

Report of the Directors

The Directors have pleasure in presenting their report together with the audited accounts for the year ended 31st December, 2004.

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, 2004 is set out on page 46. 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 26. Mr Aloysius H Y Tse was appointed as a member of the Audit Committee on 26th November, 2004. Each of the Audit Committee members of the Bank received HK\$50,000 fee for the year ended 31st December, 2004.

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 Cheng Hon Kwan, Ambrose H C Lau 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 Managers 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 26.

Charitable Donations

During the year, the Group made donations for charitable purposes amounting to approximately HK\$407,000. In addition, the Group also provided services with associated costs of HK\$82,000 to various charities in 2004.

Directors

The Directors of the Bank up to the date of the report are shown on page 26.

Mr Ho Soo Ching retired at the conclusion of the Annual General Meeting held on 22nd April, 2004. The Board would wish to express its appreciation to Mr Ho for his many contributions during his years of service.

Mr Aloysius H Y Tse was appointed as Director of the Bank on 26th November, 2004 and will retire at the forthcoming Annual General Meeting and, being eligible, offers himself for re-election. In accordance with the Bank's Articles of Association, Messrs Cheng Hon Kwan, Kenneth A Lopian and Louis C W Ho retire by rotation and, being eligible, offer themselves for re-election.

The Bank has received from each Independent Non-executive Director an annual confirmation of his independence pursuant to Rule 3.13 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") and the Bank still considers such directors to be independent.

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, 2004.

Substantial Shareholders' Interests

As at 31st December, 2004, 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 in the shares and underlying shares of the Bank kept under Section 336 of the Securities and Futures Ordinance ("SFO") were as follows:

Name	Number of shares
Aberdeen Asset Management Asia Limited	27,775,500
BNY International Financing Corporation	(1) 59,350,000
The Bank of New York	(1) 59,350,000
The Bank of New York Company, Inc.	(1) 59,350,000
Cayman International Trust Company Limited	(2) 24,098,400
Wing Hang Bank (Nominees) Limited	(2) 23,378,400
YKF Trustee Holding Inc.	(2 & 4) 24,098,400
Po Ding Company Limited	(3 & 4) 24,156,000
GZ Trust Corporation	(3) 24,156,000
Tessel Inc.	(4) 10,639,200

(1) BNY International Financing Corporation is a wholly owned subsidiary of The Bank of New York. The Bank of New York is a wholly owned subsidiary of The Bank of New York Company, Inc.

(2) Cayman International Trust Company Limited is the trustee for YKF Trustee Holding Inc. Wing Hang Bank (Nominees) Limited is the registered holder of the shares on behalf of YKF Trustee Holding Inc.

(3) Po Ding Company Limited is wholly owned by GZ Trust Corporation.

(4) 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.

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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 SFO, the parties are, therefore, each deemed to be interested in 110,216,438 shares of the Bank.

All the interests stated above represent long positions. As at 31st December, 2004, 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.

Directors' and Chief Executive's Interests

As at 31st December, 2004, the Directors' and Chief Executive's Interests according to the Register of Directors' and Chief Executive's Interests and Short Positions in the shares, underlying shares of equity derivatives and debentures of the Bank and its associated corporations (within the meaning of Part XV of the SFO) kept under Section 352 of the SFO were as follows:

Name	Personal	Family	Number of shares			Total
			Option	Award	Other	
Patrick Y B Fung	2,982,000	–	180,000	200,000	– (1, 2 & 4)	3,362,000
Frank J Wang	–	–	140,000	125,000	– (1 & 2)	265,000
Michael Y S Fung	3,000,000	60,000	140,000	100,000	– (1, 2 & 4)	3,300,000
Louis C W Ho	124,000	60,000	140,000	10,000	– (1 & 2)	334,000
Simon K Y Lee	–	–	–	–	1,394,664 (3)	1,394,664
Ambrose H C Lau	71,500	–	–	–	–	71,500

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 24th April, 2003, 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	10/03/2011	23.60
	40,000	15/03/2002	15/03/2003	15/03/2012	26.30
	40,000	14/03/2003	14/03/2004	14/03/2013	26.50
	50,000	21/05/2004	21/05/2005	21/05/2014	43.80
Frank J Wang	40,000	10/03/2001	10/03/2002	10/03/2011	23.60
	30,000	15/03/2002	15/03/2003	15/03/2012	26.30
	30,000	14/03/2003	14/03/2004	14/03/2013	26.50
	40,000	21/05/2004	21/05/2005	21/05/2014	43.80
Michael Y S Fung	40,000	10/03/2001	10/03/2002	10/03/2011	23.60
	30,000	15/03/2002	15/03/2003	15/03/2012	26.30
	30,000	14/03/2003	14/03/2004	14/03/2013	26.50
	40,000	21/05/2004	21/05/2005	21/05/2014	43.80
Louis C W Ho	40,000	10/03/2001	10/03/2002	10/03/2011	23.60
	30,000	15/03/2002	15/03/2003	15/03/2012	26.30
	30,000	14/03/2003	14/03/2004	14/03/2013	26.50
	40,000	21/05/2004	21/05/2005	21/05/2014	43.80

- (2) The Board approved the granting of certain share awards to Directors and Executives of the Bank, pursuant to the Employee Incentive Plan adopted on 22nd April, 2004, and the following Directors have accepted the following share awards:

Name	No. of shares in awards	Date granted	Vesting Period		Awards price HK\$
			From	To	
Patrick Y B Fung	200,000	21/05/2004	21/05/2010	21/05/2014	1.00
Frank J Wang	125,000	21/05/2004	21/05/2010	21/05/2014	1.00
Michael Y S Fung	100,000	21/05/2004	21/05/2010	21/05/2014	1.00
Louis C W Ho	10,000	21/05/2004	21/05/2010	21/05/2014	1.00

- (3) 1,160,500 shares were held through a family trust in which Mr Simon K Y Lee's spouse is an eligible beneficiary. In addition, the family trust was deemed to be interested in 234,164 shares of the Bank as an equity linked note was acquired during the year.
- (4) All shares and options held by Messrs Patrick Y B Fung and Michael Y S Fung are parcel of the 110,216,438 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, 2004.

