

Notes to Financial Statements

31 December 2001

1. Corporate Information

The Company was incorporated in Bermuda as an exempted company with limited liability under the Companies Act 1981 of Bermuda (as amended) on 17 May 1999. The shares of the Company are listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

During the year, the Group offered a full range of whole life, endowment and term life insurance products to individuals in Hong Kong as well as other insurance products which included accident, medical and disability policies for individuals, group life and accident, medical and disability insurance, and general insurance products through an agency arrangement. The Group was also engaged in the administration of retirement schemes and the asset management during the year.

In the opinion of the directors, the ultimate holding company is Pacific Century Group (Cayman Islands) Limited, a company incorporated in the Cayman Islands.

2. Summary of Significant Accounting Policies

The Group's accounting policies, which are set out below, have remained unchanged from prior years.

Basis of preparation

These financial statements have been prepared in accordance with Hong Kong Statements of Standard Accounting Practice, accounting principles generally accepted in Hong Kong for long term insurance companies and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention, except for the revaluation of investments and derivative financial instruments, as further explained below.

Basis of presentation and consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2001. The results of subsidiaries acquired or disposed of during the year are consolidated from or to their effective dates of acquisition or disposal, respectively.

All significant intercompany transactions and balances within the Group are eliminated on consolidation.

Subsidiaries

A subsidiary is a company in which the Company, directly or indirectly, controls more than half of its voting power or issued share capital or controls the composition of its board of directors. Interests in subsidiaries are stated at cost unless, in the opinion of the directors, there have been permanent diminutions in values, when they are written down to values determined by the directors.

Associate

An associate is a company, not being a subsidiary, in which the Group has a long term interest of generally not less than 20% of the equity voting rights and over which it is in a position to exercise significant influence.

The Group's share of the post-acquisition results and reserves of an associate is included in the consolidated revenue and profit and loss accounts and consolidated reserves, respectively. The Group's interest in an associate is stated in the consolidated balance sheet at the Group's share of net assets under the equity method of accounting less any provision for diminution in value, other than those considered to be temporary in nature, deemed necessary by the directors.

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2. Summary of Significant Accounting Policies (continued)

Profit recognition

The operating profits on the long term insurance business of the Group are arrived at annually by means of an actuarial valuation of future insurance liabilities, determined by the appointed actuary of the Group using a Net Level Premium approach. Detailed policies are as follows:

- (i) acquisition costs relating to the production of new business are deferred, to the extent that they can be recovered, and are shown explicitly as an asset in the balance sheet. Assumptions used in assessing the deferred acquisition costs reflect management's assessment of the most likely outcome of the future policy cash flows, subject to reasonable allowances for prudence purposes. All other acquisition costs and all maintenance costs are expensed as and when incurred;
- (ii) amounts received on reinsurance contracts that do not transfer significant underwriting risk are included as a component of insurance liabilities in the balance sheet; and
- (iii) premiums relating to reinsurance contracts that do not transfer significant underwriting risk are treated as adjustments to the amounts carried on the balance sheet in respect of the contracts concerned.

Premiums

Premiums in respect of traditional policies are recognised as income as they fall due, whereas those in respect of universal life, investment account and group policies are accounted for as they are received. Contributions received in respect of the group retirement scheme management business are accounted for as income as they are received.

Premiums on reinsurance contracts that transfer underwriting risk are expensed as incurred. Premiums on reinsurance contracts that do not transfer significant underwriting risk are treated as adjustments to the amounts carried on the balance sheet in respect of the contracts concerned.

Investment income

Investment income is accounted for on a receivable basis. Dividend income from investments is recognised on the date on which the related investments are quoted as ex-dividend. Interest income from investments is accrued up to the balance sheet date.

Commissions

Commissions to agents and other related policy acquisition costs are expensed as incurred.

Commissions received on reinsurance policies that transfer underwriting risk are recognised as income at the same time as the reinsurance premiums are accounted for. Amounts received on reinsurance contracts that do not transfer significant underwriting risk are included as a component of insurance liabilities on the balance sheet.

Deferred acquisition costs

The acquisition costs primarily related to the production of new business are deferred in so far as there are sufficient margins in the future premiums of the new business to fund the amortisation of the deferred acquisition costs ("DAC"). DAC include first year commissions and other costs related to the acquisition of new business.

DAC are carried at cost and amortised on a straight-line basis over ten years. In addition, DAC are adjusted for any impairment in value determined by reference to margins in the future premiums.

Insurance claims

Insurance claims are provided for as reported, whether admitted or not.

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2. Summary of Significant Accounting Policies (continued)

Fixed assets and depreciation

Fixed assets are stated at cost less accumulated depreciation. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after fixed assets have been put into operation, such as repairs and maintenance, is normally charged to the revenue and profit and loss accounts in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the fixed asset, the expenditure is capitalised as an additional cost of that asset.

