中銀香港(控股)有限公司
BOC HONG KONG (HOLDINGS) LIMITED

(Incorporated in Hong Kong with limited liability under the Companies Ordinance)

ANNOUNCEMENT OF 2002 INTERIM RESULTS

The Directors of BOC Hong Kong (Holdings) Limited (the "Company") are pleased to announce the unaudited consolidated interim results of the Company and its subsidiaries (the "Group") for the six months ended 30 June 2002 as follows:

Consolidated Profit and Loss Account (Unaudited)

		Six months ended	
	Note	**30 June 2002**	30 June 2001
		HK$'m	*HK$'m*
Interest income		**10,958**	23,261
Interest expense		**(4,067)**	(15,527)
Net interest income		**6,891**	7,734
Other operating income	2	**2,010**	2,256
Operating income		**8,901**	9,990
Operating expenses	3	**(2,899)**	(2,868)
Operating profit before provisions		**6,002**	7,122
Charge for bad and doubtful debts		**(1,766)**	(1,848)
Operating profit after provisions		**4,236**	5,274
Net gain from disposal of fixed assets		**8**	10
Net (loss)/gain from disposal of held-to-maturity securities and investment securities		**(2)**	7
(Provision)/write-back of provision for impairment in held-to-maturity securities and investment securities		**(7)**	6
Provision for impairment in investment in associates		**(30)**	—
Share of net profits of associates		**6**	77
Charge for restructuring provision		**—**	(295)
Profit before taxation	4	**4,211**	5,079
Taxation	5	**(730)**	(808)
Profit after taxation		**3,481**	4,271
Minority interests		**(63)**	(76)
Profit attributable to shareholders		**3,418**	4,195
Dividends	6	**1,935**	—
		HK$	*HK$*
Earnings per share	7	**0.065**	0.079
Earnings per share, as adjusted	7	**0.323**	0.397

Consolidated Balance Sheet (Unaudited)

	Note	As at 30 June 2002	As at 31 December 2001 (Audited)
		HK$'m	*HK$'m*
ASSETS			
Cash and short-term funds		109,408	196,255
Placements with banks and other financial institutions maturing between one and twelve months		100,918	80,773
Trade bills		584	382
Certificates of deposit held		17,471	19,474
Hong Kong SAR Government certificates of indebtedness		28,290	25,510
Held-to-maturity securities		102,555	50,988
Investment securities		50	44
Other investments in securities		48,760	56,169
Advances and other accounts	8	303,983	308,108
Investments in associates		366	416
Fixed assets		20,636	21,049
Other assets		4,757	6,972
Total assets		737,778	766,140
LIABILITIES			
Hong Kong SAR currency notes in circulation		28,290	25,510
Deposits and balances of banks and other financial institutions		16,115	55,295
Current, fixed, savings and other deposits of customers		611,470	606,428
Certificates of deposit issued		5,000	5,000
Other accounts and provisions	9	22,165	20,671
Total liabilities		683,040	712,904
CAPITAL RESOURCES			
Minority interests		1,084	1,066
Share capital	10	52,864	52,864
Reserves	11	790	(694)
Shareholders' funds		53,654	52,170
Total capital resources		54,738	53,236
Total liabilities and capital resources		737,778	766,140

Consolidated Cash Flow Statement (Unaudited)

	Six months ended 30 June 2002	30 June 2001
	HK$'m	*HK$'m*
Operating Activities		
Cash generated by operations	(27,547)	(63,108)
Disposal of loans to Bank of China Grand Cayman Branch	8,722	—
Hong Kong profit tax paid	(202)	(84)
Overseas profit tax paid	(11)	(14)
Net cash outflow from operating activities	(19,038)	(63,206)
Investing activities		
Purchase of fixed assets	(26)	(70)
Disposal of fixed assets	9	16
Disposal of investment securities	—	28
Disposal of associates	—	3
Dividend received from associates	2	—
Net cash outflow from investing activities	(15)	(23)
Net cash outflow before financing	(19,053)	(63,229)
Financing		
Remittance of profit by merging branches	—	(3,034)
Dividend paid on ordinary shares	—	(193)
Dividend paid to minority shareholders in subsidiaries	—	(62)
Net cash outflow from financing	—	(3,289)
Decrease in cash and cash equivalents	(19,053)	(66,518)
Cash and cash equivalents at 1 January	120,664	184,680
Cash and cash equivalents at 30 June	101,611	118,162

Consolidated Statement of Changes in Equity (Unaudited)

	Share capital	Merger reserve	Premises revaluation reserve	Investment properties revaluation reserve	Translation reserve	Retained earnings	Total
	HK$'m	*HK$'m*	*HK$'m*	*HK$'m*	*HK$'m*	*HK$'m*	*HK$'m*
Balance at 1 January 2001	52,864	(51,073)	—	—	(7)	31,561	33,345
Net profit for the period	—	—	—	—	—	4,195	4,195
2000 final dividend paid	—	—	—	—	—	(542)	(542)
Remittance of profits by Merging branches	—	—	—	—	—	(3,034)	(3,034)
Capital contribution from ultimate holding company	—	—	—	—	—	238	238
Balance at 30 June 2001	52,864	(51,073)	—	—	(7)	32,418	34,202
Balance at 1 July 2001	52,864	(51,073)	—	—	(7)	32,418	34,202
Surplus on revaluation of properties	—	—	8,408	3,159	—	—	11,567
Currency translation difference	—	—	—	—	(2)	—	(2)
Net loss for the period	—	—	—	—	—	(1,427)	(1,427)
Capital contribution from ultimate holding company	—	—	—	—	—	7,830	7,830
Capitalisation of reserves	—	51,073	(8,267)	(3,141)	7	(39,672)	—
Balance at 31 December 2001	52,864	—	141	18	(2)	(851)	52,170
Balance at 1 January 2002	52,864	—	141	18	(2)	(851)	52,170
Currency translation difference	—	—	—	—	1	—	1
Net profit for the period	—	—	—	—	—	3,418	3,418
Special dividend	—	—	—	—	—	(1,935)	(1,935)
Balance at 30 June 2002	52,864	—	141	18	(1)	632	53,654

Notes:

1. Basis of preparation and accounting policies

These unaudited consolidated interim financial statements are prepared in accordance with Hong Kong Statement of Standard Accounting Practice (SSAP) 25, "Interim Financial Reporting", issued by the Hong Kong Society of Accountants ("HKSA"). These interim financial statements should be read in conjunction with the Group's Financial Information as set out in Appendix I of the Company's prospectus dated 15 July 2002 for the years ended 31 December 1999, 2000, 2001 ("Financial Information").

The Company was incorporated in Hong Kong on 12 September 2001. Its shares have been listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") since 25 July 2002.

Pursuant to the group reorganisation on 1 October 2001, accomplished by the Bank of China (Hong Kong) Limited (Merger) Ordinance and the Merger Agreements, the Company acquired the entire equity interests in Bank of China (Hong Kong) Limited ("BOCHK") on 30 September 2001 and subsequently became the holding company of the Group. Details of the Restructuring and Merger are set out in the Company's prospectus dated 15 July 2002. The Restructuring and Merger represents a business combination resulting from transactions among enterprises under the common control of the Bank of China. Under the principles of merger accounting prescribed in the SSAP 27, "Accounting for Group Reconstructions", the interim financial statements of the Group are prepared as if the group structure and capital structure as at 1 October 2001 had been in existence from the beginning of the periods presented.

The accounting policies and methods of computation used in the preparation of these interim financial statements are consistent with those used in the preparation of the Group's Financial Information for the years ended 31 December 1999, 2000 and 2001. The Group has adopted the new and revised SSAPs issued by the HKSA which have become effective for accounting periods commencing on or after 1 January 2002.

2. Other operating income

	Six months ended 30 June 2002	Six months ended 30 June 2001
	HK$'m	HK$'m
Fees and commission income	1,705	1,846
Less: Fees and commission expense	(357)	(386)
Net fees and commission income	1,348	1,460
Dividend income from investments in securities		
- listed investments	—	1
- unlisted investments	11	12
Net gain from other investments in securities	70	10
Net gain from foreign exchange activities	402	568
Net gain from other dealing activities	4	10
Gross rental income from investment properties	93	93
Others	82	102
	2,010	2,256

3. Operating expenses

	Six months ended 30 June 2002	Six months ended 30 June 2001
	HK$'m	HK$'m
Staff costs (including directors' emoluments)	1,761	1,905
Premises and equipment expenses excluding depreciation		
- rental of premises	137	173
- others	223	203
Depreciation		
- owned fixed assets	359	213
Other operating expenses	419	374
	2,899	2,868

4. Segmental reporting

(a) By class of business

	Six months ended 30 June 2002					
	Commercial Banking	Treasury	Unallocated	Subtotal	Eliminations	Consolidated
	HK$'m	HK$'m	HK$'m	HK$'m	HK$'m	HK$'m
Total operating income	6,953	1,487	747	9,187	(286)	8,901
Operating profit before provisions	4,693	1,399	(90)	6,002	—	6,002
Operating profit after provisions	2,927	1,399	(90)	4,236	—	4,236
Profit before taxation	2,927	1,390	(106)	4,211	—	4,211

	Six months ended 30 June 2001					
	Commercial Banking	Treasury	Unallocated	Subtotal	Eliminations	Consolidated
	HK$'m	*HK$'m*	*HK$'m*	*HK$'m*	*HK$'m*	*HK$'m*
Total operating income	7,436	1,868	924	10,228	(238)	9,990
Operating profit before provisions	5,163	1,757	202	7,122	—	7,122
Operating profit after provisions	3,315	1,757	202	5,274	—	5,274
Profit before taxation	3,315	1,761	3	5,079	—	5,079

Commercial banking business includes acceptance of deposits, mortgage lending, credit card advances, remittance, provision of securities brokerage and insurance agency services, commercial lending, trade finance and overdraft facilities.

