

# 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, 2006.

## 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 Notes 21 and 36 to the Accounts.

## Results

The profit of the Group for the year ended 31st December, 2006 and the state of the Group's and the Bank's affairs as at that date are set out in the Accounts on pages 49 to 177. 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 23 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 32 and 33 to the Accounts.

## Charitable Donations

During the year, the Group made donations for charitable purposes amounting to approximately HK\$1,129,000 (2005: HK\$1,505,000).

## Directors

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

The Directors retiring by rotation in accordance with the Bank's Articles of Association are Dr Simon K Y Lee, Mr Tung Chee Chen and Dr Patrick Y B Fung. Retiring Directors are eligible and offer themselves for reelection.

Mr Alan R Griffith retired as a Non-executive Director at the conclusion of Annual General Meeting on 27th April, 2006.

Mr David Drabkin was appointed as a Non-executive Director on 15th June, 2006 and resigned on 30th January, 2007 at the request of The Bank of New York.

The Board wishes to express its appreciation to Mr Alan R Griffith and Mr David Drabkin for their valuable 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 and each member of the Audit Committee received a fee of HK\$50,000 for the year ended 31st December, 2006.

## Directors' and Chief Executive's Interests

As at 31st December, 2006, the interests of the Directors and the chief executive of the Bank in the shares and the underlying shares of the Bank and any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO"), which were required to be notified to the Bank and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they were taken or deemed to have under such provisions of the SFO), or which were required pursuant to Section 352 of the SFO to be entered in the register maintained by the Bank referred to therein, or which were required to be notified to the Bank and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") were as follows:

Name	Personal	Family	Number of shares held		Other	Total	% of issued share capital
			Option <sup>(1)</sup>	Award <sup>(2)</sup>			
Patrick Y B Fung <sup>(3)</sup>	2,982,000	–	230,000	650,000	–	3,862,000	1.31
Michael Y S Fung <sup>(3)</sup>	3,000,000	60,000	180,000	325,000	–	3,565,000	1.21
Simon K Y Lee	–	–	–	–	1,297,750 <sup>(4)</sup>	1,297,750	0.44
Frank J Wang	–	–	80,000	395,000	–	475,000	0.16
Louis C W Ho <sup>(3)</sup>	204,000	100,000	100,000	10,000	–	414,000	0.14
Ambrose H C Lau	71,500	–	–	–	–	71,500	0.02

Notes:

- (1) Share options were granted to the Directors pursuant to the share option scheme adopted by the Bank on 9th June, 1993 and 24th April, 2003. The details of the share options are stated under the section headed "Share Option Scheme".
- (2) Share awards were granted to the Directors pursuant to the employee incentive plan adopted by the Bank on 22nd April, 2004. The details of the share awards are stated under the section headed "Employee Incentive Plan".
- (3) Patrick Y B Fung, Michael Y S Fung and Louis C W Ho's spouse are also, together with other parties, eligible beneficiaries of the trusts of Po Ding Co. Ltd., YKF Holding Corporation and Tessel Inc. The interests of these corporations in shares of the Bank are stated under the section headed "Substantial Shareholders' Interests".
- (4) Shares are held through Dr Simon K Y Lee's family trust.

All the interests stated above represent long positions.

Save as disclosed above, as at 31st December, 2006, none of the Directors or the chief executive of the Bank and their associates had any interests or short positions in any shares, underlying shares and debentures of the Bank or any of its associated corporations (within the meaning of Part XV of the SFO), which were required to be notified to the Bank and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they were taken or deemed to have under such provisions of the SFO), or which were required pursuant to Section 352 of the SFO to be entered in the register maintained by the Bank referred to therein, or which were required to be notified to the Bank and the Stock Exchange pursuant to the Model Code.

# Report of the Directors

## Substantial Shareholders' Interests

As at 31st December, 2006, so far as was known to the Directors or the chief executive of the Bank, persons known to the Directors (other than the Directors or the chief executive of the Bank as disclosed in the above), who had interests or short positions in the shares or underlying shares of the Bank which would fall to be disclosed to the Bank under provisions of Divisions 2 and 3 of Part XV of the SFO, or recorded in the register kept by the Bank pursuant to Section 336 of the SFO and its interests were as follows:

Name	Nature of Interest	Number of shares	% of issued share capital
BNY International Financing Corporation	Beneficial owner	59,350,000 <sup>(1)</sup>	20.17
The Bank of New York	Interest in controlled corporation	59,350,000 <sup>(1)</sup>	20.17
The Bank of New York Company, Inc.	Interest in controlled corporation	59,350,000 <sup>(1)</sup>	20.17
Federal Trust Company Limited	Trustee	34,737,600 <sup>(2 &amp; 4)</sup>	11.81
Po Ding Company Limited	Trustee	24,156,000 <sup>(3 &amp; 4)</sup>	8.21
GZ Trust Corporation	Trustee	24,156,000 <sup>(3 &amp; 4)</sup>	8.21
YKF Holding Corporation	Trustee	24,098,400 <sup>(2 &amp; 4)</sup>	8.19
Aberdeen Asset Management Plc and its associates	Investment manager	23,512,529 <sup>(5)</sup>	7.99
Wing Hang Bank (Nominees) Limited	Nominee	23,378,400 <sup>(2 &amp; 4)</sup>	7.95
Aberdeen Asset Management Asia Limited	Investment manager	22,815,000 <sup>(5)</sup>	7.75
JPMorgan Chase & Co	Beneficial owner/ Investment manager/Custodian	14,732,367 <sup>(6)</sup>	5.01
Tessel Inc.	Trustee	10,639,200 <sup>(2 &amp; 4)</sup>	3.62