Depreciation is calculated on the straight-line basis to write off the cost of each asset over its estimated useful life. The principal estimated useful lives used for this purpose are as follows:

Leasehold land	50 years or the lease terms, whichever is shorter
Buildings	40 years
Computer equipment	3 years
Furniture, fixtures and equipment	5 years
Motor vehicles	5 years

The gain or loss on disposal or retirement of a fixed asset recognised in the revenue and profit and loss accounts is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Investments

Bonds held to maturity are stated at amortised cost. Premiums and discounts are amortised over the period from the date of purchase to the date of maturity or redemption.

Other investments, including bonds purchased for trading purposes, equities, equity linked notes and unit trusts, are stated at market or fair value. Any realised and unrealised gains or losses arising from changes in the fair values of other investments are dealt with in the revenue and profit and loss accounts for the period in which they arise.

Real estate

Real estate represents the Group's interests in land and buildings held in respect of the Group's long term insurance business for investment purposes. Real estate is stated at cost less any provision for diminution in value deemed necessary by the directors. This treatment is commonly adopted by life insurance companies in Hong Kong for such assets held in respect of long term insurance business and is permitted under the Hong Kong Statement of Standard Accounting Practice 2.113 "Accounting for investment properties".

Prepayments

Prepayments made in connection with the recruitment of agents are capitalised and amortised over the term of the contract with the agents.

Premium receivables

Premium receivables represent premiums which are due for payment. The Group normally allows policyholders to make payment within a grace period of one month from the due date. The grace period may be further extended by one further month by management purely on a discretionary basis. Insurance policies continue if default premiums are settled before the expiry of the grace period.

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2. Summary of Significant Accounting Policies (continued)

Future insurance liabilities

Future insurance liabilities represent net future policy liabilities as determined by the appointed actuary of the Group using the Net Level Premium approach.

Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Rentals applicable to such operating leases are charged to the consolidated revenue and profit and loss accounts on the straight-line basis over the lease terms.

Deferred tax

Deferred tax is provided, using the liability method, on all significant timing differences to the extent it is probable that the liability will crystallise in the foreseeable future. A deferred tax asset is not recognised until its realisation is assured beyond reasonable doubt.

Foreign currency transactions

Foreign currency transactions are recorded at applicable rates of exchange ruling at transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the applicable rates of exchange ruling at that date. Exchange differences are dealt with in the consolidated revenue and profit and loss accounts.

On consolidation, the financial statements of overseas subsidiaries are translated to Hong Kong dollars at the applicable rates of exchange ruling at the balance sheet date. The resulting translation differences are included in the exchange fluctuation reserve.

Derivative financial instruments

Derivative financial instruments are stated at market or fair value at the balance sheet date. Realised and unrealised gains and losses from derivative financial instruments are dealt with in the consolidated revenue and profit and loss accounts.

Related parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

Cash equivalents

For the purpose of the consolidated cash flow statement, cash equivalents represent short term highly liquid investments which are readily convertible into known amounts of cash and which were within three months of maturity when acquired, less advances from bank repayable within three months from the date of the advance. For the purpose of balance sheet classification, cash equivalents represent assets similar in nature to cash, which are not restricted as to use.

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3. Turnover

Turnover represents gross insurance premiums written and contributions received in respect of retirement scheme management, commissions received and receivable in respect of general insurance business conducted under an agency agreement, and service fees from asset management.

Revenue from the following activities has been included in turnover.

	Group	
	2001 HK\$'000	2000 HK\$'000
Revenue from:		
Long term insurance business	1,970,829	1,688,187
General insurance business under an agency agreement	8,631	7,945
Asset management business	1,772	184
Turnover	1,981,232	1,696,316

The Group's income all arises from its activities which are conducted in Hong Kong.

4. Policyholders' Benefits

	Group	
	2001 HK\$'000	2000 HK\$'000
Death and disability claims	188,192	141,256
Surrenders	370,501	195,394
Maturities and periodic payments	65,942	63,875
Policyholders' dividends	118,179	99,005
	742,814	499,530

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5. Operating Profit Before Tax

Operating profit before tax is arrived at after charging:

	Group	
	2001 HK\$'000	2000 HK\$'000
Auditors' remuneration	900	911
Depreciation	24,583	21,803
Amortisation of deferred acquisition costs	266,219	224,454
Operating lease rentals on land and buildings	52,460	48,972
Staff costs (directors' remuneration included, note 6)	167,772	154,387
Net retirement benefit scheme contributions (note 32)	9,706	21,381
Loss on disposal of fixed assets	2,346	2,012
Unrealised losses less gains on other investments:		
Listed	—	7,658
Unlisted	28,637	22,537
Realised losses less gains arising from equity-linked financial products (note (ii) below)	—	46,626
Realised losses less gains on other listed investments	37,401	—
Provision for an amount due from an associate	9,039	—
and after crediting:		
Bad and doubtful debts written back	1,861	3,127
Dividend income from listed investments	7,337	11,731
Unrealised gains less losses arising from dealing in foreign currencies (note (i) below)	180	945
Unrealised gains less losses on other listed investments	82,376	—
Realised gains less losses on other listed investments	—	23,920
Realised gains less losses on listed bonds held-to-maturity	—	79,487
Realised gains less losses arising from derivative financial instruments (note (i) below)	1,364	3,752
Realised gains less losses arising from equity-linked financial products (note (ii) below)	1,386	—
Interest income from listed investments	103,269	74,054
Other interest income	69,626	95,363

Notes:

- (i) The Group's insurance liabilities are predominantly denominated in United States dollars. It is the Group's policy to keep adequate assets in United States dollars in order to match its insurance liabilities. Where fixed interest securities (including bonds and equity linked notes) are denominated in currencies other than United States dollars, foreign currency forward contracts are bought to hedge back into United States dollars.
- (ii) Equity-linked financial products were employed, without leverage, solely for the purpose of gaining investment access into restricted equity markets, such as Taiwan and South Korea. They are in fact equivalent to local equities of these markets. They serve the same purpose as, for instance, ADR (American Depository Receipts).

