

# Report of the Directors

The Directors have pleasure in presenting their report together with the audited accounts for the year ended 31st December, 2003.

## **Principal Activities**

The Bank and its subsidiaries are engaged in commercial banking and related financial services.

The analysis of the principal activities and geographical locations of operations of the Bank and its subsidiaries during the year are set out in Note 31 to the Accounts.

## **Results**

The profit of the Group for the year ended 31st December, 2003 is set out on page 42. Particulars of dividends which have been paid or which are recommended are set out in Note 8 to the Accounts.

## **Major Customers**

The Directors believe that the Group's five largest customers accounted for less than 30% of the Group's total income.

## **Fixed Assets**

Details of the movements in fixed assets of the Group and of the Bank during the year are set out in Note 21 to the Accounts.

## **Capital and Reserves**

Details of the movements in capital and reserves of the Group and of the Bank during the year are set out in Notes 27 and 28 to the Accounts.

## **Audit Committee**

The Audit Committee of the Bank was formed in 1992. The Committee meets three times a year, and its composition is shown on page 24.

The Audit Committee is answerable to the Board and the principal duties of the Committee include the review of the Bank's financial reporting and internal controls.

## **Director Nomination Committee**

The Director Nomination Committee was formed in December 2002 consisting of three Independent Non-Executive Directors namely Messrs Ambrose H C Lau, Cheng Hon Kwan and Simon K Y Lee.

The Committee is responsible for reviewing and recommending to the Board all new appointment of Directors, Chief Executive, Deputy Chief Executive and General Manager of the Bank.

## **Compensation Committee**

The Compensation Committee was formed in 1995. The Committee meets once a year to evaluate and approve the remuneration policy and package for the Chief Executive of the Bank. Its composition is shown on page 24.

## **Charitable Donations**

During the year the Group made donations for charitable purposes amounting to approximately HK\$295,000. In addition, the Group also provided services with associated costs of HK\$76,000 to various charities in 2003.

## **Directors**

The Directors of the Bank up to the date of the report are shown on page 24.

Mr Michael J Ranieri resigned as Director of the Bank, upon his repatriation to New York, on 12th November, 2003.

Mr Andrew M Gordon and Mr Tung Chee Chen were appointed as Directors of the Bank on 23rd October, 2003 and 15th January, 2004 respectively. Mr Gordon and Mr Tung will retire at the forthcoming Annual General Meeting and, being eligible, offer themselves for re-election.

The Directors retiring by rotation in accordance with the Bank's Articles of Association are Messrs Patrick Y B Fung, Simon K Y Lee and Ho Soo Ching. Messrs Patrick Y B Fung and Simon K Y Lee, being eligible, offer themselves for re-election. In view of his business commitments, Mr Ho Soo Ching has given notice to retire from the Board at the conclusion of the Annual General Meeting to be held on 22nd April, 2004.

The Board would wish to express its appreciation to Mr Michael J Ranieri and Mr Ho Soo Ching for their many contributions during their years of service.

#### **Independent Non-executive Directors' Fees**

Each of the independent Non-executive Directors of the Bank received HK\$100,000 director's fee for the year ended 31st December, 2003.

#### **Substantial Shareholders' Interests**

As at 31st December, 2003, save as mentioned under the section headed "Directors' and Chief Executive's Interests", the Substantial Shareholders of the Bank according to the Register of Substantial Shareholders' Interests and Short Positions were as follows:

Name	Number of shares
Aberdeen Asset Management Asia Limited	18,010,500
BNY International Financing Corporation <i>(A wholly owned subsidiary of The Bank of New York Company, Inc.)</i>	(1) 73,800,000
Po Ding Company Limited	(2) 24,156,000
Tessel Inc.	(2) 10,639,200
The Capital Group Companies, Inc.	17,496,000
YKF Trustee Holding Inc.	(2) 24,098,400

(1) On 30th January, 2004, BNY International Financing Corporation had reduced its shareholding in the Bank to 59,350,000 shares after a placement of 14,450,000 shares to the institutional investors.

(2) All shares are held through the corporations in which Messrs Patrick Y B Fung, Michael Y S Fung and Louis C W Ho's spouse together with the other parties are eligible beneficiaries.

Pursuant to a shareholders' agreement dated 22nd August, 1996, BNY International Financing Corporation, Messrs Patrick Y B Fung and Michael Y S Fung, Po Ding Company Limited, YKF Trustee Holding Inc. and Majestic Investment Company Limited agree to retain joint control over an aggregate of 37.5% of the share capital of the Bank. According to Part XV of the Securities and Futures Ordinance ("SFO"), the parties are, therefore, each deemed to be interested in 110,167,688 shares of the Bank.