### Notes:

- (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) 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.
- (3) Po Ding Company Limited is wholly-owned by GZ Trust Corporation.
- (4) Each of Po Ding Co. Ltd., YKF Holding Corporation and Tessel Inc. are trusts in which Patrick Y B Fung, Michael Y S Fung and Louis C W Ho's spouse (together with other parties) are eligible beneficiaries.
- (5) Aberdeen Asset Management Asia Limited is a wholly-owned subsidiary of Aberdeen Asset Management Plc.
- (6) JPMorgan Chase & Co holds 13,988,367 of these shares as a custodian of a lending pool. It holds the remaining 744,000 as beneficial owner and as an investment manager.

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Other than the lending pool interest of JPMorgan Chase & Co referred to in Note (6) above, all the interests stated above represent long positions.

Save as disclosed, as at 31st December, 2006, so far as known to the Directors or the chief executive of the Bank, there is no person (other than the Directors or the chief executive of the Bank) who had interests or short positions in the shares and underlying shares of the Bank which would fall to be disclosed to the Bank and the Stock Exchange under the provisions of Divisions 2 and 3 of Part XV of the SFO or, who is, directly or indirectly, interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any members of the Group.

### **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 an 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 exercise price was 80% of the average closing price on the Stock Exchange on the five business days immediately preceding the date of offer of such options. After 1st September, 2001, the exercise price should be at least the higher of:

- (i) the closing price of the shares on the Stock Exchange on the date of 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, and settled by physical delivery of shares. 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 Rules Governing The Listing of Securities (the "Listing Rules") on the Stock Exchange.

At 31st December, 2006, 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, 2006, the Directors and employees of the Bank had the following interest in option to purchase the shares of the Bank (market value per share at 31st December, 2006 is HK\$91.50).

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	No. of shares <b>31/12/2006</b>	No. of shares 31/12/2005	Date granted	No. of shares exercised	No. of shares lapsed	Exercise price HK\$	Market value per share at date of grant of options HK\$	Weighted average closing price at preceding day before exercise date 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>	50,000	14/01/2005	–	–	51.25	50.75	–
Frank J Wang	–	40,000	10/03/2001	40,000	–	23.60	29.00	77.70
	–	30,000	15/03/2002	30,000	–	26.30	26.30	75.00
	–	30,000	14/03/2003	30,000	–	26.50	26.50	75.00
	<b>40,000</b>	40,000	21/05/2004	–	–	43.80	43.80	–
	<b>40,000</b>	40,000	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>	40,000	14/01/2005	–	–	51.25	50.75	–
Louis C W Ho	<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	–
	–	40,000	21/05/2004	40,000	–	43.80	43.80	63.95
	<b>40,000</b>	40,000	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>20,000</b>	40,000	15/03/2002	20,000	–	26.30	26.30	65.15
	<b>60,000</b>	80,000	14/01/2003	20,000	–	25.80	25.70	65.15
	<b>220,000</b>	220,000	21/05/2004	–	–	43.80	43.80	–
	<b>50,000</b>	50,000	14/01/2005	–	–	51.25	50.75	–
	<b>85,000</b>	105,000	28/01/2005	20,000	–	50.25	49.80	56.10
	<b>1,085,000</b>	<b>1,285,000</b>		<b>200,000</b>	<b>–</b>			

## Employee Incentive Plan

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 that 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 percentage of awards vested between the sixth to the tenth anniversaries after the date of grant is as follows:

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, 2006, the Directors and employees of the Bank had the following interest in awards to purchase the shares of the Bank.

	No. of awards 31/12/2006	No. of awards 31/12/2005	Date granted	Fair value of awards at date of grant HK\$
<b>Directors</b>				
Patrick Y B Fung	<b>200,000</b>	200,000	21/05/2004	42.80
	<b>450,000</b>	–	23/01/2006	56.20
Frank J Wang	<b>125,000</b>	125,000	21/05/2004	42.80
	<b>270,000</b>	–	23/01/2006	56.20
Michael Y S Fung	<b>100,000</b>	100,000	21/05/2004	42.80
	<b>225,000</b>	–	23/01/2006	56.20
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>615,000</b>	–	23/01/2006	56.20
	<b>2,055,000</b>	<b>495,000</b>		

On 29th January, 2007, certain employees of the Bank had been granted 140,000 awards to purchase the shares of the Bank. Fair value of each award of grant is HK\$94.60.

The Group granted awards at no consideration for certain employees to acquire ordinary shares in the Bank under the EIP. The shares will be acquired at a nominal value of HK\$1.00 per share under the awards. 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 accruals basis.

# Report of the Directors

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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, 2006.

## **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 Listing Rules on the Stock Exchange, except for certain deviations. Information about the Bank's Corporate Governance is given under "Corporate Governance Report" on pages 41 to 46.

## **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 set out on pages 49 to 177 of this annual report 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, 15th March, 2007