK\$2.30	-
Mr Tang See King Brian	1,000,000	1,000,000	17 August 1999	11 February 2000 to 1 January 2002	-	-	HK\$2.30	-
Aggregate total of employees	200,000	200,000	30 March 1995	30 March 1995 to 29 March 2005	-	-	HK\$1.00	-
	37,000	37,000	10 April 1996	11 April 1996 to 29 March 2005	-	-	HK\$1.00	-
	42,125	42,125	8 May 1997	9 May 1997 to 29 March 2005	-	-	HK\$1.00	-
	73,689	73,689	6 May 1998	7 May 1998 to 29 March 2005	-	-	HK\$1.00	-
	1,350,000	1,200,000	16 April 1999	6 August 1999 to 29 March 2005	150,000	-	HK\$1.68	HK\$2.7

Directors' interests (continued)

Senior Executive Share Option Scheme (continued)

Directors	No. of options outstanding at the beginning of the year	No. of options outstanding at the year end	Date granted	Period during which options exercisable	No. of shares acquired on exercise of options during the year	No. of options lapsed during the year	Price per share on exercise of options	Weighted average closing price (note 2)
Aggregate total of employees (continued)	4,200,000	4,200,000	17 August 1999	1 April 2000 to 29 March 2005	-	-	HK\$2.30	-
	2,000,000	2,000,000	29 February 2000	18 January 2002 to 29 March 2005	-	-	HK\$2.044	-
	1,200,000	1,000,000	16 March 2000	16 March 2001 to 29 March 2005	200,000	-	HK\$1.896	HK\$2.49
	1,700,000	1,700,000	28 March 2000	31 March 2000 to 28 March 2005	-	-	HK\$1.824	-
	2,000,000	2,000,000	19 May 2000	26 April 2002 to 29 March 2005	-	-	HK\$1.57	-
	1,000,000	1,000,000	27 June 2000	5 June 2002 to 29 March 2005	-	-	HK\$1.744	-
	700,000	700,000	10 August 2000	11 August 2001 to 29 March 2005	-	-	HK\$2.28	-
	200,000	200,000	23 August 2000	24 August 2001 to 29 March 2005	-	-	HK\$2.296	-
	2,300,000	2,300,000	5 December 2000	22 October 2001 to 29 March 2005	-	-	HK\$1.812	-
	-	300,000	26 March 2001	27 March 2002 to 29 March 2005	-	-	HK\$1.824	-

Notes:

1 All the option lapsed before expiry of the option will be added back to the number of shares available to be issued under the Option Scheme.

2 This represents the weighted average closing price of the shares of the Bank immediately before the dates the options were exercised.

The share options granted are not recognised in the financial statements until they are exercised. The value per option granted in 2001 was estimated at the date of grant using the Binomial option pricing model was HK\$2.25. The weighted average assumptions used are as follows:

Risk-free interest rate	5.22%
Expected life (in years)	3
Volatility	50%
Expected dividend per share	HK\$0.055

The Binomial option pricing model requires input of highly subjective assumptions, including the expected stock price volatility. Because the Bank's share options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, the Binomial option pricing model does not necessarily provide a reliable measure of the fair value of the share options.

Directors' interests (continued)

No contract of significance in relation to the Bank's business to which the Bank, its holding company, subsidiaries or fellow subsidiaries was a party and in which a director of the Bank had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

Apart from the above, at no time during the year was the Bank, its holding company, subsidiaries or fellow subsidiaries a party to any arrangement to enable the directors or any of their spouses or children under eighteen years of age to acquire benefits by means of the acquisition of shares in or debentures of the Bank or any other body corporate.

Substantial shareholder

As far as the directors are aware¹⁰, the following had an interest of 10% or more of the issued share capital of the Bank as at 31 December 2001:

Name of shareholder	<i>Number of ordinary shares of HK\$1 each</i>	<i>Shareholding %</i>
China International Trust and Investment Corporation ("CITIC")	1,429,577,209	55.08%

Save as disclosed above, the directors are not aware of any other party having an interest representing 10% or more of the issued share capital of the Bank.

During the year, the Group entered into transactions with CITIC, which is the Bank's controlling shareholder, and CITIC's other subsidiaries in the normal course of business. The Group's and the Bank's balances with CITIC and its other subsidiaries as at 31 December 2001 are set out in note 17 on the financial statements.

Connected transactions

On 1 September 2000, the Bank entered into a tenancy agreement with Cargary Securities Limited ("Cargary"), a non-wholly owned subsidiary, under which the Bank agreed to let to Cargary the premises on 2nd and 3rd Floors, Ka Wah Bank Centre, 232 Des Voeux Road Central, Hong Kong for a period of one year (exclusive of rates and management fee) commencing from 1 January 2000 at a monthly rental of HK\$137,016. The tenancy agreement has been renewed for another one year from 1 January 2001 at a monthly rental of HK\$107,952. The aggregate rental for the year pursuant to the tenancy agreement was HK\$1,295,424.

On 11 October 2000, the Bank entered into an agency agreement with Cargary under which Cargary appointed the Bank as its non-exclusive agent to act on its behalf to receive orders for trading of securities from its customers through the Bank's branch network. For each successfully executed transaction, the Bank is entitled to receive from Cargary an agency fee at such rate as mutually agreed by both parties from time to time (being not less than 30% of the transaction fee). The aggregate agency fee received for the year pursuant to the agency agreement was HK\$7,559,020.

Connected transactions (continued)

The Bank holds 51% of Cargary's issued share capital while the remaining 49% is held by True Worth Investments Limited, a wholly-owned subsidiary of CITIC. Accordingly, the transactions contained in the agreements constitute connected transactions under the Listing Rules of the Stock Exchange.

In the opinion of the directors and as confirmed by two independent non-executive directors, the transactions in questions were conducted on terms that are fair and reasonable so far as the Bank's shareholders are concerned and were entered into in accordance with the terms of the respective agreements. The aggregate amount of each of the rental fee and agency fee for the year did not exceed the amount of 3% of the book value of the net tangible assets of the Group as disclosed in the audited financial statements for the year.

Purchase, sale or redemption of the Bank's listed securities

The Bank has not redeemed any of its listed securities during the year. Neither the Bank nor any of its subsidiaries has purchased or sold any of the Bank's listed securities during the year.

Management contracts

No contract concerning the management and administration of the whole or any substantial part of the business of the Bank was entered into or existed during the year.

Major customers

The directors believe that the five largest customers of the Group accounted for less than 30% of the total of interest income and other operating income of the Group in the year.

Supervisory Policy Manual on Financial Disclosure by Locally Incorporated Authorised Institutions

The financial statements of the Bank for the year ended 31 December 2001 fully comply with the requirements set out in the "Supervisory Policy Manual Financial Disclosure by Locally Incorporated Authorised Institutions" issued by the Hong Kong Monetary Authority.

Compliance with the Code of Best Practice

The Bank has complied throughout the year with the Code of Best Practice as set out by the Stock Exchange in Appendix 14 to the Listing Rules, except that there is no specific term for the appointment of independent non-executive directors and the Bank is in the process of forming an audit committee in order to comply fully with paragraph 14 of the aforementioned Code.

Auditors

A resolution for the re-appointment of KPMG as auditors of the Bank is to be proposed at the forthcoming Ordinary Yearly Meeting.

On behalf of the Board

Chairman

Hong Kong, 28 February 2002