

# 20% USD Target Redemption Index Linked Deposit

Enjoy potentially higher returns with Index Linked Deposit

I Principal Brochure I

## What is 20% USD Target Redemption Index Linked Deposit?

The Target Redemption Index Linked Deposit is a highly competitive alternate investment, which provides 100% principal protection plus a 20% guaranteed coupon return to investors. The 1<sup>st</sup> and 2<sup>nd</sup> year annual coupon rates are guaranteed at 7%, payable semi-annually, which allows investors to enjoy an attractive return of 14% after 2 years. The return period for the remaining 6% coupon will be based on the change of the interest rate spread between the long-term USD interest rate (10-Year) and the short-term USD interest rate (2-Year). The maximum investment tenor is 10 years, however, once the accumulated coupon payment reaches the Target Coupon Rate of 20%, the deposit will be terminated and mature automatically.

## Benefits of 20% USD Target Redemption Index Linked Deposit

### Principal Protection

Investors will receive 100% of the invested capital at the occurrence of the Target Redemption Event or at the Maturity Date, whichever shall be earlier.

### High Fixed 1<sup>st</sup> and 2<sup>nd</sup> Year Coupons Guaranteed

The 1<sup>st</sup> and 2<sup>nd</sup> year annual coupon rates are guaranteed at 7%, payable semi-annually, which are much higher than the current time deposit rate. By the end of the 2<sup>nd</sup> year, investors would have already earned 14%, nearly three quarters of the Target Return.

### Superior Return

A superior return of 20% is guaranteed.

### Opportunity to Shorten the Investment Period

As the time to achieve the remaining 6% coupon will be based on the interest rate spread between the USD 10-Year Interest Rate and the USD 2-Year Interest Rate, there is an opportunity for investors to shorten the investment period if the long-term interest rate is rising at a faster pace than the short-term interest rate. The wider the positive spread, the shorter the investment tenor and thus the higher the average return.

### Attractive Annual Return

The shortening of investment tenor is also possible even if the spread between the USD 10-Year Interest Rate and the USD 2-Year Interest Rate is narrowing (Scenario 2 refers). In the event that the Linked Deposit is held until the Maturity Date, the average annual return will still be 2% p.a., a much higher return than the normal time deposit interest rate currently offered (Scenario 3 refers).

