

- (1) Hong Kong profits tax is calculated at 17.5% (2003: 17.5%) of the estimated assessable profit for the period.

Taxation arising in other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions.

- (2) The calculation of earnings per share, basic and diluted, is based on the profit attributable to shareholders of HK\$175,860,000 (2003: HK\$147,616,000) and on 435,000,000 (2003: 435,000,000) ordinary shares in issue during the period.
- (3) As explained in the announcement dated 16 March 2004, the Bank sold the interest in an associate and all other advances to the associate were fully repaid.

(4) Risk management

The Group has established policies, procedures, and controls for measuring, monitoring and controlling risks arising from the banking and related financial services business. These policies, procedures, and controls are implemented by various committees and departments of the Group and are regularly reviewed by the Board of Directors. The internal auditors also play an important role in the risk management process by performing regular, as well as sporadic compliance audits.

The management of assets and liabilities of the Group is conducted under the guidance of the Asset and Liability Management Committee (the "ALCO"). The ALCO comprises executive directors and senior managers representing major operations of the Group. It holds weekly meetings, and more frequent meetings when required, to review and direct the relevant policies, and to monitor the bank-wide positions. The day-to-day management of the liquidity risk, foreign exchange, interest rate and other market risks, and the compliance with the ALCO policies are monitored by the Treasury Management and the Finance Departments with the assistance of various qualitative and quantitative analyses.

(i) Capital management

The Group has adopted a policy of maintaining a strong capital base to support its business growth. Capital adequacy ratio has remained at around 20% for the past five financial years, well above the statutory minimum ratio of 8%.

(ii) Credit risk

Credit risk is the risk that a customer or counter-party may fail to meet a commitment when it falls due.

The Group's lending policy sets out in detail the credit approval and monitoring mechanism, the loan classification system and provisioning policy, which is established in accordance with the requirements and provisions of the Banking Ordinance and the guidelines issued by the Hong Kong Monetary Authority.

Day-to-day credit management is performed by the Loans Committee with reference to the creditworthiness, and concentration risk of and the collateral pledged by the counterparties. Decisions made by the Loans Committee are reviewed regularly by the Executive Loans Committee comprising executive directors.

(iii) Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its current obligations when they fall due.

The Group has laid down liquidity policy which is reviewed regularly by the Board of Directors, and the ALCO. This policy requires the Group to maintain a conservative level of liquid funds on a daily basis to ensure the availability of adequate liquid funds to meet all obligations, and the compliance with the statutory liquidity ratio requirement. The liquidity position is monitored through statutory liquidity ratio, loan-to-deposit ratio, maturity profile of assets and liabilities, and inter-bank transactions undertaken by the Group.

(4) Risk management - continued

(iv) Market risk

Market risk is the risk of losses in assets, liabilities and off-balance sheet positions arising from movement in market rates and price.

Market risk arising from the trading book is considered immaterial, as the Group does not maintain significant positions of financial instruments leading to foreign exchange, interest rate, commodity and equity exposures. Structural foreign exchange exposure is explained further under (v) foreign exchange risk.

(v) Foreign exchange risk

The Group does not have any significant foreign exchange risk as foreign exchange dealing is minimal. Structural foreign exchange exposure arising from investments in foreign branches and subsidiaries is accounted for in the reserves account. Day-to-day foreign exchange management is performed by the Treasury Management Department within approved limits.

(vi) Interest rate risk

Interest rate risk is the risk that the Group's position may be adversely affected by the change in market interest rate.

The Group does not carry interest rate positions on its trading book. Interest rate risk arises primarily from the timing differences in the repricing of, and the different bases of pricing interest-bearing assets, liabilities and commitments, and from positions of non-interest bearing balances. Interest rate risk is monitored by regular sensitivity analyses of the net repricing gap and of different scenarios of pricing bases of assets and liabilities grouped with reference to their next contractual repricing date or maturity date.

(vii) Operational and legal risk

Operational risk is the risk of unexpected losses attributable to human error, systems failures, fraud, or inadequate internal controls and procedures.

Executive directors, department heads, in-house legal counsels, and internal auditors collaborate to manage operational and legal risks through proper human resources policies, delegation of authorities, segregation of duties, and timely and accurate management information. Senior management and the Audit Committee are accountable to the Board of Directors for maintaining a strong and disciplined control environment to provide reasonable assurance that the operational and legal risks are prudently managed.

A comprehensive contingency plan is available to ensure that key business functions continue and normal operations are restored effectively and efficiently in the event of business interruption.

(viii) Reputation risk

Reputation risk is the risk to earnings or capital arising from negative public opinion.

Reputation risk is managed by ensuring proper and adequate communications and public relation efforts to foster the reputation of the Group. A risk management mechanism guided by the senior management including executive directors and senior managers has been established to manage the media exposure, handle customers' and other relevant parties' complaints and suggestions, and to ensure that new business activities and agents acting on our behalf do not jeopardise our reputation.

(5) Business and geographical segments**(i) Business segments**

The corporate and retail banking services provided by the Group are principally lending and trade finance facilities, consumer financing, chequing facilities, mandatory provident fund services, provision of fixed deposits and savings accounts, credit card, insurance and personal wealth management services. The Group also provides fully automated telephone and internet banking services to its customers. Other financial services offered include remittance and money exchange, safe deposit boxes, auto pay and direct debit services.

Treasury activities mainly comprise inter-bank placement and deposit transactions, management of overall interest rate risk and liquidity of the Group and centralised cash management. Income from foreign exchange activities is generated from services provided to customers in the form of foreign exchange trading and forward contracts.

Other business activities of the Group include investment holding, securities trading, stockbroking, commodities and futures broking, other investment advisory services and property investment.

(a) Segment information about these businesses for the period ended 30 June 2004 is presented below:

INCOME STATEMENT

	Corporate and retail banking HK\$'000	Treasury and foreign exchange activities HK\$'000	Other business activities HK\$'000	Eliminations HK\$'000	Consolidated HK\$'000
Interest income from external customers	337,807	164,686	–	–	502,493
Interest expense to external customers	(146,586)	(2,616)	–	–	(149,202)
Inter-segment income (<i>Note</i>)	44,562	–	–	(44,562)	–
Inter-segment expense (<i>Note</i>)	–	(44,562)	–	44,562	–
Net income	235,783	117,508	–	–	353,291
Other operating income	45,857	11,702	64,589	–	122,148
Operating income	281,640	129,210	64,589	–	475,439
Net charge for bad and doubtful debts	(51,817)	–	–	–	(51,817)
Net (losses) gains from disposal of property and equipment	(46)	–	31	–	(15)
Net gains from disposal of investment securities and an associate	–	–	1,176	–	1,176
Operating expenses	(133,288)	(9,272)	(11,109)	–	(153,669)
Segment profit	96,489	119,938	54,687	–	271,114
Unallocated corporate expenses					(69,551)
Profit from operations					201,563
Share of results of jointly controlled entities			5,500		5,500
Profit from ordinary activities before taxation					207,063
Net taxation charge					(31,203)
Net profit for the period					175,860

Note: Inter-segment pricing is charged at prevailing customer deposits interest rates.