Chief Executive's Report

This is the first time we announce our results in the name of Bank of China (Hong Kong).

During the year of 2001, we accomplished the restructuring and merger of the 12 commercial banks of the former Bank of China ("BOC") Group in Hong Kong and the BOC Credit Card (International) Ltd, leading to the establishment of Bank of China (Hong Kong) on 1 October 2001. This was no doubt the largest merger ever in the Hong Kong banking industry. It marked an important milestone for the Bank of China operation in Hong Kong. We have also managed to weather the difficult economic environment and embark on various business initiatives. Our emphasis has been rationalizing BOCHK's operating structure, improving asset quality and strengthening our risk management systems and practices. Hence, we have laid a strong foundation for future development.

LIU Jinbao

Vice Chairman, Bank of China
Vice Chairman, Executive Director and Chief Executive,
BOC Hong Kong (Holdings) Limited and
Bank of China (Hong Kong) Limited

A New Era Following Restructuring & Merger

Through the restructuring and merger, the Bank has formed new organization structures, defined new development strategies, established new management concepts, culture and systems in order to place our operations in line with leading market practices. As a result, the Bank has been operating very smoothly since its establishment. The following initial results brought about by the new systems and mechanisms have been positive.

(1) We have established a sound corporate governance mechanism. Under the new structure, the Bank has established an enhanced Board of Directors (the Board) system (including the appointment of independent Directors) that clearly defines the accountability and responsibilities of the Board and management. Our policy-making mechanism and process have been centralized, clarified and made more efficient, enabling the operating mechanism to function more effectively.

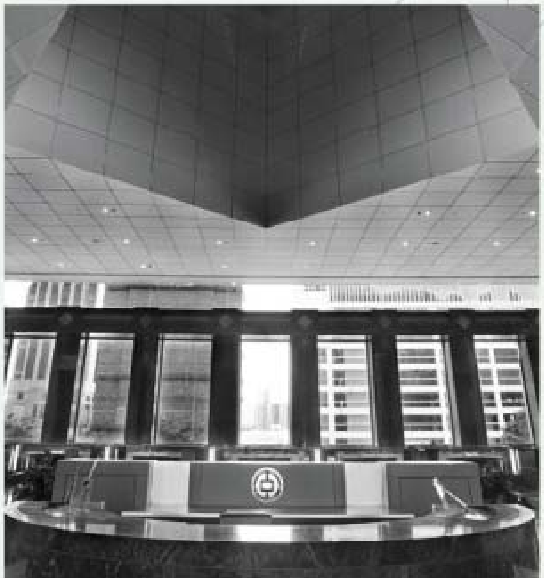
(2) The Bank has formulated a clear business development strategy. We are developing into an integrated, return-on-equity-driven financial institution by enhancing our core competency in the Hong Kong and global market places in order to maximize shareholders' value. This has allowed us to allocate resources to systematically implement various plans, in relation to market positioning, product development, customer segmentation and branch rationalization.

(3) A unified brand name, a centralized product development capacity and an extensive distribution network have enhanced the Bank's marketing capabilities. Our newly launched products have been well-received, demonstrating how these factors are facilitating the transformation from a traditional service-oriented culture towards one which is more proactive and sales-oriented.

(4) The Bank has adopted various independent risk management and control mechanisms.

By implementing our new and unified risk management policies, mechanisms and procedures, we have enhanced the effectiveness of our risk controls. As the new credit culture develops, together with the enhanced non-performing loans recovery capabilities of the newly established Special Assets Management Department, we have created favourable conditions for the improvement and enhancement of our asset quality.

(5) The Asset and Liability Management Committee (ALCO) has been set up for the improvement of the Bank's overall asset and liability structure in order to ensure an effective equilibrium between investment returns and risks. ALCO is responsible for allocation of capital, transfer of internal funds, management of interest rate and liquidity risks, setting risk limits and formulation of risk policies. Our Treasurer now monitors and evaluates the Bank's interest rate and liquidity risk profile under the guidance of the ALCO to ensure that the ALCO's policies are effectively implemented.