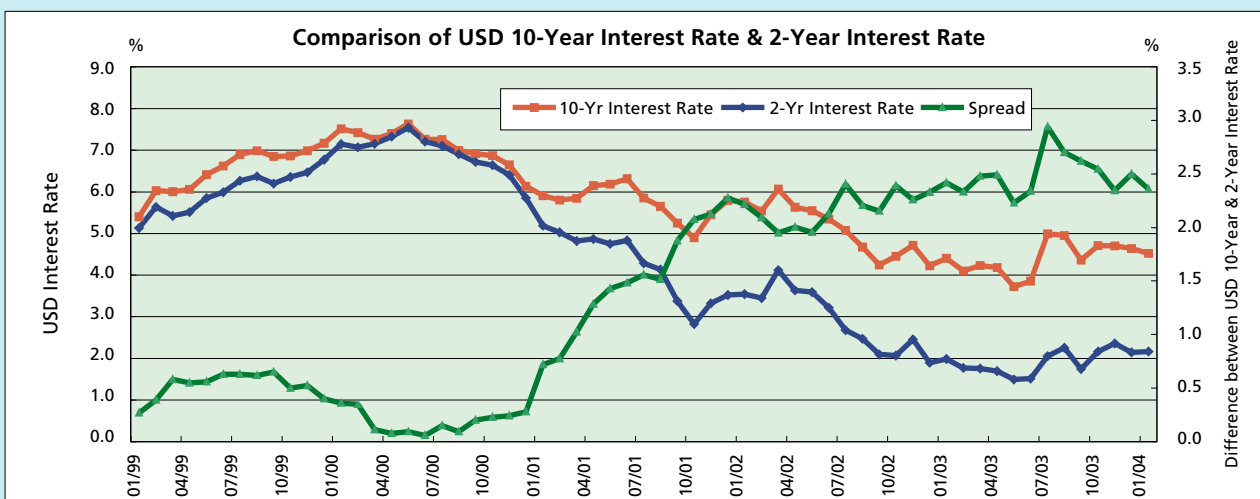
## Current Market Situation

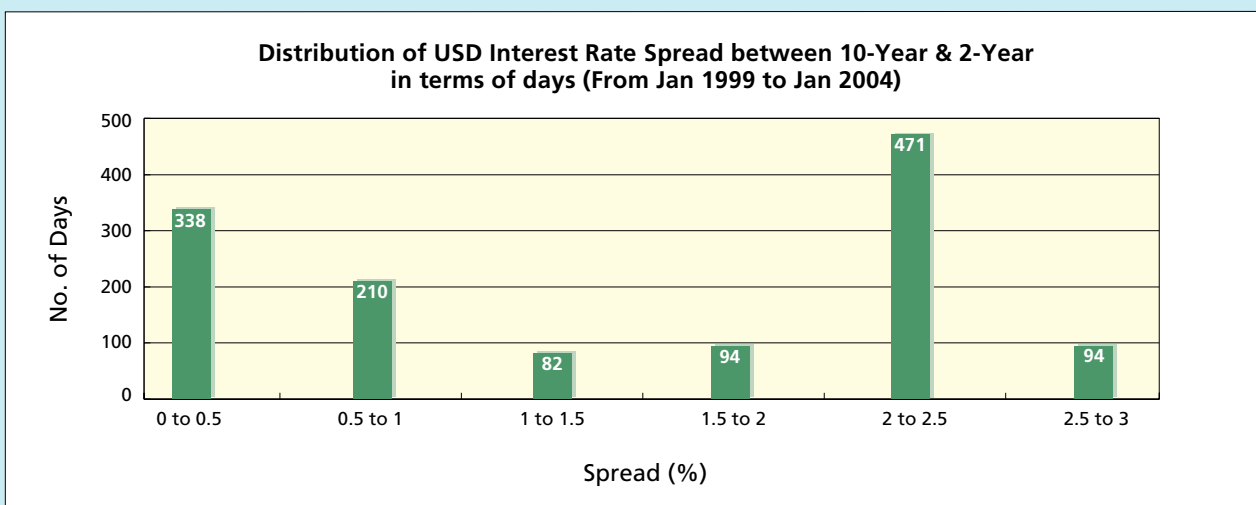
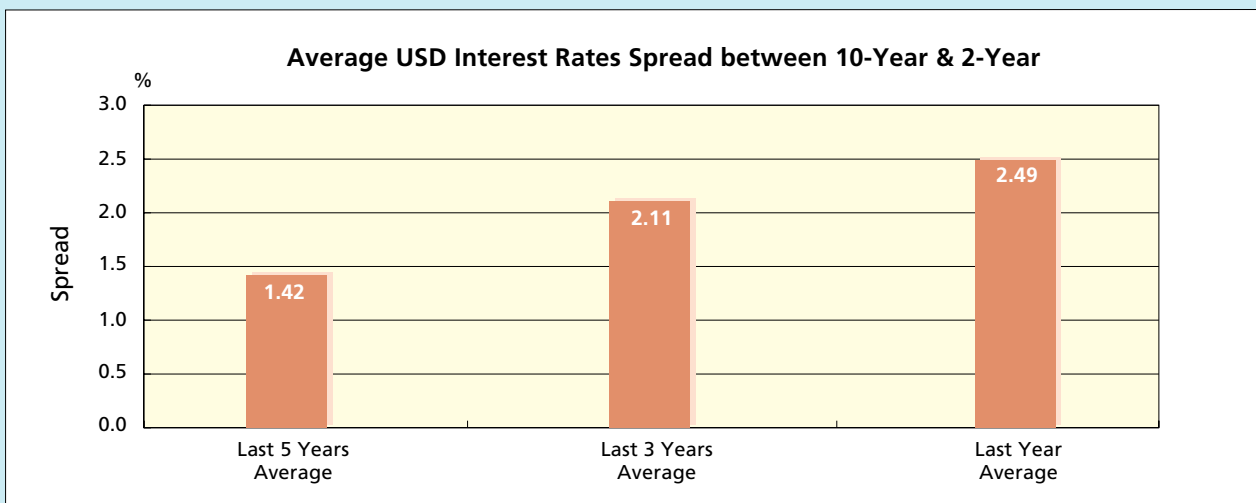
Comments by the US Fed during most of January 2004 suggested that rates would remain unchanged for the foreseeable future due to the low level of inflation and excess capacities. At its meeting on 28<sup>th</sup> January 2004, the FOMC remarked that it believes it can be patient in removing "Monetary Stimulus". Accordingly, it is expected that the prospect for rate hikes is less probable since any deviation from the current low interest rate environment would dampen the mood for further investment from corporations and reduce the consumption expenditure from consumers. Any tightening policies would lengthen the recovery process, which the US Fed would not like to see. Albeit the huge current account deficit, enormous national debt and the continual fall of the US dollar, it is expected that the US Fed may continue its accommodative interest rate policy at least before the November presidential election this year.