All the interests stated above represent long positions. As at 31st December, 2004, 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 Scheme

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.

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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, 2004, total number of ordinary shares available for issue under the new Share Option Scheme is 14,143,000 or 4.8% of the issued share capital of the Bank.

At 31st December, 2004, 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, 2004 is HK\$54.50).

	No. of shares 31/12/2004	No. of shares 31/12/2003	Date granted	No. of shares exercised	No. of shares lapsed	Option price HK\$	Market value per share at date of grant of options HK\$	Weighted average closing price per share at preceding day before exercise date HK\$
Directors								
Patrick Y B Fung	50,000	50,000	10/03/2001	–	–	23.60	29.00	–
	40,000	40,000	15/03/2002	–	–	26.30	26.30	–
	40,000	40,000	14/03/2003	–	–	26.50	26.50	–
	50,000	–	21/05/2004	–	–	43.80	43.80	–
Frank J Wang	40,000	40,000	10/03/2001	–	–	23.60	29.00	–
	30,000	30,000	15/03/2002	–	–	26.30	26.30	–
	30,000	30,000	14/03/2003	–	–	26.50	26.50	–
	40,000	–	21/05/2004	–	–	43.80	43.80	–
Michael Y S Fung	40,000	40,000	10/03/2001	–	–	23.60	29.00	–
	30,000	30,000	15/03/2002	–	–	26.30	26.30	–
	30,000	30,000	14/03/2003	–	–	26.50	26.50	–
	40,000	–	21/05/2004	–	–	43.80	43.80	–
Louis C W Ho	40,000	40,000	10/03/2001	–	–	23.60	29.00	–
	30,000	30,000	15/03/2002	–	–	26.30	26.30	–
	30,000	30,000	14/03/2003	–	–	26.50	26.50	–
	40,000	–	21/05/2004	–	–	43.80	43.80	–
Other Employees	60,000	90,000	10/03/2001	30,000	–	23.60	29.00	54.50
	40,000	60,000	15/03/2002	20,000	–	26.30	26.30	55.00
	80,000	160,000	14/01/2003	80,000	–	25.80	25.70	52.70
	325,000	–	21/05/2004	–	40,000	43.80	43.80	–
	1,105,000	740,000		130,000	40,000			

The share options granted are not recognised in the accounts until they are exercised. The value per option granted on 21st May, 2004 is estimated at the dates of grant using the Black-Scholes pricing model was HK\$15.94. The assumption used is as follows:

	Option granted on 21st May, 2004
Risk-free interest rate (%)	4.69
Expected life (in years)	10.0
Volatility (%)	38.38
Expected dividend yield (%)	3.14

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.

Employee Incentive Plan

During the year, a new employee incentive plan was approved. Pursuant to the approved Employee Incentive Plan ("EIP"), the directors are authorised, at their discretion, to invite certain executives, to take up awards to vesting ordinary shares in the Bank as incentive for them to remain in employment with the Bank. The maximum number of awards in respect of which awards may be granted under the EIP may not exceed 1% of the issued share capital of the Bank for the time being in issue within five years of the date of approval of the plan on 22nd April, 2004. The awards can be vested between the sixth to the tenth anniversaries after the date of grant with the following percentage of award vesting.

Date	Percentage of Award vesting
Sixth anniversary of the date of grant	5%
Seventh anniversary of the date of grant	10%
Eighth anniversary of the date of grant	15%
Ninth anniversary of the date of grant	20%
Tenth anniversary of the date of grant	50%

The Group granted awards at no consideration for certain employees to acquire shares of the Bank under the EIP. The shares will be acquired at the nominal value of HK\$1 per share under the award. The fair value of the awards is measured at the grant date and is charged to the profit and loss account and credited to shareholders' funds between the grant date and vesting date. The cash amount equal to the dividend that would have been paid during the period up to vesting will be charged to the profit and loss account as bonus expenses on an accrual basis.

At 31st December, 2004, the directors and employees of the Bank had the following interest in awards to purchase the shares of the Bank.

	No. of awards 31/12/2004	Date granted	Fair value of awards of grant HK\$
Directors			
Patrick Y B Fung	200,000	21/05/2004	42.80
Frank J Wang	125,000	21/05/2004	42.80
Michael Y S Fung	100,000	21/05/2004	42.80
Louis C W Ho	10,000	21/05/2004	42.80
Other Employees	60,000	21/05/2004	42.80
	<u>495,000</u>		

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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 and the Employee Incentive Plan 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 listed securities during the year ended 31st December, 2004.

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 have complied 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.

Model Code for Securities Transactions by Directors

The Bank has adopted for compliance by the Directors the code of conduct for dealings in securities of the Bank as set out in Appendix 10 – Model Code for Securities Transactions by Directors of Listed Issuers ("Model Code"), of the Listing Rules, and that the Directors have complied with the required standards set out in the Model Code throughout the year ended 31st December, 2004.

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, 10th March, 2005