Treasury activities include money market, foreign exchange dealing and capital market activities. Treasury manages the funding position of the Group. Treasury provides funding to all other business segments and receives funds from commercial banking's deposit taking activities. These inter-segment funding transactions are priced either at market bid/offer rates as appropriate or at an internal funding rate as determined by the average funding requirements of other business segments and the average one-month inter-bank rates of the relevant financial period. In addition, the gains and losses on the foreign exchange activities of the Group are included under Treasury. The profit and loss information presented in this note has been prepared using intersegment charging/income transactions.

Unallocated items mainly comprise income and expenses relating to fixed assets of the Group, investment securities, interests in associates and other items which cannot be reasonably allocated to a specific business segment. The interest benefit of the capital of the Group is also included as unallocated within net interest income. Rental expenses are allocated to business segments based on a fixed rate per square footage occupied.

Operating expenses of a functional unit are allocated to the relevant business segment which is the predominant user of the services provided by the unit. Operating expenses of other shared services which cannot be allocated to a specific business segment are included under Unallocated.

(b) By geographical area

No geographical reporting is provided as over 90% of the Group's revenues and profits are derived from Hong Kong.

5. **Taxation**

The amount of taxation charged to the consolidated profit and loss account represents:

	Six months ended 30 June 2002	Six months ended 30 June 2001
	HK$'m	*HK$'m*
Bank and subsidiaries		
Hong Kong profits tax	738	819
Overseas taxation	5	10
Over provisions in prior years	(6)	(27)
	737	802
Associates		
Hong Kong profits tax	(6)	11
Attributable share of estimated Hong Kong profits tax losses arising from investments in partnerships	(7)	(34)
Investments in partnerships written off	6	29
	(1)	(5)
	730	808

Hong Kong profits tax has been provided at the rate of 16% (2001:16%) on the estimated assessable profit for the periods ended 30 June 2002 and 2001. Taxation on overseas profits has been calculated on the estimated assessable profit for the period ended 30 June 2002 and 2001 at the rates of taxation prevailing in the countries in which the Group operates.

The Group has entered into a number of aircraft leasing and coupon strip transactions involving special purpose partnerships in which the Group is the majority general partner. The Group does not control the partnerships and consequently they are not consolidated in the Group's accounts. As at 31 December 2001 and 30 June 2002, the Group's investment in such partnerships, which is included in "Other assets" in the balance sheet amounted to HK$876 million and HK$359 million respectively. The Group's investments in partnerships are amortised over the life of the partnership in proportion to the taxation benefits resulting from those investments.

There is no significant deferred taxation liability not provided for.

6. **Dividends**

Prior to the listing, on 18 June 2002, the Board of Directors proposed a special dividend amounting to HK$1,935 million. On 28 June 2002, the shareholders of the Company approved a special dividend of HK$0.0366 per ordinary share (without taking into account the share consolidation) or HK$0.183 per share (taking into account the share consolidation) with respect to the period to 18 June 2002. The total amount of this special dividend was HK$1,935 million, which was paid by cash generated from operations.

This special dividend is reflected as a dividend payable in the financial statements and is presented as an appropriation of retained earnings for the period ended 30 June 2002.

7. **Earnings per share**

The calculation of basic earnings per share is based on profit attributable to shareholders for the period ended 30 June 2002 of approximately HK$3,418,000,000 (HK$4,195,000,000 for the period ended 30 June 2001) and on the ordinary shares in issue of 52,863,901,330 shares (52,863,901,330 ordinary shares for the period ended 30 June 2001) pursuant to the Restructuring and Merger and as if these shares have been in issue during these two periods.

The calculation of basic earnings per share, as adjusted, is based on profit attributable to shareholders of approximately HK$3,418,000,000 (HK$4,195,000,000 for the period ended 30 June 2001) and on the ordinary shares in issue of 10,572,780,266 shares (10,572,780,266 ordinary shares for the period ended 30 June 2001) after adjusting for the effect of the share consolidation as described in note 10, as if the share consolidation had occurred at the beginning of the earliest period presented.

8. (a) **Advances and other accounts**

	As at 30 June 2002	As at 31 December 2001
	HK$'m	*HK$'m*
Advances to customers	317,634	323,038
Accrued interest	1,883	2,180
	319,517	325,218
Provision for bad and doubtful debts		
- General	(6,538)	(6,538)
- Specific	(8,999)	(10,576)
	(15,537)	(17,114)
	303,980	308,104
Advances to banks and other financial institutions	3	4
	303,983	308,108

Non-performing loans are analysed as follows:

	Advances to customers	
	As at 30 June 2002	As at 31 December 2001
	HK$'m	*HK$'m*
Non-performing loans	28,498	35,512
Specific provisions made in respect of such advances	8,996	10,322
As a percentage of total advances to customers	8.97%	10.99%
Amount of interest in suspense	422	610

Non-performing loans are defined as loans and advances to customers on which interest is being placed in suspense or on which interest accrual has ceased. The specific provisions were made after taking into account the value of collateral in respect of such advances.

There were no advances to banks and other financial institutions on which interest has been placed in suspense or on which interest accrual has ceased as at 31 December 2001 and 30 June 2002 nor were there any specific provisions made.

On 26 June 2002, BOCHK disposed of loans with a gross book value of HK$11,401 million net of specific provisions of HK$2,679 million to Bank of China Grand Cayman Branch (Note 15(a)). As at 31 December 2001, the outstanding balance of non-performing loans which were disposed of in 2002 amounted to HK$7,269 million and specific provisions made in respect of such non-performing loans amounted to HK$2,538 million. Had the disposal taken place as at 31 December 2001, the non-performing loans as a percentage of total advances to customers would have been 9.06%.

(b) **Gross advances to customers by industry sector**

	As at 30 June 2002	As at 31 December 2001
	HK$'m	*HK$'m*
Loans for use in Hong Kong		
Industrial, commercial and financial		
- Property development	26,818	28,300
- Property investment	44,814	47,758
- Financial concerns	6,691	7,314
- Stockbrokers	81	108
- Wholesale and retail trade	22,419	24,091
- Manufacturing	11,140	11,477
- Transport and transport equipment	9,780	8,778
- Others	51,487	51,054
Individuals		
- Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	20,032	20,273
- Loans for purchase of other residential properties	85,689	82,513
- Credit card advances	3,462	3,019
- Others	9,280	9,735
Total loans for use in Hong Kong	291,693	294,420
Trade finance	9,763	10,566
Loans for use outside Hong Kong	16,178	18,052
Total advances to customers	317,634	323,038

(c) **Geographical analysis of gross advances to customers, overdue advances and non-performing loans**

The following geographical analysis of gross advances to customers, overdue advances for more than three months and non-performing loans is based on the location of the counterparties, after taking into account of the transfer of risk in respect of such advances where appropriate.

(i) Gross advances to customers

	As at 30 June 2002	As at 31 December 2001
	HK$'m	*HK$'m*
Hong Kong	305,892	310,953
Mainland China	6,348	7,753
Others	5,394	4,332
	317,634	323,038

(ii) Overdue advances for over three months

	As at 30 June 2002	As at 31 December 2001
	HK$'m	*HK$'m*
Hong Kong	19,296	21,713
Mainland China	2,294	3,465
Others	137	120
	21,727	25,298

(iii) Non-performing loan

	As at 30 June 2002	As at 31 December 2001
	HK$'m	*HK$'m*
Hong Kong	25,821	30,043
Mainland China	2,483	5,130
Others	194	339
	28,498	35,512

(d) Cross-border claims

The information on cross-border claims discloses exposures to foreign counterparties on which the ultimate risk lies, and is derived according to the location of the counterparties after taking into account any transfer of risk. In general, such transfer of risk takes place if the claims are guaranteed by a party in a country which is different from that of the counterparty or if the claims are on an overseas branch of a bank whose head office is located in another country. Only regions constituting 10% or more of the aggregate cross-border claims are analysed by geographical areas and disclosed as follows:

	Banks and other financial institutions	Public sector entities	Others	Total
As at 30 June 2002	*HK$'m*	*HK$'m*	*HK$'m*	*HK$'m*
Asia, other than Hong Kong	65,728	7,555	9,749	83,032
North America	23,323	27,443	16,771	67,537
Western Europe	152,709	3,587	20,049	176,345
Caribbean	—	—	2,545	2,545
	241,760	38,585	49,114	329,459

	Banks and other financial institutions	Public sector entities	Others	Total
As at 31 December 2001	*HK$'m*	*HK$'m*	*HK$'m*	*HK$'m*
Asia, other than Hong Kong	133,805	15,771	10,337	159,913
North America	34,303	18,526	8,725	61,554
Western Europe	143,297	3,172	3,934	150,403
Caribbean	—	—	3,105	3,105
	311,405	37,469	26,101	374,975

(e) Overdue and rescheduled assets

(I) Advances to customers

(i) Gross amount of overdue advances

	As at 30 June 2002 HK$'m	% of gross advances to customers	As at 31 December 2001 HK$'m	% of gross advances to customers
Gross advances to customers which have been overdue for:				
- six months or less but over three months	2,455	0.77%	4,212	1.30%
- one year or less but over six months	5,770	1.82%	5,427	1.68%
- over one year	13,502	4.25%	15,659	4.85%
	21,727	6.84%	25,298	7.83%

At 30 June 2002 and 31 December 2001, there were no advances to banks and other financial institutions which were overdue for over three months.