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5. Operating Profit Before Tax (continued)

The operating profit before tax is analysed by activity as follows:

	Group	
	2001 HK\$'000	2000 HK\$'000
Long term insurance business	164,807	160,017
General insurance business under an agency agreement	(1,836)	(3,111)
Asset management business (note (iii) below)	(5,810)	(3,227)
Operating profit before tax	157,161	153,679
Notes:		
(iii) Income from operations - asset management	13,565	5,501
Less: Intragroup Income	(11,277)	(5,007)
	2,288	494
Operating expenses before tax	(8,098)	(3,721)
	(5,810)	(3,227)

The Group's operating profit before tax arises from its direct underwriting activities conducted in Hong Kong.

6. Directors' Remuneration

	2001 HK\$'000	2000 HK\$'000
Directors' remuneration:		
Fees	2,680	2,560
Other emoluments	27,791	27,680
	30,471	30,240

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6. Directors' Remuneration (continued)

The remuneration of the directors of the Company for the year disclosed pursuant to the Rules Governing the Listing of Securities on the Stock Exchange and Section 161 of the Hong Kong Companies Ordinance is analysed as follows:

	2001 HK\$'000	2000 HK\$'000
Executive and non-executive directors:		
The aggregate of the directors' fees	2,320	2,200
The aggregate of the directors' basic salaries, housing allowances, other allowances and benefits in kind	15,925	15,925
The aggregate of contributions to retirement benefit schemes	1,470	1,470
The aggregate of bonuses paid or receivable by directors	10,396	10,285
	30,111	29,880
Independent non-executive directors:		
The aggregate of the directors' fees	360	360
	30,471	30,240

The independent non-executive directors have been appointed for an initial term of three years with effect from 8 June 1999, and are entitled to an annual directors' fee of HK\$120,000 each. The non-executive director has been appointed for an initial term of three years with effect from 30 November 2000.

The remuneration of directors fell within the following bands:

	Number of directors	
	2001	2000
Nil - HK\$1,000,000	12	13
HK\$7,500,001 - HK\$8,000,000	2	2
HK\$12,500,001 - HK\$13,000,000	1	1
	15	16

There was no arrangement under which a director waived or agreed to waive any remuneration during the year.

Details of options granted to directors are set out in note 25 to the financial statements and the section "Directors' and chief executive's rights to acquire shares" in the Report of the Directors.

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7. Five Highest Paid Employees

The five highest paid employees in the Group included three directors. Further details of their remuneration are set out in note 6 above. The details of the remuneration of the two non-director, highest paid employees are as follows:

	Group	
	2001 HK\$'000	2000 HK\$'000
The aggregate of basic salaries, housing allowances, other allowances and benefits in kind	4,203	4,940
The aggregate of contributions to pension schemes	388	456
The aggregate of bonuses paid or receivable which are discretionary	441	302
	5,032	5,698

The remuneration of the non-director, highest paid employees fell within the following bands:

	Number of employees	
	2001	2000
HK\$2,000,001 - HK\$2,500,000	1	1
HK\$2,500,001 - HK\$3,000,000	1	—
HK\$3,000,001 - HK\$3,500,000	—	1
	2	2

8. Tax

	2001 HK\$'000	2000 HK\$'000
Group:		
Hong Kong profits tax	904	—
Overseas tax	80	196
Underprovision/(overprovision) in prior years	792	(559)
Associate	—	—
Tax charge/(credit) for the year	1,776	(363)

The assessable profits of a wholly-owned subsidiary, which is engaged in the long term insurance business and retirement scheme management, are computed in accordance with the special provisions of the Hong Kong Inland Revenue Ordinance. This subsidiary had sufficient agreed tax losses brought forward from prior years to offset against any assessable profits for long term insurance business and retirement scheme management arising in Hong Kong during the year.

Hong Kong profits tax has been provided at the rate of 16% on the estimated assessable profits solely arising from asset management business conducted in Hong Kong during the year. Overseas tax has been calculated on the estimated assessable profits for the year at the rates of tax prevailing in the countries in which the Group operates based on existing legislation, interpretations and practices in respect thereof.

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9. Net Profit Attributable to Shareholders

The net profit/(loss) attributable to shareholders dealt with in the financial statements of the Group and the Company are as follows:

	2001 HK\$'000	2000 HK\$'000
Group	155,948	154,274
Company	(4,634)	(4,091)

10. Dividend

The directors do not recommend the payment of any dividend in respect of the year (2000: Nil).