(6) After the integration and re-engineering of the back office, we have introduced standardized operational processes and procedures into the Bank, moving towards integrated and systematic operations. At the same time, we will increase our investment in information technology. A number of the automated and electronic systems and workflow of the back office have been or are now in the process of being implemented to fully capitalize on the advantages and effectiveness of our back-office centralization.

Ever since the operation of the Bank on 3 October 2001, we are pleased to see that the Bank's receptiveness to conceptual changes and its adaptability to the new mechanisms are smoother than expected, thanks to the concerted and dedicated efforts of our entire staff and management. We have every confidence in being able to accelerate our smooth integration process in order to fully realize the synergies arising from the restructuring and merger.

Operation Optimized For Solid Foundation

As everybody knows, 2001 was a difficult year for the entire banking industry in Hong Kong. The September 11 event in the United States seriously exacerbated the widespread recession in the West. Afflicted by the external economic cycle and internal structural adjustment, Hong Kong's economic growth declined remarkably. Generally, all sectors suffered, including the banking industry. Although the interest rates fell substantially, the weak demand for loans remained unchanged and market competition became even more heated. Marginal profitability of various banking businesses thus dropped substantially.

BOCHK (including its subsidiaries of Nanyang Commercial Bank, Chiyu Banking Corporation and BOC Credit Card (International) Ltd) recorded a consolidated net profit attributable to shareholders of HK$2,768 million in 2001, representing a decrease of HK$2,445 million or 46.9% compared with 2000. There are three major factors leading to a fall in net earnings: firstly, the decrease in net interest income by approximately HK$1,000 million, secondly, restructuring charges of more than HK$900 million; and thirdly, the loss on the revaluation of fixed assets of more than HK$1,200 million. Of these three factors, the second was a one-off item whilst the first and the third factors were results of an adverse market environment. It is worth mentioning, however, that we believe property prices seem to have reached bottom, thus limiting the risk of additional negative revaluation. Indeed, there are early signs of a potential recovery.

In 2001, operating profit before provisions was HK$13,162 million, representing a decrease of HK$1,968 million or 13.01% from 2000. In particular, net interest income was HK$14,987 million, representing a decrease of 6.6% from 2000. Other operating income was HK$4,022 million, representing a drop of 13.5% from the preceding year. The decline in net interest income was mainly due to a decreased return from cost-free funds resulting from the fall in market interest rates during the year as well as the narrowing of interest spreads. In addition, the decline of our bills business volume and the shrinking of stock trading volume led to the fall in related fees and commission income.

Operating expenses in 2001 amounted to HK$5,847 million, representing a rise of HK$279 million or 5.01% from the previous year. Staff costs were the largest operating expenses, representing 64.92% of total expenses, and increased by 13.08% to

HK$3,796 million. This was mainly due to a general salary increment and overtime payments relating to the restructuring and merger.

As a result of the decline in operating income and the increase in operating expenses, the cost to income ratio rose from 26.9% in 2000 to 30.76% in 2001. Despite the increase, our cost to income ratio was amongst the lowest of our peers in Hong Kong.

During the year, our management has conducted comprehensive reviews on the asset quality of most of our loan portfolio, with the assistance of an independent third party expert. As a result, new specific provisions of HK$10,649 million were made in 2001, compared to HK$7,583 million in 2000. Because the improved quality of certain loans led to the release of general and relevant specific provisions, the net charge for bad and doubtful debts in 2001 was HK$7,412 million. This represented a decrease of HK$1,181 million or 13.74% from 2000.

The total expenditure for the BOC Group's restructuring and merger recorded a total of HK$937 million. This included mainly stamp duty levied on the transfer of shares and immovable properties, legal and professional fees, severance payments and other related restructuring and merger costs. In addition, due to the change in our accounting policy on properties and investment premises from being stated at cost less depreciation to valuation in 2001, a net loss on the revaluation of fixed assets of HK$1,241 million was recorded.

After the merger, we have changed the management of liquid and short term surplus funds from the various bases of individual member banks of the former BOC Group in Hong Kong to a single basis of centralized asset and liability management. The Bank has also adjusted its investment strategy and increased its investment in relatively higher-yielding securities. Certificates of deposits and investment securities held as at 31 December 2001 amounted to HK$126,675 million, representing 16.53% of total assets and an increase of 17.07% from the preceding year.