(ii) Overdue advances are reconciled to non-performing loans as follows:

	As at 30 June 2002 HK$'m	As at 31 December 2001 HK$'m
Advances which are overdue for more than three months	21,727	25,298
Add: non-accrual advances which are overdue for three months or less		
- included in rescheduled advances	1,480	1,315
- others	6,152	10,685
Less: advances which are overdue for more than three months and on which interest is still being accrued	(861)	(1,786)
Non-performing loans	28,498	35,512

(iii) Rescheduled advances (net of amounts included in overdue advances for more than three months and reported in item (i) above) are as follows:

	As at 30 June 2002 HK$'m	% of gross advances to customers	As at 31 December 2001 HK$'m	% of gross advances to customers
Rescheduled advances	1,617	0.51%	1,814	0.56%

At 30 June 2002 and 31 December 2001, there were no rescheduled advances to banks and other financial institutions.

(II) **Other overdue assets**

	As at 30 June 2002	As at 31 December 2001
	HK$'m	*HK$'m*
Overdue for:		
- six months or less but over three months	10	9
- one year or less but over six months	21	5
- over one year	19	4
	50	18

9. **Other accounts and provisions**

	As at 30 June 2002	As at 31 December 2001
	HK$'m	*HK$'m*
Interest payable	1,197	1,615
Current taxation	576	59
Deferred taxation	8	8
Restructuring provision	658	666
Special dividend payable (Note 6)	1,935	—
Accruals and other payables	17,791	18,323
	22,165	20,671

10. **Share capital**

	As at 30 June 2002	As at 31 December 2001
	HK$'m	*HK$'m*
Authorised:		
100,000 million ordinary shares of HK$1.00 each	100,000	100,000
Issued and fully paid:		
52,864 million ordinary shares of HK$1.00 each	52,864	52,864

Pursuant to a written resolution of all the shareholders of the Company passed on 30 September 2001, the directors were given a general mandate to allot and issue shares.

On 17 June 2002, the directors allotted and issued five ordinary shares of HK$1.00 each fully paid for cash at par, of which two shares to BOC Hong Kong (BVI) Limited and three shares to Hua Chiao Commercial Limited.

Pursuant to written resolutions of all the shareholders of the Company passed on 10 July 2002, the authorised and issued share capital of the Company, comprising 100,000,000,000 and 52,863,901,330 ordinary shares of HK$1.00 each, respectively, was consolidated and divided into 20,000,000,000 shares and 10,572,780,266 shares, respectively.

11. **Reserves**

	As at 30 June 2002	As at 31 December 2001
	HK$'m	*HK$'m*
Premises revaluation reserve	141	141
Investment properties revaluation reserve	18	18
Translation reserve	(1)	(2)
Retained earnings	632	(851)
	790	(694)

12. **Maturity profile**

The maturity profile of assets and liabilities analysed by the remaining period as at 30 June 2002 and 31 December 2001 to the contractual maturity dates is as follows:

	As at 30 June 2002						
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	Total
	HK$'m	*HK$'m*	*HK$'m*	*HK$'m*	*HK$'m*	*HK$'m*	*HK$'m*
Assets							
- Treasury bills	—	16,197	149	—	—	—	16,346
- Cash and other short-term funds	5,217	87,845	—	—	—	—	93,062
- Placements with banks and other financial institutions	—	87,556	13,362	—	—	—	100,918
- Certificates of deposit held	—	3,024	5,825	8,419	203	—	17,471
- Other investments in securities -debt securities	—	18,636	5,815	22,164	2,053	—	48,668
- Held-to-maturity securities	—	10,106	11,024	78,180	3,204	90	102,604
- Advances to customers	29,221	18,162	23,217	116,749	101,248	29,037	317,634
- Advances to banks and other financial institutions	—	—	2	1	—	—	3
	34,438	241,526	59,394	225,513	106,708	29,127	696,706
Liabilities							
- Deposits and balances of banks and other financial institutions	4,392	11,485	238	—	—	—	16,115
- Current, fixed, savings and other deposits of customers	215,223	368,576	26,984	687	—	—	611,470
- Certificates of deposit issued	—	5,000	—	—	—	—	5,000
	219,615	385,061	27,222	687	—	—	632,585

	As at 31 December 2001						
	Repayable on demand	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	Total
	HK$'m	HK$'m	HK$'m	HK$'m	HK$'m	HK$'m	HK$'m
Assets							
- Treasury bills	—	12,721	6,190	—	—	—	18,911
- Cash and other short-term funds	59,898	117,446	—	—	—	—	177,344
- Placements with banks and other financial institutions	—	53,700	27,073	—	—	—	80,773
- Certificates of deposit held	—	4,768	6,768	7,789	149	—	19,474
- Other investments in securities -debt securities	—	27,021	5,885	22,130	1,043	—	56,079
- Held-to-maturity securities	2	8,641	12,853	24,675	4,859	—	51,030
- Advances to customers	29,161	19,787	22,809	111,542	103,796	35,943	323,038
- Advances to banks and other financial institutions	—	—	—	4	—	—	4
	89,061	244,084	81,578	166,140	109,847	35,943	726,653
Liabilities							
- Deposits and balances of banks and other financial institutions	5,154	48,477	1,664	—	—	—	55,295
- Current, fixed, savings and other deposits of customers	205,835	367,024	32,473	1,096	—	—	606,428
- Certificates of deposit issued	—	—	5,000	—	—	—	5,000
	210,989	415,501	39,137	1,096	—	—	666,723

13. **Assets pledged as security**

	As at 30 June 2002	As at 31 December 2001
	HK$'m	HK$'m
Secured liabilities	3,426	1,813
Assets pledged as security		
- Securities pledged as collateral	3,606	1,883

Secured liabilities and assets pledged as security relate to short positions in Exchange Fund Bills and Notes ("EFBNs") which are collateralised by long positions in EFBNs.

14. Off-balance sheet exposures

(a) Contingent liabilities and commitments

The following is a summary of the contractual amounts of each significant class of contingent liability and commitment:

	As at 30 June 2002	As at 31 December 2001
	HK$'m	*HK$'m*
Direct credit substitutes	2,606	1,967
Transaction-related contingencies	2,551	2,273
Trade-related contingencies	17,870	16,391
Other commitments with an original maturity of:		
- under 1 year or which are unconditionally cancelable	76,318	84,497
- 1 year and over	56,432	43,879
Forward forward deposits placed	11,018	11,872
Others	—	88
	166,795	160,967

(b) Derivatives

The following is an analysis of the aggregate notional amounts of each significant type of derivative:

	As at 30 June 2002			As at 31 December 2001		
	HK$'m (Trading)	*HK$'m* (Hedging)	*HK$'m* (Total)	*HK$'m* (Trading)	*HK$'m* (Hedging)	*HK$'m* (Total)
Exchange rate contracts						
Spot	32,548	—	32,548	18,766	—	18,766
Forward and futures contracts	711	—	711	3,224	—	3,224
Swaps	159,547	6,284	165,831	124,585	4,688	129,273
Foreign exchange option contracts:						
- Currency options purchased	903	—	903	2,195	—	2,195
- Currency options written	28,034	—	28,034	19,850	—	19,850
	221,743	6,284	228,027	168,620	4,688	173,308
Interest rate contracts						
Interest rate swaps	228	15,959	16,187	60	10,088	10,148
Forward rate agreements	600	—	600	1,280	—	1,280
Forward forward deposits borrowed	3,036	—	3,036	11,872	—	11,872
	3,864	15,959	19,823	13,212	10,088	23,300
Bullion contracts	246	—	246	545	—	545
Equity contracts						
- Equity options purchased	119	—	119	—	—	—
- Equity options written	96	—	96	—	—	—
	215	—	215	—	—	—
	226,068	22,243	248,311	182,377	14,776	197,153

The replacement costs and credit risk weighted amounts of the above off-balance sheet exposures which do not take into account the effects of bilateral netting arrangements are as follows:

	Credit risk weighted amount		Replacement cost	
	As at 30 June 2002	As at 31 December 2001	**As at 30 June 2002**	As at 31 December 2001
	HK$'m	*HK$'m*	***HK$'m***	*HK$'m*
Contingent liabilities and commitments	**36,752**	29,490	**N.A.**	N.A.
Derivatives:				
- Exchange rate contracts	**637**	407	**832**	457
- Interest rate contracts	**74**	37	**159**	99
- Bullion contracts	**2**	5	**3**	6
- Equity contracts	**7**	—	**5**	—
	37,472	29,939	**999**	562

The contract or notional amounts of these instruments indicate the volume of transactions outstanding as at the balance sheet date; they do not represent the amounts at risk.