All the interests stated above represent long positions. As at 31st December, 2003, no short positions were recorded in the Register of Substantial Shareholders' Interests and Short Positions required to be kept under section 336 of the SFO.

## Report of the Directors

### Directors' and Chief Executive's Interests

As at 31st December, 2003, the Directors' and Chief Executive's Interests in the share capital of the Bank according to the Register of Directors' and Chief Executive's Interests and Short Positions were as follows:

Name	Personal	Numbers of Shares		Total
		Family	Other	
Patrick Y B Fung	2,982,000	-	130,000 (1&3)	3,112,000
Frank J Wang	-	-	100,000 (1)	100,000
Michael Y S Fung	3,060,000	-	100,000 (1&3)	3,160,000
Louis C W Ho	124,000	60,000	100,000 (1)	284,000
Simon K Y Lee	-	-	10,000 (2)	10,000
Ambrose H C Lau	71,500	-	-	71,500
Ho Soo Ching	10,000	-	-	10,000

#### Notes:

(1) The Board approved the granting of certain share options to Directors and Executives of the Bank, pursuant to the Share Option Scheme adopted on 9th June, 1993, and the following Directors have accepted the following options:

Name	No. of shares in options	Date granted	Exercise Period		Option price HK\$
			From	To	
Patrick Y B Fung	50,000	10/03/2001	10/03/2002	9/03/2011	23.60
	40,000	15/03/2002	15/03/2003	14/03/2012	26.30
	40,000	14/03/2003	14/03/2004	13/03/2013	26.50
Frank J Wang	40,000	10/03/2001	10/03/2002	9/03/2011	23.60
	30,000	15/03/2002	15/03/2003	14/03/2012	26.30
	30,000	14/03/2003	14/03/2004	13/03/2013	26.50
Michael Y S Fung	40,000	10/03/2001	10/03/2002	9/03/2011	23.60
	30,000	15/03/2002	15/03/2003	14/03/2012	26.30
	30,000	14/03/2003	14/03/2004	13/03/2013	26.50
Louis C W Ho	40,000	10/03/2001	10/03/2002	9/03/2011	23.60
	30,000	15/03/2002	15/03/2003	14/03/2012	26.30
	30,000	14/03/2003	14/03/2004	13/03/2013	26.50

(2) Such shares were held through a corporation in which Mr Simon K Y Lee controlled more than one-third of the voting power and were transferred in March 2002 to a family trust in which Mr Simon K Y Lee's spouse is an eligible beneficiary.

(3) All shares and options held by Messrs Patrick Y B Fung and Michael Y S Fung are parcel of the 110,167,688 shares of the Bank under the shareholders' agreement as mentioned in the section headed "Substantial Shareholders' Interests".

Save as disclosed, none of the Directors, the Chief Executive and their associates had any other beneficial interests in the securities of the Bank or any of its associated corporations (within the meaning of Part XV of SFO) at 31st December, 2003.

All the interests stated above represent long positions. As at 31st December, 2003, no short positions were recorded in the Register of Directors' and Chief Executive's Interests and Short Positions required to be kept under section 352 of the SFO.

### Share Option Information

Pursuant to the approved Share Option Scheme, the directors are authorised, at their discretion, to invite certain executives, to take up options to purchase ordinary shares in the Bank as incentive to them. The maximum number of shares in respect of which options may be granted under the Share Option Scheme may not exceed 5% of the issued share capital of the Bank as at the date of approval of the scheme. Prior to 1st September, 2001, the option price was 80% of the average last dealt price on The Stock Exchange of Hong Kong Limited ("SEHK") on the five

business days immediately preceding the date of offer of such options. After 1st September, 2001, the option price should be at least the higher of :

- i) the closing price of the shares on the SEHK on the date of the grant, which must be a trading day, and
- ii) the average closing price of the shares on the SEHK for the five business days immediately preceding the date of grant.

The options must be held for at least one year and can be exercised between the first and the tenth anniversaries of the date of grant. The amount payable on acceptance of the share option was HK\$1. The share option scheme was terminated on 24th April, 2003 and replaced by a new share option scheme for a period of 10 years with amendments which complied with Chapter 17 of the Listing Rules.

The maximum number of shares in respect of which options may be granted under the new Share Option Scheme may not exceed 5% of the issued share capital of the Bank as at the date of approval of the scheme. At 31st December, 2003, total number of ordinary shares available for issue under the new Share Option Scheme is 14,678,000 or 5% of the issued share capital of the Bank.

