

# Report of the Directors

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The Directors have pleasure in presenting their report together with the audited accounts for the year ended 31st December, 2005.

## **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 38 to the Accounts.

## **Results**

The profit of the Group for the year ended 31st December, 2005 is set out on page 51. Particulars of dividends which have been paid or which are recommended are set out in Note 9 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 25 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 34 and 35 to the Accounts.

## **Charitable Donations**

During the year, the Group made donations for charitable purposes amounting to approximately HK\$1,505,000.

## **Directors**

The Directors of the Bank up to the date of the report are shown on page 28.

The Directors retiring by rotation in accordance with the Bank's Articles of Association are Messrs Ambrose H C Lau, Alan R Griffith, Frank J Wang and Michael Y S Fung. Upon retirement from The Bank of New York, Mr Alan R Griffith has given notice to retire from the Board at the conclusion of the Annual General Meeting to be held on 27th April, 2006 and would not stand for re-election. Other retiring Directors are eligible and offer themselves for re-election.

The Board wishes to express its appreciation to Mr Alan R Griffith for his many contributions during his 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 and each member of the Audit Committee received a fee of HK\$50,000 for the year ended 31st December, 2005.

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## Substantial Shareholders' Interests

As at 31st December, 2005, 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	(1) 22,815,000
Aberdeen Asset Management Plc and its associates	(1) 23,536,000
BNY International Financing Corporation	(2) 59,350,000
The Bank of New York	(2) 59,350,000
The Bank of New York Company, Inc.	(2) 59,350,000
Federal Trust Company Limited	(3 & 5) 34,737,600
Tessel Inc.	(3 & 5) 10,639,200
Wing Hang Bank (Nominees) Limited	(3 & 5) 23,378,400
YKF Holding Corporation	(3 & 5) 24,098,400
Po Ding Company Limited	(4 & 5) 24,156,000
GZ Trust Corporation	(4 & 5) 24,156,000

- (1) Aberdeen Asset Management Asia Limited is a wholly owned subsidiary of Aberdeen Asset Management Plc.
- (2) 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.
- (3) Federal Trust Company Limited is the trustee for Tessel Inc. and YKF Holding Corporation. Wing Hang Bank (Nominees) Limited is the registered holder of certain shares on behalf of YKF Holding Corporation.
- (4) Po Ding Company Limited is wholly owned by GZ Trust Corporation.
- (5) 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 Holding Corporation 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 110,257,688 shares of the Bank.

All the interests stated above represent long positions. As at 31st December, 2005, 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.

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## Directors' and Chief Executive's Interests

As at 31st December, 2005, 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		Other	Total
			Option	Award		
Patrick Y B Fung	2,982,000	-	230,000	200,000	- (1, 2 & 4)	3,412,000
Frank J Wang	-	-	180,000	125,000	- (1 & 2)	305,000
Michael Y S Fung	3,000,000	60,000	180,000	100,000	- (1, 2 & 4)	3,340,000
Louis C W Ho	164,000	100,000	140,000	10,000	- (1 & 2)	414,000
Simon K Y Lee	-	-	-	-	1,451,500 (3)	1,451,500
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
	50,000	14/01/2005	14/01/2006	14/01/2015	51.25
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
	40,000	14/01/2005	14/01/2006	14/01/2015	51.25
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
	40,000	14/01/2005	14/01/2006	14/01/2015	51.25
Louis C W Ho	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
	40,000	14/01/2005	14/01/2006	14/01/2015	51.25

- (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) Shares were held through a family trust in which Dr Simon K Y Lee's spouse is an eligible beneficiary.
- (4) All shares, options and awards held by Messrs Patrick Y B Fung and Michael Y S Fung are parcel of the 110,257,688 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, 2005.

All the interests stated above represent long positions. As at 31st December, 2005, 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 (the "Stock Exchange") 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 Stock Exchange on the date of the grant, which must be a trading day, and
- ii) the average closing price of the shares on the Stock Exchange 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\$1.00. 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, 2005, total number of ordinary shares available for issue under the new Share Option Scheme is 13,793,000 or 4.7% of the issued share capital of the Bank.

At 31st December, 2005, 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, 2005 is HK\$55.80).