The credit risk weighted amounts are the amounts which have been calculated in accordance with the Third Schedule of the Banking Ordinance and guidelines issued by the Hong Kong Monetary Authority. The amounts calculated are dependent upon the status of the counterparty and the maturity characteristics of each type of contract.

Replacement cost is the cost of replacing all contracts which have a positive value when marked to market (should the counterparty default on its obligations) and is obtained by marking contracts to market. Replacement cost is a close approximation of the credit risk for these contracts at the balance sheet dates.

15. **Related party transactions**

Related parties are those parties which have the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence.

The Group entered into various transactions with related parties including the ultimate holding company, the associates of the Group and entities, directly or indirectly, controlled or significantly influenced by the ultimate holding company.

(a) **Sale of certain assets to related parties**

Sale of loans to Bank of China Grand Cayman Branch in 2002

Pursuant to a sale and purchase agreement entered into on 26 June 2002 between BOCHK and Bank of China ("BOC") acting through its Grand Cayman branch, BOCHK disposed of all of its beneficial interest in certain loans with a gross book value of HK$11,401 million net of specific provisions of HK$2,679 million for a consideration of HK$8,722 million.

The sale and purchase agreement provides that BOCHK sells and BOC acquires, on and from the transaction date, without recourse the beneficial interests of BOCHK in the loans together with certain related security.

Service and administration of loans sold to related parties

Pursuant to servicing agreements entered into in June 2002 between BOCHK, Nanyang Commercial Bank, Limited ("Nanyang"), BOC and Zhong Gang (Cayman) Company Limited, BOCHK and Nanyang undertake to service and administer the loans and the related securities transferred in both 1999 and 2002 at a fee which is agreed between the parties from time to time.

(b) **Loans to related parties**

In the ordinary course of business, the Group extends loans and credit facilities to fellow subsidiaries, associates of BOC and associates of the Group on normal commercial terms with reference to prevailing market rates. The revenue from such transactions would include interest income on the amount drawn as well as arrangement fees.

The gross value of loans outstanding is set out below:

	As at 30 June 2002	As at 31 December 2001
	HK$'m	*HK$'m*
Loans at normal commercial terms (gross value)	1,425	6,531

In 2002, certain loans granted to related parties with a gross book value HK$5,693 million net of specific provisions of HK$749 million were sold to BOC, acting through its Grand Cayman Branch, for a consideration of HK$4,944 million (Note 15(a)). The gross and net book value of these loans included in the balance sheet as at 31 December 2001 amounted to HK$5,418 million and HK$4,635 million, respectively. The related party loans remaining in the Group's books after this disposal relate to loans to fellow subsidiaries on normal commercial terms with reference to prevailing market rates.

As at 30 June 2002, a fellow subsidiary provided guarantees for loans amounting to HK$1,347 million (31 December 2001: HK$1,900 million) granted to certain third parties in which the fellow subsidiary has equity interests of less than 20%.

(c) **Summary of transactions entered into during the ordinary course of business with the related parties**

The aggregate income and expenses arising from the related party transactions with BOC, fellow subsidiaries, and associates are summarised as follows:

		Six months ended	
	Note	30 June 2002	30 June 2001
		HK$'m	*HK$'m*
Profit and loss items:			
Interest income	(i)	361	3,269
Interest expense	(ii)	(122)	(1,752)
Insurance commission received (net)	(iii)	11	26
Rental and license fees received	(iv)	11	13
Information technology service fee received	(iv)	2	3
Credit card commission paid (net)	(v)	(22)	(7)
Securities brokerage commission paid (net)	(v)	(54)	(78)
Rental fees paid	(v)	(29)	(30)
Property management and letting agency fees paid	(v)	(8)	(8)
Charge for bad and doubtful debts		15	(66)

	Note	As at 30 June 2002	As at 31 December 2001
		HK$'m	*HK$'m*
Balance sheet items:			
Cash and short-term funds	(i)	**12,380**	69,458
Placements with banks and other financial institutions	(i)	**11,933**	13,400
Advances	(i), (vi)	**1,425**	6,531
Other investments in securities	(i)	**234**	234
Other assets	(vii)	**80**	106
Deposits from and balances of banks and other financial institutions	(ii)	**7,409**	48,386
Current, fixed, savings and other deposits from customers	(ii)	**3,315**	3,958

Notes:

(i) Interest income

In the ordinary course of business, the Group enters into various transactions with BOC, fellow subsidiaries and associates including deposit of cash and short term funds, placement of interbank deposits, investments in its securities and provision of loans. The transactions were conducted in the normal course of business at prices and terms which are no more favourable than those charged to and contracted with other third party customers of the Group.

(ii) Interest expense

In the ordinary course of the business, the Group accepts interbank deposits and current, fixed, savings and other deposits from BOC, fellow subsidiaries and associates on normal commercial terms with reference to prevailing market rates.

(iii) Insurance commission received (net)

In the ordinary course of the business, the Group provides insurance agency services to and purchases general and life insurance policies from fellow subsidiaries on normal commercial terms with reference to prevailing market rates.

(iv) Service fee, rental and license fees received

In the ordinary course of the business, the Group provides information technology services to BOC, fellow subsidiaries and associates on normal commercial terms with reference to prevailing market rates.

The Group receives office premises rental and license fees from associates of BOC in its ordinary course of business on normal commercial terms entered into on an arm's length basis.

(v) Commission, property management, letting agency fee and rental expenses paid

In the ordinary course of the business, the Group pays commission fees for credit card administrative and promotional services, securities brokerage services, property management and letting agency fees to BOC and fellow subsidiaries on normal commercial terms with reference to prevailing market rates.

The Group pays rental fees to BOC and its associates in its ordinary course of business on normal commercial terms entered into on arm's length basis.

(vi) Advances to related parties

In the ordinary course of business, the Group extends loans and credit facilities to BOC, fellow subsidiaries, and associates on normal commercial terms with reference to prevailing market rates as described in Note 15(b) above. The revenue from such transactions would include interest income on the amount drawn as well as arrangement and commitment fees.

(vii) Other assets

Included within "Other assets" are receivables due from BOC and fellow subsidiaries. The receivables arose from transactions carried out in the normal course of business.

(d) **Off-balance sheets items**

Contingent liabilities and commitments

In the ordinary course of business, the Group provides guarantees for the obligations of fellow subsidiaries and associates and have commitment outstanding to BOC and fellow subsidiaries on normal commercial terms. Such guarantees and commitments as at 30 June 2002 amounted to HK$270 million and HK$4,172 million respectively (31 December 2001: HK$297 million and HK$358 million respectively). Fees are receivable for guarantees granted in favour of independent third parties and BOC.

Derivatives

In the ordinary course of business, the Group enters into foreign exchange contracts and interest rate contracts with BOC, fellow subsidiaries, and associates. Such derivative transactions amounted to HK$9,825 million as at 30 June 2002 (31 December 2001: HK$10,655 million). These transactions are executed on normal commercial terms with reference to prevailing market rates.

(e) **Balances with group companies and associates**

Included in the following balance sheet captions are balances with the ultimate holding company:

	As at 30 June 2002	As at 31 December 2001
	HK$'m	*HK$'m*
Cash and short-term funds	**12,328**	69,197
Placements with banks and other financial institutions	**11,836**	13,053
Advances	**17**	37
Other investments in securities	**234**	234
Other assets	**71**	106
Deposits from and balances of banks and other financial institutions	**6,940**	48,004

Included in the following balance sheet captions are balances with fellow subsidiaries of the ultimate holding company:

	As at 30 June 2002	As at 31 December 2001
	HK$'m	*HK$'m*
Cash and short-term funds	52	191
Placements with banks and other financial institutions	97	347
Advances	1,040	5,717
Other assets	9	—
Deposits from and balances of banks and other financial institutions	460	379
Current, fixed, savings and other deposits from customers	3,237	3,936

There are no material balances with associates as at 30 June 2002.

(f) **Key management personnel**

During the first six months ended 30 June 2002 and 2001, no material transaction was conducted with key management personnel of BOCHK and its holding companies and parties related to them.

16. **Post-listing Share Option Scheme and Sharesave Plan**

The principal terms of Share Option Scheme and the Sharesave Plan were conditionally approved and adopted by written resolutions of all the shareholders of the Company passed on 10 July 2002. The purpose of the Share Option Scheme is to provide Participants with the opportunity to acquire proprietary interests in the Company. The Board may, in its absolute discretion, offer to grant options to any person the Board may select. The subscription price for Shares shall be determined on the date of grant at the discretion of the Board as an amount per Share calculated on the basis of established rules. An option may be exercised in whole or in part at any time or times after the date prescribed by the Board in its absolute discretion and from time to time as is specified in the offer and on or before the termination date prescribed by the Board.

The purpose of the Sharesave Plan is to encourage broad-based employee ownership of the Shares. The amount of the monthly contribution under the Savings Contract to be made in connection with an option shall be the amount which the relevant Eligible Employee is willing to contribute, which amount shall not be less than 1% and not more than 10% of the Eligible Employee's monthly salary as at the date of application or such other maximum or minimum amounts as permitted by the Board. When exercised in an Exercise Period, an option shall be exercised in whole or in part.