At 31st December, 2003, the directors and employees of the Bank had the following interest in option to purchase for the shares of the Bank (market value per share at 31st December, 2003 is HK\$46.20).

	No. of shares <b>31/12/2003</b>	No. of shares 31/12/2002	Date granted	No. of shares exercised	Option price HK\$	Market value per share at date of grant HK\$	Weighted average closing price per share at preceding day before exercise date HK\$
<b>Directors</b>							
Patrick Y B Fung	-	30,000	10/03/1994	30,000	14.83	18.25	27.20
	<b>50,000</b>	50,000	10/03/2001	-	23.60	29.00	-
	<b>40,000</b>	40,000	15/03/2002	-	26.30	26.30	-
	<b>40,000</b>	-	14/03/2003	-	26.50	26.50	-
Frank J Wang	<b>40,000</b>	40,000	10/03/2001	-	23.60	29.00	-
	<b>30,000</b>	30,000	15/03/2002	-	26.30	26.30	-
	<b>30,000</b>	-	14/03/2003	-	26.50	26.50	-
Michael Y S Fung	-	24,000	10/03/1994	24,000	14.83	18.25	27.20
	<b>40,000</b>	40,000	10/03/2001	-	23.60	29.00	-
	<b>30,000</b>	30,000	15/03/2002	-	26.30	26.30	-
	<b>30,000</b>	-	14/03/2003	-	26.50	26.50	-
Louis C W Ho	-	24,000	10/03/1994	24,000	14.83	18.25	27.20
	<b>40,000</b>	40,000	10/03/2001	-	23.60	29.00	-
	<b>30,000</b>	30,000	15/03/2002	-	26.30	26.30	-
	<b>30,000</b>	-	14/03/2003	-	26.50	26.50	-
<b>Other Employees</b>							
	-	24,000	10/03/1994	24,000	14.83	18.25	27.20
	<b>90,000</b>	210,000	10/03/2001	120,000	23.60	29.00	34.20
	<b>60,000</b>	160,000	15/03/2002	100,000	26.30	26.30	37.96
	<b>160,000</b>	-	14/01/2003	-	25.80	25.70	-
	<b>740,000</b>	<u>772,000</u>		<u>322,000</u>			

The share options granted are not recognised in the accounts until they are exercised. The option price of share options granted on 10th March, 1994 for HK\$14.83 was after adjustment of one for five bonus issued in May 1997.

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The value per option granted on 14th January, 2003 and 14th March, 2003 are estimated at the dates of grant using the Black-Scholes pricing model were HK\$5.11 and HK\$4.24 respectively. The assumption used are as follows:

	Options granted on 14th January, 2003	Options granted on 14th March, 2003
Risk-free interest rate (%)	4.65	4.40
Expected life (in years)	10.00	10.00
Volatility (%)	21.69	17.47
Expected dividend yield (%)	3.92	3.92

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, such 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 Black-Scholes option pricing model does not necessarily provide a reliable measure of the fair value of the share option.

### **Directors' Interests in Contracts**

No contract of significance to which the Bank or any of its subsidiaries was a party and in which a Director of the Bank had a material interest subsisted at the end of the year or at any time during the year.

Except for the above mentioned Share Option Scheme of the Bank, at no time during the year was the Bank or any of its subsidiaries a party to any arrangements to enable the Directors of the Bank to acquire benefits by means of the acquisition of shares in or debentures of the Bank or any other body corporate.

None of the Directors of the Bank has a service contract with the Bank.

### **Purchase, Sale or Redemption of Listed Securities**

There were no purchases, sales or redemptions by the Bank or any of its subsidiaries, of the Bank's shares during the year ended 31st December, 2003.

### **Compliance with the Code of Best Practice**

The Bank has complied throughout the year with the Code of Best Practice as set out in Appendix 14 of the Listing Rules of The Stock Exchange of Hong Kong Limited, except that a specified term was not fixed for the appointment of Non-executive Directors.

### **Compliance with the Module on "Financial Disclosure by Locally Incorporated Authorised Institutions"**

The annual accounts comply fully with the module on the "Financial Disclosure by Locally Incorporated Authorised Institutions" under the Supervisory Policy Manual issued by the Hong Kong Monetary Authority.

### **Auditors**

The accounts have been audited by KPMG.

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

On behalf of the Board

### **Patrick Y B Fung**

*Chairman and Chief Executive*

Hong Kong, 11th March, 2004