Even if there is a chance of interest rates hike, the magnitude may be modest. The possibility of the yield curve having a reverse slope seems very unlikely. History has shown that over the past 10 years, not a single day has the USD 10-Year Interest Rate fallen below the USD 2-Year Interest Rate.

Therefore, it is believed that the current interest rate trend may remain unchanged and the difference between the USD 10-Year Interest Rate and USD 2-Year Interest Rate will stay near around the current level (2.44%) for the next couple of years.

## USD 10-Year Interest Rate and USD 2-Year Interest Rate





## Mechanism of 20% USD Target Redemption Index Linked Deposit

Target Coupon Rate: 20%

1<sup>st</sup> & 2<sup>nd</sup> Years Coupon Rate: 7% p.a.

Coupon Rate from 3<sup>rd</sup> Year onwards: The higher of  $[(1.5 \times (\text{USD 10-Year Interest Rate} - \text{USD 2-Year Interest Rate})) \text{ or } 0\%]$  p.a. If the sum of (i) the aggregate coupon amount paid / accrued before the relevant Coupon Payment Date and (ii) the coupon amount in respect of such Coupon Payment Date calculated based on the above formula (the "Formula Coupon Amount") equals to or is more than the Target Coupon Rate of the Deposit Amount, investors will receive the difference between the Target Coupon Rate of the Deposit Amount and the sum of all coupon amount paid / accrued prior to such Coupon Payment Date (but not the Formula Coupon Amount) on such Coupon Payment Date.

\* "USD 10-Year Interest Rate" is the US dollar 10-Year swap rate fixing at 11:00 a.m. New York time as shown in Reuters Page "ISDAFIX1" on 5 London and New York Business Days before the relevant Coupon Payment Date from Year 3 onwards

\*\* "USD 2-Year Interest Rate" is the US dollar 2-Year swap rate fixing at 11:00 a.m. New York time as shown in Reuters Page "ISDAFIX1" on 5 London and New York Business Days before the relevant Coupon Payment Date from Year 3 onwards

Coupon Payment Date(s): 24 Sept 2004, 24 Mar 2005, 24 Sept 2005, 24 Mar 2006, 24 Sept 2006, 24 Mar 2007, 24 Sept 2007, 24 Mar 2008, 24 Sept 2008, 24 Mar 2009, 24 Sept 2009, 24 Mar 2010, 24 Sept 2010, 24 Mar 2011, 24 Sept 2011, 24 Mar 2012, 24 Sept 2012, 24 Mar 2013, 24 Sept 2013, 24 Mar 2014; or if such day is not a Business Day, the next following Business Day.