Advances and other accounts decreased by 5.36% year-on-year to HK$308,108 million as at 31 December 2001. This was due to the sluggish demand in local loan market amidst the weak economy, our adoption of more prudent risk management policy on credit extension, together with HK$10,435 million of the bad debts written off in the year.

Following the restructuring and merger, we have also established a specialized Risk Management Department and the Special Assets Management

Department. The Risk Management Department ensures adequate and independent supervision and control over credit risk. It also enforces an appropriate and prudent credit management mechanism to improve our asset quality. The Special Assets Management Department has strengthened the monitoring, cleaning up and recovery of non-performing loans. Advances overdue for more than 3 months amounted to HK$25,298 million as at the end of 2001, representing a drop of HK$3,925 million from 2000. Its ratio to total advances to customers also decreased from 8.59% to 7.83%. As we have implemented a more prudent credit rating policy, the total amount of non-performing loans increased by 2.49% to HK$35,512 million, representing an increase from 10.19% to 10.99% in total advances to customers.

In June 2002, the Bank entered into a sale and purchase agreement with the Bank of China Grand Cayman Branch to dispose of loans with a gross book value of HK$11,401 million (net of specific provisions of HK$2,679 million).

The Bank has maintained an appropriate and adequate provisioning policy in compliance with the guidelines set by the Hong Kong Monetary Authority. As at 31 December 2001, the total provision for bad and doubtful debts stood at HK$17,114 million, representing 5.3% of the total gross advances to customers.

Following the full deregulation of interest rates in Hong Kong from 3 July 2001, we have introduced a new tiered interest-rate structure and revised some of the service charges so as to more effectively meet the ever-changing operating environment in the banking industry and improve our customer base. During 2001, the tightening of the interest rate gap between fixed deposits and savings accounts has resulted in greater shift to more liquid savings deposits. Furthermore, with the Bank's initiatives to control funding costs, there was a decrease in large deposits with high interest rates. This has helped lower the Bank's costs of funding. Overall, deposit balances amounted to HK$606,428 million as at the end of 2001, representing a decrease of 2.93%.

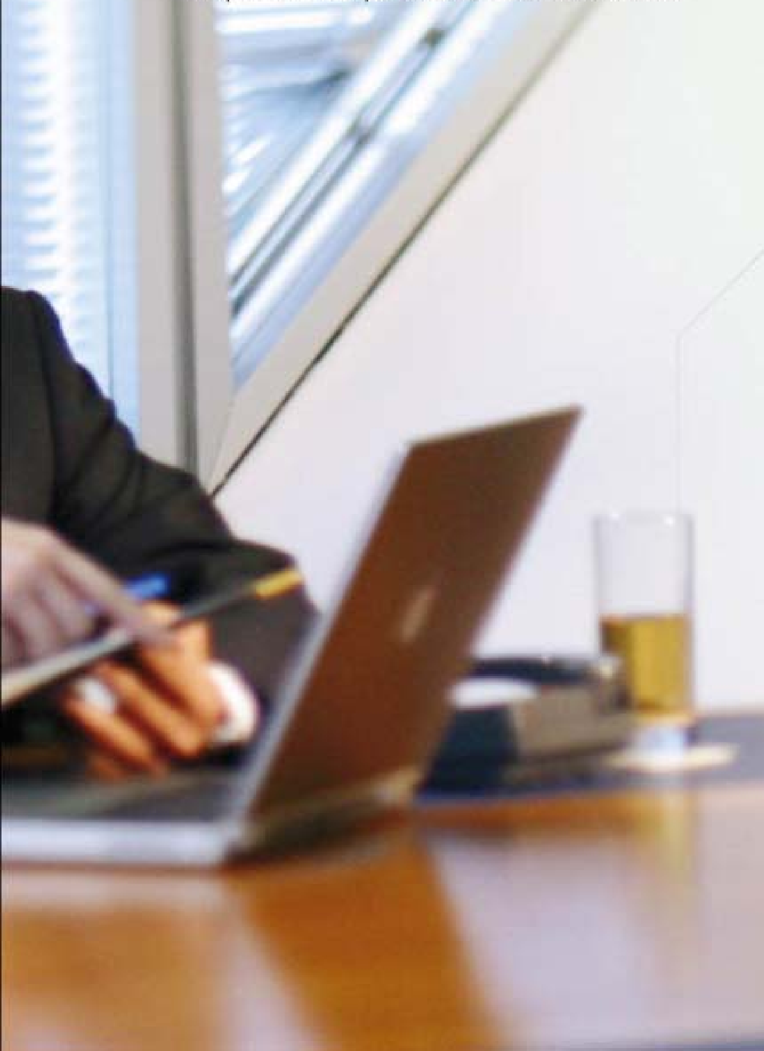
Our shareholders' funds increased from HK$33,345 million as at 31 December 2000 to HK$52,170 million for the same period in 2001. During the restructuring, the Bank's capital base was strengthened due to the injection of capital and enhanced value of assets by the Bank of China. The capital adequacy ratio as at end-2001 was 14.38%, indicating that the Bank was well capitalized. The average liquidity ratio was 39.88%, which reflects not only our maintenance of adequate liquidity, but also our efficiency in capital utilization.