11. Earnings Per Share

The calculation of basic earnings per share is based on the net profit attributable to shareholders for the year of HK\$155,948,000 (2000: HK\$154,274,000) and the weighted average number of 827,100,000 shares (2000: 827,100,000 shares*) in issue during the year.

The diluted earnings per share for the years ended 31 December 2000 and 2001 have not been calculated because the effect arising from the deemed exercise of share options outstanding during these years would have had an anti-dilutive effect on the basic earnings per share.

* Adjusted for bonus issue.

12. Fixed Assets

Group	Leasehold land and buildings HK\$'000	Computer equipment HK\$'000	Furniture, fixtures and equipment HK\$'000	Motor vehicles HK\$'000	Total HK\$'000
Cost:					
At 1 January 2001	226,971	29,629	133,086	3,152	392,838
Additions	—	4,868	1,882	—	6,750
Disposals	—	(8,286)	(15,857)	—	(24,143)
At 31 December 2001	226,971	26,211	119,111	3,152	375,445
Accumulated depreciation:					
At 1 January 2001	13,520	24,603	82,804	2,083	123,010
Provided during the year	5,160	2,614	16,356	453	24,583
Disposals	—	(6,684)	(15,113)	—	(21,797)
At 31 December 2001	18,680	20,533	84,047	2,536	125,796
Net book value:					
At 31 December 2001	208,291	5,678	35,064	616	249,649
At 31 December 2000	213,451	5,026	50,282	1,069	269,828

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12. Fixed Assets (continued)

Details of the Group's leasehold land and buildings, which are held under medium lease terms, are as follows:

	Group	
	2001 HK\$'000	2000 HK\$'000
Hong Kong	216,520	216,520
Elsewhere	10,451	10,451
	226,971	226,971

13. Interests in Subsidiaries

	Company	
	2001 HK\$'000	2000 HK\$'000
Unlisted shares, at cost	365,614	365,614
Amounts due from subsidiaries	499,050	504,058
	864,664	869,672

The amounts due from subsidiaries are unsecured, interest-free and are not repayable in the next twelve months.

Particulars of the principal subsidiaries are as follows:

Name	Place of incorporation	Nominal value of issued share capital	Percentage of equity attributable to the Company		Principal activities
			Direct	Indirect	
Bright Victory International Limited	British Virgin Islands	Ordinary US\$7,743,935	100	—	Investment holding
Pacific Century Insurance Company Limited	Bermuda	Ordinary US\$65,921,820 Redeemable US\$9,000,000	—	100	Life assurance, administration of retirement schemes and other related businesses
Pacific Century Trustees Limited	Hong Kong	Ordinary HK\$30,000,000	—	100	Provision of trustee services
Berta Company Limited	Hong Kong	Ordinary HK\$2	—	100	Investment holding

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13. Interests in Subsidiaries (continued)

Name	Place of incorporation	Nominal value of issued share capital	Percentage of equity attributable to the Company		Principal activities
			Direct	Indirect	
Calton International Limited	Hong Kong	Ordinary HK\$2	—	100	Investment holding
Keira Limited	Hong Kong	Ordinary HK\$2	—	100	Investment holding
Kingsway Developments Limited	Hong Kong	Ordinary HK\$2	—	100	Investment holding
Prior Company Limited	Hong Kong	Ordinary HK\$2	—	100	Investment holding
PCI Investment Management Limited	Hong Kong	Ordinary HK\$10,000,000	100	—	Asset management
IGA Data Centre Limited	Hong Kong	Ordinary HK\$2	—	100	Provision of information technology services
IGA Financial Services Limited	Hong Kong	Ordinary HK\$2	—	100	Provision of financial services
PCI Moneycare Limited [#]	Hong Kong	Ordinary HK\$2	100	—	Dormant

[#] Newly acquired during the year.

Note: The above subsidiaries operate principally in Hong Kong.

The above table lists the new subsidiary of the Company and subsidiaries which, in the opinion of the directors, principally affected the results for the year or formed a substantial portion of the net assets of the Group. To give details of other subsidiaries would, in the opinion of the directors, result in particulars of excessive length.

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14. Interest in an Associate

	Group	
	2001 HK\$'000	2000 HK\$'000
Share of net assets	—	—
Due from an associate	22,520	28,136
Provision for an amount due from an associate	(9,039)	—
	13,481	28,136

Particulars of the associate are as follows:

Name	Business structure	Place of incorporation	Percentage of ownership interest attributable to the Group	Principal activity
Advanced Internet Visions Limited	Corporate	British Virgin Islands	30	Investment holding

15. Investments

	Note	Group	
		2001 HK\$'000	2000 HK\$'000
Listed bonds, at market value:	16		
Hong Kong		685,737	253,250
Elsewhere		2,000,572	851,577
		2,686,309	1,104,827
Listed equities, at market value:			
Hong Kong		34,357	139,426
Elsewhere		15,187	200,988
		49,544	340,414
Listed unit trusts, at market value:			
Hong Kong		—	22,800
Unlisted unit trusts, at fair value		523,377	234,874
		3,259,230	1,702,915

All investments, being available for sale, are classified as current assets.