As the date of this interim report, none of our employees has participated in the two schemes mentioned above. Details of the Share Option Schemes and Sharesave Plan as at 30 June 2002 are set out in Appendix VI of the Company's prospectus dated 15 July 2002.

17. **Litigation**

Details of the following litigation are stated in the Company's prospectus dated 15 July 2002.

On 17 June 2002, a trial commenced in the federal court in New York relating to BOC's claim against members of the Chou Group and the third-party claims by certain of members of the Chou Group against BOCHK and other branches and affiliates of BOC.

On 11 July 2002, the jury found that BOCHK was not negligent in its banking transactions with members of the Chou Group. In addition, at the end of trial, the Judge dismissed the third-party claims against BOCHK for violation of the Racketeer Influenced and Corrupt Organizations ("RICO") Act and for promissory estoppel. As a result, all the claims asserted against by the Chou Group have been disposed of, subject to any appeal by the Chou Group.

18. **Capital adequacy**

	As at 30 June 2002	As at 31 December 2001
Capital adequacy ratio	14.68%	14.38%
Adjusted capital adequacy ratio	15.02%	14.57%

The capital adequacy ratio represents the consolidated ratio of BOCHK as at 30 June 2002 and 31 December 2001 computed in accordance with the Third Schedule of the Banking Ordinance.

The adjusted capital adequacy ratio represents the consolidated ratio of the BOCHK as at 30 June 2002 and 31 December 2001 computed in accordance with the guideline "Maintenance of Adequate Capital Against Market Risks" issued by the Hong Kong Monetary Authority. The adjusted ratio takes into account both credit and market risk as at 30 June 2002 and 31 December 2001.

19. **Components of capital base after deductions**

The consolidated capital base of BOCHK after deductions used in the calculation of the above capital adequacy ratios as at 30 June 2002 and 31 December 2001 and reported to the Hong Kong Monetary Authority is analysed as follows:

	As at 30 June 2002	As at 31 December 2001
	HK$'m	*HK$'m*
Core capital:		
Paid up ordinary share capital	43,043	43,043
Reserves	8,631	9,481
Profit and loss account	1,610	(850)
Minority interests	850	910
	54,134	52,584
Supplementary capital:		
General provisions for doubtful debts	4,990	4,943
Gross value of supplementary capital	4,990	4,943
Eligible value of supplementary capital	4,990	4,943
Total capital base before deductions	59,124	57,527
Deductions:		
Shareholdings in subsidiaries or holding company	(360)	(375)
Exposures to connected companies	(230)	(347)
Equity investments of 20% or more in non-subsidiary companies	(221)	(256)
Investments in the capital of other banks or other financial institutions	(1)	(1)
	(812)	(979)
Total capital base after deductions	58,312	56,548

20. **Liquidity ratio**

	30 June 2002	31 December 2001
Average liquidity ratio - BOCHK	41.26%	39.88%

The average liquidity ratio for the period ended 30 June 2002 is calculated as the simple average of each calendar month's average liquidity ratio of BOCHK for the period.

The average liquidity ratio for 2001 is calculated as the simple average of each calendar month's average liquidity ratio of BOCHK for the 3 months from 1 October 2001 (the date of the restructuring and merger) to 31 December 2001.

The liquidity ratio is computed on the solo basis (the Hong Kong offices only) and is in accordance with the Fourth Schedule of the Banking Ordinance.

Prior to the Restructuring and Merger, the liquidity ratio of each of the predecessor entities was managed on an individual basis.

21. **Currency concentrations**

The following is a summary of the major foreign currency exposures arising from trading, non-trading and structural positions. The net option position is calculated based on the "worst-case" approach set out in the prudential return "Foreign Currency Position" issued by the HKMA.

	As at 30 June 2002						
	Equivalent in millions of HK$						
	US Dollars	Pound Sterling	New Zealand Dollars	Australian Dollars	Japanese Yen	Others	Total
Spot assets	181,434	11,806	8,418	25,671	13,465	22,076	262,870
Spot liabilities	(134,844)	(17,922)	(15,035)	(26,722)	(2,953)	(19,567)	(217,043)
Forward purchases	109,340	11,365	8,528	8,142	17,557	18,990	173,922
Forward sales	(145,155)	(5,229)	(1,924)	(7,111)	(28,095)	(21,375)	(208,889)
Net options position	446	7	143	146	—	39	781
Net long/(short) position	11,221	27	130	126	(26)	163	11,641

	As at 31 December 2001						
	Equivalent in millions of HK$						
	US Dollars	Pound Sterling	New Zealand Dollars	Australian Dollars	Japanese Yen	Others	Total
Spot assets	197,497	15,996	14,167	28,316	3,428	22,113	281,517
Spot liabilities	(134,348)	(17,971)	(14,550)	(27,380)	(2,081)	(18,859)	(215,189)
Forward purchases	70,500	5,230	1,211	1,623	10,834	12,726	102,124
Forward sales	(124,606)	(3,233)	(794)	(2,538)	(12,190)	(15,807)	(159,168)
Net options position	4,277	14	43	135	(7)	22	4,484
Net long/(short) position	13,320	36	77	156	(16)	195	13,768

There were no significant net structural positions for the Group as at 30 June 2002 and 31 December 2001.

Risk Management

BOCHK's goal in risk management is to maximise its long-term risk-adjusted return on capital as well as shareholders' wealth while maintaining its risk exposure within acceptable parameters. Our risk management philosophy seeks to achieve our goal by:

- establishing a more independent, centralised and comprehensive risk management system, which stresses on standardising corporate governance structure, maximising shareholders' value and balancing the risk and return level;
- emphasising the importance of risk control responsibility and accountability;
- adopting international risk management principles and best practices;
- improving our management information systems, risk measurement techniques and risk monitoring controls; and
- modernising our risk management culture on a continuous basis.

BOCHK has developed and implemented comprehensive risk management policies and procedures to identify, measure, monitor and control credit risk, market risk, liquidity risk and operational risk across the organisation. The Risk Management Committee under the Board of Directors has the responsibility of approving risk management policies and procedures.

Our Chief Risk Officer oversees and monitors the operations of the risk management department ("RMD") and reports directly to the Risk Management Committee. The Chief Risk Officer is also responsible for assisting the Chief Executive on bank-wide credit risk, market risk and operational risk management and submitting to the Risk Management Committee the independent risk management report each month. In addition, our Chief Financial Officer, with assistance of the Treasurer, monitors the bank-wide interest rate risk and liquidity risk and submits reports to the Asset and Liability Management Committee ("ALCO") on a regular basis.

BOCHK's principal banking subsidiaries, Nanyang and Chiyu Banking Corporation Limited ("Chiyu"), also face the same types of inherent business risks and they generally follow our risk management strategies and policies. In addition, Nanyang and Chiyu have generally implemented risk management controls and procedures that are in compliance with the risk management controls and procedures of BOCHK. Within this general risk management framework, Nanyang and Chiyu may conduct their existing risk management practices according to their own specific circumstances.

Credit risk management

Credit risk is the risk that a customer or counterparty will be unable or unwilling to meet a commitment that it has entered into with BOCHK. Credit risk arises principally from BOCHK's lending, trade finance and treasury operations.

BOCHK considers that independence and proper checks-and-balances are of critical importance in carrying out effective risk management. To this purpose, BOCHK's managerial/organisational structure placed our RMD and Audit Department in a hierarchical position in which they report directly to the Risk Management Committee and Audit Committee respectively. These committees and departments form an independent line of control.

To avoid any potential conflicts of interest, the credit review functions are independent of the business development units. BOCHK's credit assessment emphasises a thorough understanding of the purpose and structure of the loan, the borrower's financial status, cash flow position and repayment ability as well as business management.

BOCHK exercises credit risk monitoring in a prudent manner with the involvement of multiple levels within our organisation. This process enables BOCHK to promptly detect any early signs of loan deterioration and identifies potential loan classification downgrades so that the appropriate actions can be taken to manage the loans. To improve the credit quality and control the non-performing loan ratio, BOCHK establishes a clear target to evaluate the performance of the credit initiation units and the Special Asset Management Department.

Market risk management

Market risk is the risk that the movements in interest rates or market prices will result in losses in on- and off-balance sheet positions. BOCHK's market risk arises from customer-related business and from position taking. Market risk trading positions are subject to daily mark-to market valuation.

Market risk is managed within risk limits approved by the Risk Management Committee. The overall risk limits are set into sub-limits by reference to different risk factors, which are interest rate, foreign exchange, commodity and equity prices. Considering the different nature of the products involved, limits are set by using a combination of risk measurement techniques, including position limits and sensitivity limits.

The Market Risk Division in the RMD is responsible for the daily market risk management. Through the daily risk monitoring process, the Market Risk Division measures risk exposures against approved limits and initiates specific action to ensure that the overall and individual market risks are managed within an acceptable level.

Value at Risk ("VaR") is a statistical technique which estimates the potential losses that could occur on risk positions taken due to movements in foreign exchange, interest rates, commodity and equity prices over a specified time horizon and to a given level of confidence. The model used by BOCHK to calculate portfolio and individual VaR on a variance/covariance basis, uses historical movements in market rates and prices, a 99% confidence level and a 1-day holding period and generally takes account of correlations between different markets and rates.