Grasping Opportunity for Better Performance

The West, in particular the US economy, has experienced an early recovery in 2002, although the strength of recovery is uncertain. The Mainland of China is expected to keep its 7.5% growth rate, which should have a positive impact on Hong Kong's economy. As the external environment continues to improve, Hong Kong's economy is expected to rebound due to an increase in exports and a blooming tourist industry. We are also seeing signs of an improvement in the property market. Despite of the fact that Hong Kong is still to experience a high unemployment rate and persistent deflation, consumption and investment are predicted to improve gradually in the latter half of the year. We expect that real GDP growth will reach 2%, higher than that of 0.2% last year.

Under these circumstances, the banking industry will continue to face sluggish environment with only modest loan demand and narrowing interest margins. Increased competition could lead to lower profit margins in our traditional banking business. On the other hand, the restructuring we have been through gives us scope for enhancing our profitability through better internal management, exploring new wealth management and investment business opportunities and greater cooperation with our parent in the Mainland of China, which is the reason we expect that our profits will be significantly better than those of last year.

2002 will be the first year in which the Bank implements its new long-term development strategy. We will be focused on the core task of business development. We will strive to accelerate our business development by capitalizing on the strengths and opportunities arising from our restructuring and merger, in order to enhance our return-on-equity and increase our competitiveness. By leveraging our broad customer base and extensive distribution network, together with a more comprehensive and precise understanding of our customers' needs, we will develop more customer-tailored products to cater for various targeted customers. A proactive marketing approach will be adopted to increase our revenue. The Bank will also give particular attention to enhancing our non-interest income through a better mix of products and more effective cross-selling. We will fully exploit the further opening of the financial and banking markets in the Mainland of China and take advantage of our 14 mainland branches, our product innovation and marketing capabilities. These, coupled with our parent bank's extensive branch network and well-recognised brand name, will strengthen our integrated services offered to local and overseas customers, further enhance our mainland business and broaden our development opportunities in Hong Kong.



While developing our business, we will work hard to enhance our efficiency and optimize the quality of our management. In order to facilitate a smooth integration process, we will improve processing procedures, accelerate and render more effective decision making process in line with our new corporate culture. We will also upgrade our information technology and other infrastructure facilities by phasing in new systems in departments such as back office, centralized processing services, risk management, human resources and customer relations. By continuing to rationalize the branch network, we will gradually optimize the functionality and geographical distribution of our branches in order to provide better services to our target customer segments. Furthermore, we will improve the mechanisms for performance appraisal, staff evaluation, remuneration and incentives, and management capabilities. Through staff training and better allocation of human resources, we aim to increase the overall employee productivity and revenues per capita.

Last year, we accomplished the great project of restructuring and merger. This year, we achieve another significant milestone: a public listing. We would like to demonstrate to Hong Kong and the world that BOCHK is a bank that is shareholder and return driven with a new vision, new mechanisms and new models. We are committed to providing innovative and quality financial services to all our customers, locally and abroad. In essence, BOCHK is a bank with a bright future that will provide value and quality return-on-equity to its shareholders.