During the year, the Group has invested in bonds of a total nominal amount of US\$37,000,000 issued by PCCW Capital Limited and PCCW-HKTC Capital Limited, with maturity dates between 2005 and 2011. The cost of these bonds amounted to HK\$262,538,000 (2000: Nil). As at 31 December 2001, the market value of these bonds amounted to HK\$282,512,000 (2000: Nil).

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16. Listed Bonds

Listed bonds analysed by issuer as at the balance sheet date were as follows:

	Group	
	2001 HK\$'000	2000 HK\$'000
Governments	477,832	150,737
Banks and other financial institutions	715,835	236,447
Corporate entities	1,492,642	717,643
Listed bonds	2,686,309	1,104,827

The maturity profile of the listed bonds as at the balance sheet date was as follows:

	Group	
	2001 HK\$'000	2000 HK\$'000
With a residual maturity of:		
Three months or less	29,951	186,286
One year or less but over three months	62,166	129,369
Five years or less but over one year	1,476,454	620,819
Over five years	1,117,738	168,353
Listed bonds	2,686,309	1,104,827

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17. Loans

	Group	
	2001 HK\$'000	2000 HK\$'000
Secured loans to directors	—	22,643
Policy loans	147,290	149,427
Loans to employees and agents	136,999	191,384
Other loans	—	15,600
	284,289	379,054

The policy loans are made to policyholders and secured by the policies' cash surrender value. They have no fixed terms of repayment.

Particulars of secured loans to directors disclosed pursuant to Section 161B of the Hong Kong Companies Ordinance are as follows:

	Balance as at 31 December 2001 HK\$'000	Maximum amount outstanding during the year HK\$'000	Balance as at 1 January 2001 HK\$'000
Mr. YANG Fan Shing, Andrew	—	22,276	22,276
Mr. LEE Ho Sang	—	—	—
Mr. LUK Kin Yu, Peter	—	367	367
	—	367	22,643

The Group provides secured loans to directors, employees and agents which are interest-bearing at the prevailing bank lending rate, secured by underlying properties and/or motor vehicles, and repayable by monthly instalments.

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18. Deferred Acquisition Costs

	Group	
	2001 HK\$'000	2000 HK\$'000
Balance at beginning of year	1,640,930	1,459,902
Additions	298,707	405,482
Less: Amortisation	(266,219)	(224,454)
Balance at 31 December	1,673,418	1,640,930
Portion reclassified as current assets	(275,371)	(245,500)
Non-current portion	1,398,047	1,395,430

19. Cash and Cash Equivalents

	Group		Company	
	2001 HK\$'000	2000 HK\$'000	2001 HK\$'000	2000 HK\$'000
Cash and bank balances	336,863	234,773	108	100
Fixed term deposits	340,044	1,427,815	9,568	9,211
	676,907	1,662,588	9,676	9,311

The maturity profile of the fixed term deposits as at the balance sheet date was as follows:

	Group		Company	
	2001 HK\$'000	2000 HK\$'000	2001 HK\$'000	2000 HK\$'000
With a residual maturity of:				
Three months or less	338,019	1,425,888	9,568	9,211
One year or less but over three months	2,025	1,927	—	—
	340,044	1,427,815	9,568	9,211

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20. Premium Deposits

Premium deposits are amounts that are left on deposit with the Group for the payment of future premiums.

21. Due to Related Companies

The amounts due to related companies arose from the ordinary and normal course of business with terms similar to those offered to other customers of the Group.

22. Future Insurance Liabilities

	Group	
	2001 HK\$'000	2000 HK\$'000
As at 1 January	3,133,667	2,596,527
Increase for the year	445,367	531,286
Currency realignment	(902)	5,854
	3,578,132	3,133,667
Non-current portion of amounts payable under financial reinsurance contracts	8,967	56,689
At 31 December	3,587,099	3,190,356

As at 31 December 2001, the current portion of amounts payable under financial reinsurance contracts amounted to HK\$45,759,000 (2000: HK\$48,168,000), which is included in other insurance liabilities.

23. Deferred Tax

As at 31 December 2001, the Group and the Company did not have any significant unprovided deferred tax liabilities (2000: Nil).

No future tax benefit arising from the utilisation of the available tax losses of a subsidiary has been recognised as at 31 December 2001 (2000: Nil).

24. Share Capital

	Company	
	2001 HK\$'000	2000 HK\$'000
Authorised: 3,000,000,000 shares of HK\$1 each	3,000,000	3,000,000
Issued and fully paid 827,100,000 (2000: 689,250,000) shares of HK\$1 each	827,100	689,250

On 17 May 2001, the Company allotted and issued 137,850,000 bonus shares to shareholders whose names appeared on the register of members of the Company on 8 May 2001 on the basis of one bonus share for every five existing shares held by shareholders by way of capitalisation of a sum of HK\$137,850,000 standing to the credit of the share premium account.