The VaR for all trading market risk exposure of BOCHK at 30 June 2002 was HK$6.5 million (HK$1.6 million at 31 December 2001), the VaR for all trading interest rate risk exposure was HK$7.8 million (HK$1.5 million at 31 December 2001) and the VaR for all trading foreign exchange risk exposure was HK$0.9 million (HK$1.2 million at 31 December 2001). The average VaR for the period ended 30 June 2002 was HK$2.5 million.

Prior to the restructuring and merger, market risk of each of the predecessor entities was managed on an individual basis. As a result, the average VaR from market risk-related trading activities of BOCHK for the period ended 30 June 2001 is not comparable and hence not presented.

Foreign exchange risk management

BOCHK provides foreign exchange deposit, margin trading and forward transaction services to its customers. BOCHK's trading activities in the foreign currency markets expose it to exchange rate risk. BOCHK manages exchange rate risks through its interbank market activities. In particular, BOCHK mitigates exchange rate risks by establishing position limits and limits on the loss of the whole foreign exchange trading floor. All these limits are approved by the Risk Management Committee. The RMD is responsible for monitoring foreign exchange exposure and related stop-loss limits on a day-to-day basis as well as controlling BOCHK's credit risk exposure arising from foreign exchange transactions.

Interest rate risk management

BOCHK's balance sheet consists predominantly of Hong Kong dollar denominated interest rate sensitive assets and liabilities. BOCHK's primary sources of interest rate risk are mismatches in the maturities or re-pricing periods of these assets and liabilities and movements in interest rates. In addition, different pricing bases for different transactions may also lead to interest rate risk for BOCHK's assets and liabilities within the same re-pricing period.

BOCHK's Treasurer is responsible for formulating the policy and developing risk management system to assist BOCHK's ALCO in identifying, measuring, monitoring and controlling interest rate risk. The Treasurer uses gap analysis to measure BOCHK's exposure to interest rate risk. The gap is the difference between the amount of interest-earning assets and interest-bearing liabilities that mature or must be re-priced within a specific time band. It provides BOCHK with a static view of the maturity and re-pricing characteristics of its balance sheet positions. The Treasurer measures the gaps by classifying all assets, liabilities and off-balance sheet items for each currency into appropriate time bands according to contracted maturities or anticipated re-pricing time bands to indicate the extent to which BOCHK is exposed to the risk of potential changes in the margins on new or re-priced assets and liabilities. The potential risks associated with these gaps are measured through simulated interest rate scenarios to testify that the interest income variations are within the manageable range and the results are reflected on daily reports.

Liquidity risk management

Liquidity risk arises in the funding of lending, trading and investment activities and in the management of trading positions. Liquidity risk includes both the risk of unexpected increase in the cost of funding to refinance the BOCHK's asset portfolio at appropriate maturities and the risk of being unable to liquidate a position in a timely manner and/or at a reasonable price. The goal of liquidity management is for BOCHK to be able, even under adverse market conditions, to meet all its maturing repayment obligations on time and fund all of its investment opportunities.

BOCHK maintains flexibility in meeting its funding requirements by maintaining diverse sources of liquidity. BOCHK funds its operations principally by accepting deposits from retail and corporate depositors. BOCHK may also borrow in the short-term interbank markets, although it is typically a net lender of funds. In addition, BOCHK may from time to time raise funds through the sale of investments.

BOCHK uses the majority of funds raised to extend loans, make investments in debt securities or conduct interbank placements. Generally, deposits are of shorter average maturity than that of loans or investments and are of longer average maturity compared with interbank placements.

BOCHK maintains a buffer portfolio of liquid, high quality securities that is managed by BOCHK's Treasurer. These securities may generally be sold at any time at market prices to meet BOCHK's emergent liquidity needs. BOCHK may also manage its liquidity by borrowing in the interbank markets on a short-term basis. The interbank markets generally provide an adequate amount of liquidity, at borrowing rates that are subject to market conditions.

The primary goal of the BOCHK's asset and liability management strategy is to achieve an optimal return while ensuring adequate levels of liquidity and capital within an effective risk control framework and at reasonable cost of funding. BOCHK's ALCO is responsible for establishing these policy directives and works closely with the Treasurer to ensure that BOCHK maintains adequate levels of liquidity and secures the lowest possible cost of funding, while closely planning and monitoring BOCHK's on- and off-balance sheet assets and liabilities according to the risk incurred. The Treasurer adjusts, as necessary, BOCHK's liquidity and foreign exchange positions in line with the policies of ALCO, and also provides reporting and analytical services to ALCO with respect to current and planned positions taken for investment, funding and foreign exchange management purposes. In particular, BOCHK has implemented various measures to:

- improve its management information system to provide timely information on the movement of its liquid assets and that of its customer deposits on a daily, weekly and monthly basis;
- monitor liquidity ratios in compliance with the HKMA's requirements;
- prepare regular maturity gap analyses to enable management to review and monitor BOCHK's liquidity position on a timely basis;
- conduct scenario analysis to estimate the impact of various risk factors on the liquidity position;
- establish a range of liquidity risk factors to be monitored and a liquidity risk warning index system to detect early signs of any irregularities; and
- create a three-tier response system to effectively deal with any emergencies.

Capital management

The Group monitors the adequacy of its capital using the Capital Adequacy Ratio ("CAR") as one of the major measurements, which is subject to the Hong Kong Monetary Authority regulatory requirements. The Group maintained its capital to comply with all the statutory standards for all the periods presented in the report. On consolidated basis, BOCHK's unadjusted CAR and adjusted CAR incorporating market risk were improved from 14.38% and 14.57% as at the end of last year to 14.68% and 15.02% respectively. Both were well above the statutory minimum standards.

Operational risk management

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It is one of the major risks to which BOCHK is exposed and is inherent to various businesses and back office processing.

BOCHK manages operational risk mainly through its internal controls to ensure all operations are conducted effectively. At the same time, BOCHK is enhancing its business continuity plan to ensure that the operation of critical functions can recover within a short time frame and minimise the impact to customers in the event of a disaster.

To be in line with international best practices, BOCHK will further enhance the methodologies in identifying, measuring, monitoring and controlling operational risk.

Financial Overview

Financial Performance

Our consolidated financial results must be viewed in light of the Restructuring and Merger as described in our Prospectus dated 15 July 2002. The results of BOCHK, our principal operating subsidiary, for the first half of 2001 were the combined results of the merging entities before the reorganisation. As these entities were previously operating autonomously with different risk and financial control systems, these results may not be representative of the consolidated results of the Group. After the merger, we have adopted common provisioning standard and alignment of classification to all accounts of the merging entities. **When drawing comparisons of the financial results of the Group for the first half of 2002 with those of the corresponding period last year, we would like to draw your attention to the above mentioned differences.**

In the first six months of 2002, we strived to develop our business as planned against the backdrop of a difficult and challenging operating environment, and achieved a consolidated profit attributable to shareholders of HK$3,418 million. This results represented 54.4% of our profit forecast for the year 2002.

In the first half of 2002, the Group launched a range of new products and services and improved profitability through optimising our asset-liability mix and adjusting our pricing. We reduced our non-performing loan ratio through a combination of disposal of loans (including non-performing loans) to Bank of China Grand Cayman Branch, write-off of bad and doubtful debts, aggressive collection efforts, and the implementation of a comprehensive credit risk management system, etc. In addition, we continued to place emphasis on the rationalisation of our branch network and improvement in efficiency, which have significantly reduced our staff costs.

Our Group's net profit attributable to shareholders in the first half of 2002 represented a decrease of 18.5% as compared with the first half of 2001. Operating profit before provisions decreased by 15.7% to HK$6,002 million in the first half of 2002.

After taking the effect of the share consolidation into account, earnings per share as adjusted for the six months ended 30 June 2002 was HK$0.323. Return on average total assets and return on average shareholders' funds on an annualised basis were 0.93% and 12.92%, respectively.

Net interest income

Net interest income was HK$6,891 million for the first half of 2002, a decrease of HK$843 million or 10.9% from the corresponding period in 2001. Net interest spread rose by 25 basis points to 1.85%, while net interest margin rose marginally by 1 basis point to 1.98%. Increased holdings of higher yielding securities helped improve net interest margin by 14 basis points. This was offset by a 23 basis points reduction in contribution from cost free fund as a result of the drastic fall in market interest rates, coupled with an 11 basis points reduction in contribution from mortgages as a result of reduction in mortgage yield.

Other operating income

Other operating income totalled HK$2,010 million in the first half of 2002, a fall of HK$246 million or 10.9% from the first half of 2001. Fees and commission income declined by 7.6% to HK$1,705 million. In the first half of 2002, we explored business opportunities and accomplished significant growth in return from sale of funds, etc. However, the increased contribution from our investment product services was offset by a drop in fees and commission income generated from bills, stock brokerage and loan origination due to poor market conditions and more intense competitions. Fees and commission expenses fell by 7.5% to HK$357 million. As a result, net fees and commission income declined by 7.7% as compared with the same period in 2001.