Additional Coupon Amount: If the sum of all coupon amount paid / accrued during the deposit period up to and including the Maturity Date is less than the Target Coupon Rate of the Deposit Amount, the Bank will pay to the investors an additional amount that is equal to the difference between the Target Coupon Rate of the Deposit Amount and the sum of the coupon amount paid / accrued during such deposit period, up to and including the Maturity Date.

Target Redemption Event: **Once the accumulated coupon payment as at any Coupon Payment Date reaches the Target Coupon Rate of the Deposit Amount, the Linked Deposit will be terminated and mature automatically upon such Coupon Payment Date.**

## Illustrative Examples

Depending on the interest rate movement, the total return for each USD 10,000 deposit is illustrated as follows:

**Assumption: Based on 13 Feb 2004 USD Interest Rate, 1) 2-Year Interest Rate = 2.000% and 2) 10-Year Interest Rate = 4.440%**

**Scenario 1:** 2-Year Interest Rate and 10-Year Interest Rate move up by **0.3%** and **0.6%** respectively every half-year after launch (i.e. the positive spread is widening gradually)

**Scenario 2:** 2-Year Interest Rate and 10-Year Interest Rate move up by **0.5%** and **0.4%** respectively every half-year after launch (i.e. the positive spread is narrowing gradually)

**Scenario 3:** 2-Year Interest Rate and 10-Year Interest Rate move up by **0.7%** and **0.4%** respectively every half-year after launch (i.e. the positive spread is narrowing drastically and turns to negative at the beginning of the 5<sup>th</sup> year)