25. Share Option Scheme

The Company operates a share option scheme (the "Scheme") for the purpose of attracting, retaining and motivating talented participants to strive for future developments and expansion of the Group. Eligible participant of the Scheme includes (a) any employee as well as any executive director of the Group and (b) any agent who has agreed by a contract in writing to render full time and exclusive services to the Group and (for new options only) who has or will have rendered such services for a continuous period of at least 12 months as at the date of grant. The Scheme became effective on 16 June 1999 and, unless otherwise cancelled or amended, will remain in force for a period of 10 years commencing on that date.

The maximum number of unexercised share options currently permitted to be granted under the Scheme is an amount equivalent, upon their exercise, to 10% of the shares of the Company in issue at any time. At 31 December 2001, the number of shares issuable under share options granted under the Scheme was 65,529,330, which represented approximately 7.9% of the Company's shares in issue as at that date. The maximum number of shares issuable under share options to each eligible participant in the Scheme within any 12-month period, is limited to 1% of the shares of the Company in issue at any time. Any further grant of share options in excess of this limit is subject to shareholders' approval in a general meeting.

Share options granted to a director, chief executive or substantial shareholder of the Company, or to any of their associates, are subject to approval in advance by the independent non-executive directors. In addition, any share options granted to a substantial shareholder or an independent non-executive director of the Company, or to any of their associates, in excess of 0.1% of the shares of the Company in issue at any time and with an aggregate value (based on the price of the Company's shares at the date of the grant) in excess of HK\$5 million, within any 12-month period, are subject to shareholders' approval in a general meeting.

The offer of a grant of share options may be accepted within 28 days from the date of the offer, upon payment of a nominal consideration of HK\$1 by the grantee. The exercise period of the share options granted is determinable by the directors, and unless resolved otherwise commences on the first anniversary of the date of grant and ends on a date which is not later than five years from the relevant exercise date of the share options or the expiry date of the Scheme, if earlier.

The exercise price of the share options is determinable by the directors, but may not be less than the higher of (i) the Stock Exchange closing price of the Company's shares on the date of the offer of the share options; and (ii) the average Stock Exchange closing price of the Company's shares for the five trading days immediately preceding the date of the offer.

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25. Share Option Scheme (continued)

As at 31 December 2001, the Company had 65,529,330 (2000: 71,958,750*) outstanding share options. Details of outstanding share options under the Scheme during the year were as follows:

Name or category of participant	Date of grant of share options	Exercisable period	Exercise price HK\$	Number of share options					Outstanding at 31 December 2001
				Outstanding at 31 December 2000	Granted during the year	Exercised during the year	Lapsed during the year	Cancelled during the year	
(i) Directors, chief executive and their associates									
In aggregate	7 July 1999	7 July 2000 to 6 July 2007	4.187	1,458,000	—	—	—	—	1,458,000
	7 July 1999	7 July 2000 to 6 July 2009	5.233	48,000,000	—	—	—	—	48,000,000
				49,458,000	—	—	—	—	49,458,000
Please refer to the section "Directors' and chief executive's rights to acquire shares" in the Report of the Directors for individual details.									
(ii) Options granted in excess of the individual limit									
Nil	—	—	—	—	—	—	—	—	—
(iii) Other employees									
In aggregate	7 July 1999	7 July 2000 to 6 July 2007	4.187	3,874,800	—	—	1,065,600	—	2,809,200
	7 July 1999	7 July 2000 to 6 July 2009	4.448	1,224,600	—	—	388,800	—	835,800
	7 July 1999	7 July 2000 to 6 July 2009	5.233	2,435,520	—	—	2,435,520	—	—
				7,534,920	—	—	3,889,920	—	3,645,000

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25. Share Option Scheme (continued)

Name or category of participant	Date of grant of share options	Exercisable period	Exercise price HK\$	Number of share options					Outstanding at 31 December 2001
				Outstanding at 31 December 2000	Granted during the year	Exercised during the year	Lapsed during the year	Cancelled during the year	
(iv) Suppliers of goods or services									
Nil	—	—	—	—	—	—	—	—	—
(v) Others (Agents)									
In aggregate	7 July 1999	7 July 2000 to 6 July 2007	4.187	9,109,590	—	—	1,630,800	—	7,478,790
	7 July 1999	7 July 2000 to 6 July 2009	4.448	5,331,360	—	—	798,060	—	4,533,300
	7 July 1999	7 July 2000 to 6 July 2009	5.233	524,880	—	—	110,640	—	414,240
				14,965,830	—	—	2,539,500	—	12,426,330

* The exercise price per share option and the number of share options outstanding as at 31 December 2000 have been adjusted as a result of the completion of the bonus issue of ordinary shares on 17 May 2001.

The vesting period of the share options is as follows:

20% to 60% of the holders' entitlements to the outstanding share options granted became exercisable commencing on the first anniversary of the date of grant, and on subsequent second to fifth anniversaries of the date of grant, further 20% tranches of the holders' entitlements, as applicable, become exercisable.

During the year, no share options were granted, cancelled or exercised and 6,429,420 share options had lapsed.