Operating expenses

Operating expenses in the first half of 2002 amounted to HK$2,899 million, representing an increase of HK$31 million or 1.1% as compared with the same period in 2001. The increase in operating expenses was primarily due to the increase in depreciation expenses arising from the revaluation of our premises.

The depreciation expenses rose by HK$146 million or 68.5% to HK$359 million in the first half of 2002. If we excluded the depreciation expenses related to our own fixed assets, the operating expenses would have recorded a decrease of HK$115 million or 4.3% as compared with the corresponding period in 2001. This decline was largely due to cost synergies from the merger and ongoing restructuring.

Other operating expenses also increased by HK$45 million or 12% to HK$419 million, mainly attributable to the rise in advertising expenses.

The increase in depreciation and other operating expenses was partially offset by the decline in staff costs and premises and equipment expenses (excluding depreciation). Staff costs (including directors' emoluments) declined by HK$144 million or 7.6% to HK$1,761 million, due to a reduction in number of staff as part of our rationalisation initiatives. The number of staff was 13,191 as at 30 June 2002, representing a decrease of 8.3% as compared with the end of first half of 2001. Premises and equipment expenses (excluding depreciation) fell by HK$16 million or 4.3% to HK$360 million.

As a result of a decrease in operating income and a modest increase in operating expenses, the cost to income ratio rose from 28.7% for the first half of 2001 to 32.6% for the same period of 2002.

Asset Quality

Net charge for bad and doubtful debts

In the first half of 2002, the net charge for bad and doubtful debts (net of recoveries of advances and releases of specific provisions) decreased by HK$82 million or 4.4% to HK$1,766 million, as compared with that over the same period in 2001. Total recoveries of advances previously written off were HK$350 million for the first half of 2002, 52.8% more than those in the same period in 2001. This improvement stemmed from our focus on loan recoveries and setting up of our Special Assets Management Department.

Non-performing loans

As at 30 June 2002, non-performing loans decreased by HK$7,014 million or 19.8% to HK$28,498 million, as compared with 31 December 2001. The decline was a result of the disposal of loans with total gross book value of HK$11,401 million (of which HK$7,029 million are non-performing loans) to Bank of China Grand Cayman Branch in June 2002. The write-off of the bad and doubtful debts amounting to HK$1,013 million also helped lower our non-performing loans. As a result, the percentage of non-performing loans to total gross advances to customers reduced from 10.99% as at 31 December 2001 to 8.97% as at 30 June 2002.

Our Group has employed a prudent and conservative policy in making provision for bad and doubtful debts, complying with the guidelines set by the Hong Kong Monetary Authority.

Specific provisions coverage ratio for non-performing loans and loan loss provision ratio improved from 29.8% and 48.2% as at 31 December 2001 to 31.6% and 54.5% respectively as at 30 June 2002. The ratio of total provisions for bad and doubtful debts to gross advances to customers fell to 4.9%, as compared with 5.3% at the end of last year.

Financial Position

Assets

As at 30 June 2002, total assets decreased by HK$28,362 million or 3.7% as compared with 31 December 2001. After the merger, operating as a locally incorporated independent entity, BOCHK has its own liquidity management policies and mechanism. Consequently, it withdrew the inter-bank placement of HK$54,635 million with Bank of China, resulting in a drop in total assets. During the first half of 2002, the Hong Kong market continued to experience sluggish loan demand. Our gross advances to customers decreased by HK$5,404 million or 1.7% as compared with 31 December 2001. This fall was primarily due to our loan disposal in June 2002. However, excluding the loan disposal in June 2002, the Group's advances to customers would have recorded a rise of 1.9%.

In terms of geographical dispersion of our loan portfolio, Hong Kong related loans accounted for the majority, down by HK$5,061 million or 1.6%. Loans in connection with Mainland China fell by HK$1,405 million or 18.1% and loans to other geographical areas grew by HK$1,062 million or 24.5%. We will continue to develop our Mainland China business solidly.

The Group has further optimised the asset structure by revising its investment strategies to enhance yield on assets. The Group increased its exposure to debt securities relative to inter-bank placements. Certificates of deposit held, held-to-maturity securities, investment securities and other investments in securities as at 30 June 2002 amounted to HK$168,836 million, representing 22.9% of total assets, and the total balance increased by HK$42,161 million from HK$126,675 million as at 31 December 2001, an increase of 33.3%.

Liabilities

As at 30 June 2002, total liabilities decreased by HK$29,864 million or 4.2% as compared with 31 December 2001. This decline was attributable to the withdrawal of inter-bank funds of approximately HK$41,000 million by Bank of China.

Despite the fall in customer deposits in Hong Kong during the first half of 2002, the Group was able to maintain a stable customer deposit base. Deposit balance increased by HK$5,042 million or 0.8% from 31 December 2001. In an effort to manage the cost of funding, the Group sought to optimise the deposit structure and revised the deposit pricing strategy to be in line with our peers during the first half of 2002. The tightening of the interest rate gap between fixed deposits and savings deposits persisted in the first half of 2002, resulting in fixed deposits funds shifting to more liquid savings deposits. This lowered our overall cost of funding.

Lackluster loan demand in Hong Kong together with the loan disposal resulted in a decrease of the loans to deposits ratio from 53.3% as at 31 December 2001 to 52% as at 30 June 2002.

As at 30 June 2002, the Group had no significant mismatches between assets and liabilities in all foreign currencies and hence the exposure to currency risks was limited.

Liquidity and capital strength

The Group maintained ample liquidity with the average liquidity ratio of 41.3% for the first half of 2002, as compared with 39.9% for the 3 months from 1 October 2001 (the date of the Restructuring and Merger) to 31 December 2001. We remained well capitalised with a capital adequacy ratio of 14.7% as at 30 June 2002, as compared with 14.4% as at 31 December 2001.

Operations Review

In the first half of 2002, we continued to leverage our strengths and capitalise on the opportunities arising from the Restructuring and Merger. We successfully introduced a broad range of new products and services, further rationalised our branch network, and made good progress in our business.

Retail Banking

To improve distribution efficiency, we continued to reengineer our distribution channels. In the first half of 2002, we combined 8 branches with their neighboring branches, established a new branch, and reduced our branch numbers to 358. We began our "Model branches" pilot program for different types of branches, including Full Service Branch, Investment Centers, Personal Financial Service Centers, Automated Banking Centers and VIP Centers. We are now working on site selection and layout design. We will complete the pilot program and commence its operation by the end of this year or early next year.

We have continued to provide diversified mortgage products and services. In the first half of 2002, our residential mortgages in Hong Kong, excluding those under the Home Ownership

Scheme, rose by 3.9%. We also launched a number of personal loan products, such as "Standby Overdraft" and "Decoration Loan", which will further facilitate the cash management capability of our customers. We have also offered a "Fund Pledge" service to our investment customers to allow greater flexibility in their investment planning.

To better serve our customers, we have introduced a broader range of wealth management products and services, including "Guaranteed Fund", "Retail Bonds", "Equity Linked Deposit" (a product combining the features of term deposit and stock option), "Monthly Stocks Savings Plan", etc. In addition, we have begun to introduce the Customer Relationship Management ("CRM") System. We are currently expanding our financial consulting team to meet future needs.

During the first half of 2002, sale of retail bonds amounted to HK$2,487 million. In addition, the sale of 8 guaranteed funds amounted to HK$3,081 million. Among those, "BOCHK BOCI-Prudential AUD Australia Growth Guaranteed Fund" was the first non-US dollar denominated guaranteed fund in Hong Kong and was warmly received by the market. Another product - the "Currency Option Deposit" doubled in transaction volume when compared with that in the first half of last year.

The credit card business continues to be one of our core businesses. For the first half of 2002, the number of cards, credit card receivables and cardholder spending experienced double-digit growth compared to the same period last year. We successfully launched the "Y-not" credit card to target our female customers, which increased our customer base by about 25,000 cards. The Great Wall International Card is another focus product of our credit card business. We achieved over 110% growth in the number of Great Wall International Card issued as compared with that in the same period of last year. We were the first in the market to provide RMB credit cards to our customers. Our merchant acquiring business remains healthy with a 2% growth in Hong Kong and 17% rapid growth in China. We continue to maintain our leading position in Mainland China.

In light of the persistent sluggish economic environment, and rising personal bankruptcies in Hong Kong, our annualised credit card charge-off ratio increased to 7.45% in the first half of 2002. To safeguard our asset quality, we have reviewed and tightened our credit policies.

Corporate Banking

We have a strong position in the local corporate and commercial lending markets. In addition to continuously building close bilateral banking relationships with our corporate customers, we are actively leveraging our restructuring and merger and our extensive corporate customer network to develop our syndicated loan business more effectively. By shifting our focus to an arranger role rather than a participant role in syndicated loan transactions, we intend to increase our non-interest income and enhance our position in the syndicated loan market.

For our small and medium-sized enterprise ("SME") customers, we have introduced unsecured financing schemes. We have also joined and launched the SME installations and Equipment Loan Guarantee Scheme introduced by the HKSAR Government to help enhance productivity and competitiveness of our SME customers.

We have established a very cooperative relationship with our parent, Bank of China, in a variety of areas, including corporate lending, financial institution services, settlement, treasury, trade finance and custodian services, etc. Some of these areas have already shown good progress.