	No. of shares <b>31/12/2005</b>	No. of shares 31/12/2004	Date granted	No. of shares exercised	No. of shares lapsed	Option price	Market value per share at date of grant of options	Weighted average closing price per share at preceding day before exercise date
						HK\$	HK\$	HK\$
<b>Directors</b>								
Patrick Y B Fung	<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>	40,000	14/03/2003	-	-	26.50	26.50	-
	<b>50,000</b>	50,000	21/05/2004	-	-	43.80	43.80	-
	<b>50,000</b>	-	14/01/2005	-	-	51.25	50.75	-
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>	30,000	14/03/2003	-	-	26.50	26.50	-
	<b>40,000</b>	40,000	21/05/2004	-	-	43.80	43.80	-
	<b>40,000</b>	-	14/01/2005	-	-	51.25	50.75	-
Michael Y S Fung	<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>	30,000	14/03/2003	-	-	26.50	26.50	-
	<b>40,000</b>	40,000	21/05/2004	-	-	43.80	43.80	-
	<b>40,000</b>	-	14/01/2005	-	-	51.25	50.75	-
Louis C W Ho	-	40,000	10/03/2001	40,000	-	23.60	29.00	48.20
	<b>30,000</b>	30,000	15/03/2002	-	-	26.30	26.30	-
	<b>30,000</b>	30,000	14/03/2003	-	-	26.50	26.50	-
	<b>40,000</b>	40,000	21/05/2004	-	-	43.80	43.80	-
	<b>40,000</b>	-	14/01/2005	-	-	51.25	50.75	-
<b>Other Employees</b>	<b>60,000</b>	60,000	10/03/2001	-	-	23.60	29.00	-
	<b>40,000</b>	40,000	15/03/2002	-	-	26.30	26.30	-
	<b>80,000</b>	80,000	14/01/2003	-	-	25.80	25.70	-
	<b>220,000</b>	325,000	21/05/2004	70,000	35,000	43.80	43.80	55.55
	<b>50,000</b>	-	14/01/2005	-	-	51.25	50.75	-
	<b>105,000</b>	-	28/01/2005	-	25,000	50.25	49.80	-
	<b>1,285,000</b>	1,105,000		110,000	60,000			

The fair value per option at the dates of grant using the Bi-nominal pricing model is set out in Note 42 to the Accounts.

## Employee Incentive Plan (“EIP”)

Pursuant to the approved Employee Incentive Plan, 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%

At 31st December, 2005, the Directors and employees of the Bank had the following interest in awards to purchase the shares of the Bank.

	No. of awards 31/12/2005	No. of awards 31/12/2004	Date granted	Fair value of awards of grant HK\$
<b>Directors</b>				
Patrick Y B Fung	<b>200,000</b>	200,000	21/05/2004	42.80
Frank J Wang	<b>125,000</b>	125,000	21/05/2004	42.80
Michael Y S Fung	<b>100,000</b>	100,000	21/05/2004	42.80
Louis C W Ho	<b>10,000</b>	10,000	21/05/2004	42.80
<b>Other Employees</b>	<b>60,000</b>	60,000	21/05/2004	42.80
	<b>495,000</b>	495,000		

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The Directors and employees of the Bank had been granted the following interest in awards on 23rd January, 2006 to purchase the shares of the Bank. The fair value of the awards was measured at the grant date was HK\$56.20.

	No. of awards
<b>Directors</b>	
Patrick Y B Fung	<b>450,000</b>
Frank J Wang	<b>270,000</b>
Michael Y S Fung	<b>225,000</b>
<b>Other Employees</b>	<b>615,000</b>
	<b><u>1,560,000</u></b>

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\$1.00 per share under the award. The fair value of the awards was 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 are charged to the profit and loss account as bonus expenses on an accrual basis.

### 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, 2005.

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## **Code on Corporate Governance Practices**

The Bank has complied throughout the year and adopted all the Code Provisions set out in Appendix 14 - Code on Corporate Governance Practices of the Rules Governing the Listing of Securities (the “Listing Rules”) on the Stock Exchange, except for certain deviations. Information about the Bank’s Corporate Governance is given under “Corporate Governance Report” on page 44 to 48.

## **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.

## **Public Float**

As at the date of this report, the Bank has maintained the prescribed public float under the Listing Rules, based on information that is publicly available to the Bank and within the knowledge of its Directors.

## **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, 16th March, 2006