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26. Reserves Group

	Share premium HK\$'000	Contributed surplus (Note (i)) HK\$'000	Retained profits/ (accumulated losses) HK\$'000	Total HK\$'000
At 1 January 2000	167,880	160,400	665,970	994,250
Net profit for the year	—	—	154,274	154,274
At 31 December 2000 and 1 January 2001	167,880	160,400	820,244	1,148,524
Capitalisation issue of shares	(137,850)	—	—	(137,850)
Net profit for the year	—	—	155,948	155,948
At 31 December 2001	30,030	160,400	976,192	1,166,622

Company

	Share premium HK\$'000	Contributed surplus (Note (ii)) HK\$'000	Retained profits/ (accumulated losses) HK\$'000	Total HK\$'000
At 1 January 2000	167,880	15,614	2,418	185,912
Net loss for the year	—	—	(4,091)	(4,091)
At 31 December 2000 and 1 January 2001	167,880	15,614	(1,673)	181,821
Capitalisation issue of shares	(137,850)	—	—	(137,850)
Net loss for the year	—	—	(4,634)	(4,634)
At 31 December 2001	30,030	15,614	(6,307)	39,337

Notes:

- (i) The contributed surplus of the Group represents the difference between the nominal value of the shares and the share premium account of the Group's then holding company acquired pursuant to the group reorganisation in 1999 over the nominal value of the Company's shares issued in exchange upon reorganisation.
- (ii) The contributed surplus of the Company represents the excess of the fair value of the shares of the subsidiaries acquired pursuant to the group reorganisation in 1999, over the nominal value of the Company's shares issued in exchange upon reorganisation. Under the Companies Act 1981 of Bermuda (as amended), the Company may make distributions to its members out of the contributed surplus under certain circumstances.
- (iii) The Company depends primarily on dividends from its life insurance subsidiary in order to pay dividends to shareholders. Hong Kong insurance legislation limits the extent of retained earnings that can be paid to the Company, through the use of minimum solvency margins and prudential regulations over the value of actuarial liabilities.

As at 31 December 2001, the Company had distributable reserves amounting to HK\$9,307,000 (2000: HK\$13,941,000).

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27. Notes to the Consolidated Cash Flow Statement

(a) Reconciliation of operating profit before tax to net cash inflow from operating activities

	Group	
	2001 HK\$'000	2000 HK\$'000
Operating profit before tax	157,161	153,679
Depreciation	24,583	21,803
Loss on disposal of fixed assets	2,346	2,012
Provision for an amount due from an associate	9,039	—
Interest income on policy loans	(13,501)	(9,991)
Interest income on loans to officers, employees and agents	(14,996)	(23,392)
Interest and dividend income from listed and unlisted investments	(151,735)	(143,104)
Realised and unrealised capital gains on investments	(15,421)	(31,034)
Increase in prepayments and other debtors	(42,023)	(76,670)
Increase in deferred acquisition costs	(32,488)	(181,028)
Increase in premiums receivable	(35,831)	(7,644)
Increase/(decrease) in claims payable	(758)	523
Increase/(decrease) in premium deposits and accrued expenses and other creditors	(78,499)	123,353
Increase/(decrease) in other insurance liabilities	(2,409)	4,765
Increase in future insurance liabilities	396,743	488,972
Increase in policyholders' dividends and bonuses	84,316	100,260
Increase/(decrease) in amounts due to related companies	(5,124)	5,479
Net cash inflow from operating activities	281,403	427,983

(b) Analysis of changes in financing activities during the year

	Share capital and share premium HK\$'000	Minority interests HK\$'000
At 1 January 2000	857,130	795
Share of loss for the year	—	(232)
At 31 December 2000 and 1 January 2001	857,130	563
Share of loss for the year	—	(563)
	857,130	—

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28. Contingent Liabilities

As at 31 December 2001, other than as set out below in note 29, the Group and the Company had no material contingent liabilities other than contingencies arising from the ordinary course of the long term insurance business (2000: Nil).

29. Pending Litigation

On 21 September 2000, a writ was issued against a number of persons, including Pacific Century Insurance Company Limited ("PCI"), a wholly-owned subsidiary of the Company, and certain insurance agents of PCI, by certain members of an insurance group operating in Hong Kong (the "Plaintiffs"), whereby the Plaintiffs sought, among other things, injunctive relief and damages against PCI in connection with PCI's plan matching scheme and the purported use of certain documents and information.

On 24 July 2001, a High Court judge granted the Plaintiffs interim injunctive relief pending the trial of the action or further order. The interim injunctive relief restrains PCI, among others, from disclosing or otherwise making any use of certain documents and information, and accepting applications for life insurance policies in certain circumstances.

Having consulted legal counsel, the Group has determined that it will continue to defend vigorously these proceedings. In the opinion of the directors and based on legal advice, it is unlikely that the final outcome of these proceedings would materially affect the financial position of the Group.