Financial Institution Services

In addition to the unilateral clearing for HK dollar cheque for Shenzhen, we have been mandated as the HK dollar cheque bilateral clearing agency for both Guangzhou and Shenzhen in Mainland China after the signing of business and service agreements with the local authorities.

We have actively taken part in developing the Shenzhen-Hong Kong Real Time Gross Settlement ("RTGS") System in order to provide real time, safe and low cost electronic means of fund transfer between Shenzhen and Hong Kong.

Treasury

We have developed a customer-driven treasury platform and set up dedicated treasury teams to provide marketing and sales support and expertise to our key customers for sophisticated treasury products. Benefiting from our large customer base, extensive distribution channels and synergies created by the restructuring, we have successfully enhanced the cross selling of our treasury products and services. By the end of June 2002, the number of our treasury customers doubled when compared with the end of last year. By expanding Mainland China related products and services, our deposits from small to medium sized Mainland China financial institutions increased 6% in the first half of 2002.

China Related Business and Mainland Branches

The Group has a total of fourteen Mainland branches. Twelve of these branches are eligible for conducting full foreign currency services to all kinds of customers including local individuals and locally funded enterprises in China. Three of our Mainland branches are eligible to conduct RMB business on a limited scope. Another five branches have applied for the license to provide RMB business to foreign individuals and foreign funded enterprises.

As a result of the China's entry into the World Trade Organisation, we are cooperating closely with Mainland China to fully exploit the potential of future business opportunities. We have recently joined hands with Bank of China Shenzhen Branch to provide Automated Fund Transfer ("AFT"), a service for Hong Kong residents who have purchased properties in Mainland China. A variety of mortgage repayment plans with currency options were introduced to increase payment flexibility for our customers.

Back-office Operations

We have further standardised our back-office operations. Through improving our workflow and upgrading our system functions, we have enhanced our operational efficiency, manpower and thus achieved cost savings. Also by centralising the loans documentary management, we have saved storage space and hence reduced our operating costs. During the first half of the year, we completed the feasibility study and finalised the blueprint of the Global Payment

System Project and Information Processing Centralisation Project. For the Credit Workflow System Project, the first phase of system development has kicked off and it will be scheduled to launch in the fourth quarter this year. We expect most of our loan processes will be automated upon completion.

Information Technology

We have begun to transform our information technology organisation and significantly upgrade our current information infrastructure to allow us to better support our current business operations as well as our business strategies. During the first half of 2002, a number of key projects made solid progress.

Human Resources

In alignment with the initial public offering, we have designed the Stock Option Scheme and Sharesave Plan in the first half of this year, and are actively seeking to reform the existing compensation and incentive mechanism. At the same time, we have initiated work on enhancing our employee profile within our organisational structure. To improve the quality of employees, we have expanded the training efforts for senior to middle management and front-line staff. Coupled with this is our recruitment activity, which targets experienced professionals in the market to cater for business development needs.

In the first half of 2002, the number of employees of the Group reduced by 237 to 13,191.

Prospects

The outlook for Hong Kong's economy enters into a phase of uncertainty following the tumble of the world equity markets in July 2002. The interest rate hike in the U.S. and Hong Kong anticipated earlier this year might not come about. Instead, speculation is building up for a lowering of interest rates, which would put further pressure on the interest rate margin and return from cost free funds. Against this background, the banking environment in the second half of 2002 will remain difficult.

Despite the difficult operating environment, we will continue to build on our core strengths and exploit new opportunities arising from our restructuring and the initial public offering so as to enhance shareholders' value.

Working with Bank of China, Bank of China Group affiliates and leading third parties, we plan to develop and distribute a broader portfolio of products and services to increase our penetration rate and cross-selling ratio. We will focus on higher ROE and innovative business, particularly in the areas of wealth management.

We will continue to improve our asset quality by adopting more effective credit control and risk management systems.

We will continue to capture significant efficiency and synergy gains by upgrading information technology systems and streamlining our branch network and back offices.

We will continue to improve our overall balance sheet management so as to optimise our asset liability mix, capital sourcing and yield.

By leveraging our customer base in Hong Kong and our existing 14 Mainland branches, we will fully exploit the business opportunities resulting from the further opening of the financial and banking markets in Mainland China. With extensive branch network in Mainland China, Bank of China's franchise will give BOCHK a unique international gateway into China.

We are committed to providing efficient and quality financial services to our customers. With the continued support of our shareholders, customers and staff, we are confident that we can achieve better results in the years to come.

Substantial shareholders

As the shares of the Company was listed and commenced trading on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 25 July 2002, the Company was not required to maintain a register of substantial shareholders under Section 16(1) of the Securities (Disclosure of Interests) Ordinance (the "SDI Ordinance") prior to 25 July 2002. For information purposes, the following shareholders had an interest of 10% or more in the share capital of the Company as at 30 June 2002 and 25 July 2002 respectively:

Name of Shareholder	No. of shares beneficially held as at 30 June 2002 (Note a)	No. of shares beneficially held as at 25 July 2002
Bank of China ("BOC")	45,966,026,020 (86.95%)	8,292,345,266 (78.44%) (Note b)
BOC Hong Kong (Group) Limited ("BOCHKG")	45,966,026,020 (86.95%)	6,894,770,204 (65.22%)
BOC Hong Kong (BVI) Limited ("BOC (BVI)") (Note c)	45,966,026,020 (86.95%)	6,894,770,204 (65.22%)
Hua Chiao Commercial Limited ("Hua Chiao") (Note d)	6,897,875,310 (13.05%)	1,379,575,062 (13.05%)

Notes:

a. Prior to 10 July 2002, the issued share capital of the Company was HK$52,863,901,330 divided into 52,863,901,330 shares of HK$1.00 each. By an ordinary resolution passed by the shareholders on 10 July 2002, the issued share capital of the Company was consolidated and divided into 10,572,780,266 shares of HK$5.00 each.

b. The number of shares shown includes 9,000,000 shares in the Company beneficially held by each of Bank of China Group Insurance Company Limited and BOC Group Life Assurance Company Limited, both of which are wholly owned subsidiaries of BOC.

c. BOC (BVI) is a wholly owned subsidiary of BOCHKG, which in turn is a wholly owned subsidiary of BOC. Accordingly, BOCHKG and BOC are deemed to have the same interests in the shares of the Company as BOC (BVI) for the purpose of the SDI Ordinance.

d. BOC beneficially owns 93.64% of Hua Chiao. Accordingly, BOC is deemed to have the same interests in the shares of the Company as Hua Chiao for the purpose of the SDI Ordinance.

Directors and Chief Executive's interests in the Company's shares

As at 30 June 2002, none of the Directors, the Chief Executive or their respective associates has any interests in shares of the Company or any of its associated corporations within the meaning of the SDI Ordinance, which, if the Company were listed on 30 June 2002, would have been required to be recorded in the register required to be kept under Section 29 of the SDI Ordinance or as otherwise would have been required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

Directors and Chief Executive's rights to subscribe for the Company's shares

As at 30 June 2002, none of the Directors, the Chief Executive or their respective associates has any right to subscribe for shares of the Company. On 5 July 2002, the following Directors together with approximately 60 senior management personnel of the Group were granted options by BOC (BVI) to purchase an aggregate of 31,132,600 existing issued shares of the Company at a price of HK$8.50 per share.

Name of Director	No. of underlying shares in respect of which options were granted
LIU Mingkang	1,735,200
SUN Changji	1,590,600
LIU Jinbao	1,735,200
PING Yue	1,446,000
HUA Qingshan	1,446,000
LI Zaohang	1,446,000
HE Guangbei	1,446,000
ZHOU Zaiqun	1,446,000
ZHANG Yanling	1,446,000
Total:	13,737,000

None of these options may be exercised within one year from 25 July 2002. These options have a vesting period of four years from 25 July 2002 with a valid exercise period of ten years. 25% of the number of shares subject to such options will vest at the end of each year.

Purchase, sale or redemption of the Company's shares

During the period under review, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's shares.

Audit Committee

At the request of the Audit Committee of the Company, the Group's external auditors have carried out a review of the unaudited financial statements in accordance with the Statement of Auditing Standards ("SAS") 700 issued by the Hong Kong Society of Accountants. The Audit Committee has reviewed with management the accounting principles and practices adopted by the Group and discussed auditing, internal control and financial reporting matters including the review of the unaudited interim financial statements.

Compliance with the Code of Best Practice

Although the shares of the Company was only listed and commenced trading on the Stock Exchange on 25 July 2002, none of the Directors is aware of any information which would reasonably indicate that the Company is not, or was not, for any part of the accounting period for the period ended 30 June 2002, in compliance with the Code of Best Practice as set out in Appendix 14 of the Rules Governing the Listing of Securities on the Stock Exchange except that non-executive Directors were not appointed for a specific term but are subject to retirement by rotation at annual general meetings pursuant to the Company's Articles of Association.

Compliance with disclosure requirements

In preparing its interim report for the period ended 30 June 2002, the Group has fully complied with the guideline on "Interim Financial Disclosure by Locally Incorporated Authorised Institutions" under the Supervisory Policy Manual issued by the Hong Kong Monetary Authority in November 2001.

By Order of the Board
BOC Hong Kong (Holdings) Limited
Jason C.W. Yeung
Company Secretary

Hong Kong, 27th August 2002