30. Commitments

(a) Operating lease commitments

	Group	
	2001 HK\$'000	2000 HK\$'000
At 31 December 2001, the Group had total future minimum lease payments under non-cancellable operating leases in respect of land and buildings, falling due as follows:		
Within one year	54,704	255
In the second to fifth years, inclusive	33,477	54,212
	88,181	54,467

(b) Derivative financial instruments

— Foreign currency forward contracts

The Group's insurance liabilities are predominantly denominated in United States dollars. It is the Group's policy to keep adequate assets in United States dollars in order to match its insurance liabilities. Where fixed interest securities (including bonds and equity linked notes) are denominated in currencies other than United States dollars, foreign currency forward contracts are bought to hedge the future cash flows of securities back into United States dollars. There were no outstanding foreign currency forward contract commitments as at 31 December 2001 (2000 : Nil).

— Future contracts

As at the balance sheet date, the Group did not have outstanding future contract commitments to sell United States Treasury Notes (2000: HK\$19,815,000).

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31. Related Party Transactions

(a) Details of transactions with companies related to the Group are as follows:

	Notes	Group	
		2001 HK\$'000	2000 HK\$'000
Premium income in respect of group life and medical policies issued to:			
Pacific Century Asset Management (HK) Limited (trading as "Pacific Century Group")	(i)	5,882	3,432
PCCW Services Limited		5,015	1,003
Pacific Century Systems Limited		507	418
Morningstar Asia Limited		127	66
Power Logistics Limited		126	—
		11,657	4,919
General insurance commission income received from The Ming An Insurance Company (Hong Kong), Limited	(ii)	8,631	7,945

Notes:

- (i) The Group entered into a number of group life and medical policies with certain companies related to the ultimate holding company of the Group, Pacific Century Group (Cayman Islands) Limited and its associates. In the opinion of the directors (including the independent non-executive directors), the group life and medical policies for these related companies are negotiated and conducted on terms and conditions similar to those offered to other policyholders of the Group, in the ordinary and usual course of business of the Group and on terms that are fair and reasonable so far as the shareholders of the Company are concerned. The total amount of premium income derived therefrom did not exceed 2% of the total turnover of the Group for the year ended 31 December 2001.
- (ii) Pursuant to an agency agreement dated 1 November 1994 and subsequently replaced by an Agency Agreement effective 1 January 2001, Pacific Century Insurance Company Limited, a wholly-owned subsidiary of the Group, was, effective as from 1 January 2001 appointed as an underwriting agent of The Ming An Insurance Company (Hong Kong), Limited ("Ming An"), with authorisation to underwrite and to settle claims of certain types of general insurance businesses on behalf of Ming An. Ming An is a substantial shareholder of the Company.

The Agency Agreement is based on arm's length commercial terms in accordance with the prevailing market conditions.

- (b) On 27 April 2000, the Group allied with a fellow subsidiary, Pacific Century CyberWorks Limited ("PCCW"), and established a company, Advanced Internet Visions Limited ("AIV") (note 14). AIV acted as an investment vehicle for the holding of and interest in Morningstar Asia Limited ("MAL"), a company incorporated in Hong Kong. MAL was engaged in providing financial information and related services in Asia (outside Japan) by way of, among other things, printed materials, computer software products and/or Internet products.

The Group's attributable equity interest in MAL is approximately 12%.

- (c) The Group provided secured loans to directors, employees and agents which are interest-bearing at the prevailing bank lending rate, secured by the underlying properties and/or motor vehicles, and repayable on a monthly instalment basis.
- (d) As mentioned in note 21, as at 31 December 2001, the Group had a total amount of HK\$11,420,000 (2000: HK\$16,544,000) payable to related companies which arose from the ordinary and normal course of business conducted on terms similar to those offered to other customers of the Group.

The transactions mentioned in (a) to (c) above constitute connected transactions under The Rules Governing the Listing of Securities on the Stock Exchange.

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32. Retirement Benefit Schemes

The Group operates mandatory provident fund ("MPF") schemes and defined contribution retirement schemes for eligible employees and agents. According to the terms of the MPF schemes, the Group and each of the eligible employees make monthly contributions at 5% of the eligible employee's basic monthly salary, limited to a maximum of HK\$1,000 each per month. The Group also makes contributions to the retirement schemes at rates ranging from 5% to 10% of the eligible employees' basic monthly salaries less contributions to the MPF schemes, and at the same rates for agents' income. Eligible employees and agents are required to make monthly contributions equivalent to 5% of their basic monthly salaries and income, respectively, less their contributions to the MPF schemes, if applicable. The assets of the schemes are held separately from those of the Group in funds under the control of the trustee. As at 31 December 2001, the Group did not have any forfeited contributions available to offset future contributions payable (2000: HK\$6,983,723).

The Group's contributions to the schemes are expensed as incurred. The aggregate of the Group's contributions, net of forfeited contributions, which have been dealt with in the revenue and profit and loss accounts of the Group for the year, amounted to:

	Group	
	2001 HK\$'000	2000 HK\$'000
Gross Group's contributions:		
Employees	9,762	8,798
Agents	12,767	14,566
	22,529	23,364
Less: Forfeited contributions utilised to offset Group's contributions for the year:		
Employees	(8,160)	—
Agents	(4,663)	(1,983)
	(12,823)	(1,983)
Net Group's contributions charged to the revenue and profit and loss accounts	9,706	21,381

33. Approval of the Financial Statements

The financial statements were approved by the board of directors on 15 March 2002.