Fixing Date	Scenario 1 2-Yr & 10-Yr Interest Rate ↑ 0.3% & 0.6% respectively every half-year					Scenario 2 2-Yr & 10-Yr Interest Rate ↑ 0.5% & 0.4% respectively every half-year					Scenario 3 2-Yr & 10-Yr Interest Rate ↑ 0.7% & 0.4% respectively every half-year				
	2-Yr Int Rate	10-Yr Int Rate	Spread	Semi-annual Return	Cumul. Return	2-Yr Int Rate	10-Yr Int Rate	Spread	Semi-annual Return	Cumul. Return	2-Yr Int Rate	10-Yr Int Rate	Spread	Semi-annual Return	Cumul. Return
1H Year 1	2.300%	5.040%	2.740%	$7.000\% / 2 = 3.500\%$	3.500%	2.500%	4.840%	2.340%	$7.000\% / 2 = 3.500\%$	3.500%	2.700%	4.840%	2.140%	$7.000\% / 2 = 3.500\%$	3.500%
2H Year 1	2.600%	5.640%	3.040%	$7.000\% / 2 = 3.500\%$	7.000%	3.000%	5.240%	2.240%	$7.000\% / 2 = 3.500\%$	7.000%	3.400%	5.240%	1.840%	$7.000\% / 2 = 3.500\%$	7.000%
1H Year 2	2.900%	6.240%	3.340%	$7.000\% / 2 = 3.500\%$	10.500%	3.500%	5.640%	2.140%	$7.000\% / 2 = 3.500\%$	10.500%	4.100%	5.640%	1.540%	$7.000\% / 2 = 3.500\%$	10.500%
2H Year 2	3.200%	6.840%	3.640%	$7.000\% / 2 = 3.500\%$	14.000%	4.000%	6.040%	2.040%	$7.000\% / 2 = 3.500\%$	14.000%	4.800%	6.040%	1.240%	$7.000\% / 2 = 3.500\%$	14.000%
1H Year 3	3.500%	7.440%	3.940%	$(1.5 \times 3.94\%) / 2 = 2.955\%$	16.955%	4.500%	6.440%	1.940%	$(1.5 \times 1.94\%) / 2 = 1.455\%$	15.455%	5.500%	6.440%	0.940%	$(1.5 \times 0.94\%) / 2 = 0.705\%$	14.705%
2H Year 3	3.800%	8.040%	4.240%	$(1.5 \times 4.24\%) / 2 = 3.180\%$	<b>20.000%</b>	5.000%	6.840%	1.840%	$(1.5 \times 1.84\%) / 2 = 1.380\%$	16.835%	6.200%	6.840%	0.640%	$(1.5 \times 0.64\%) / 2 = 0.480\%$	15.185%
1H Year 4	<div style="border: 1px solid red; border-radius: 50%; padding: 10px; display: inline-block;">                     Total return: 20% Investment Tenor: 3 Years                 </div>					5.500%	7.240%	1.740%	$(1.5 \times 1.74\%) / 2 = 1.305\%$	18.140%	6.900%	7.240%	0.340%	$(1.5 \times 0.34\%) / 2 = 0.255\%$	15.440%
2H Year 4						6.000%	7.640%	1.640%	$(1.5 \times 1.64\%) / 2 = 1.230\%$	19.370%	7.600%	7.640%	0.040%	$(1.5 \times 0.04\%) / 2 = 0.030\%$	15.470%
1H Year 5						6.500%	8.040%	1.540%	$(1.5 \times 1.54\%) / 2 = 1.155\%$	<b>20.000%</b>	8.300%	8.040%	-0.260%	$(1.5 \times -0.26\%) / 2 = 0\%$	15.470%
2H Year 5	<div style="border: 1px solid red; border-radius: 50%; padding: 10px; display: inline-block;">                     Total return: 20% Investment Tenor: 4½ Years                 </div>					9.000%	8.440%	-0.560%	$(1.5 \times -0.56\%) / 2 = 0\%$	15.470%					
1H Year 6						9.700%	8.840%	-0.860%	$(1.5 \times -0.86\%) / 2 = 0\%$	15.470%					
2H Year 6						10.400%	9.240%	-1.160%	$(1.5 \times -1.16\%) / 2 = 0\%$	15.470%					
1H Year 7						11.100%	9.640%	-1.460%	$(1.5 \times -1.46\%) / 2 = 0\%$	15.470%					
2H Year 7						11.800%	10.040%	-1.760%	$(1.5 \times -1.76\%) / 2 = 0\%$	15.470%					
1H Year 8						12.500%	10.440%	-2.060%	$(1.5 \times -2.06\%) / 2 = 0\%$	15.470%					
2H Year 8						13.200%	10.840%	-2.360%	$(1.5 \times -2.36\%) / 2 = 0\%$	15.470%					
1H Year 9						13.900%	11.240%	-2.660%	$(1.5 \times -2.66\%) / 2 = 0\%$	15.470%					
2H Year 9						14.600%	11.640%	-2.960%	$(1.5 \times -2.96\%) / 2 = 0\%$	15.470%					
1H Year 10						15.300%	12.040%	-3.260%	$(1.5 \times -3.26\%) / 2 = 0\%$	15.470%					
2H Year 10	16.000%	12.440%	-3.560%	$(1.5 \times -3.56\%) / 2 = 0\%$	15.470%										
													<b>Additional coupon</b>	4.530%	<b>20.000%</b>
<b>Total return</b>	<b>USD 2,000</b>					<b>USD 2,000</b>					<b>USD 2,000</b>				
<b>Return per year</b>	<b>20% / 3 years = 6.667% p.a.</b>					<b>20% / 4.5 years = 4.444% p.a.</b>					<b>20% / 10 years = 2.00% p.a.</b>				

## USD Time Deposit (for comparison basis only)

Deposit Amount	USD 10,000
1 Year Deposit Rate	0.625% p.a. *
Deposit Period	12 months
1 Year Interest Earned	USD 62.50
Total Interest Earned for 10 Years	USD 625 #

\* 0.625% is sourced from BEA's 1-year USD Time Deposit as on 13 February 2004 for deposit amount USD 10,000.

# BEA does not provide time deposit of over 1 year. The above time deposit return is for reference only and is subject to interest rate movement.

## Target Investors

20% USD Target Redemption Index Linked Deposit may particularly be an ideal investment tool for investors who

- prefer to have a pre-determined target return for their invested capital;
- believe that the interest rate spread between the USD 10-Year Interest Rate and USD 2-Year Interest Rate will neither be narrowing rapidly nor become negative (i.e. the 2-Year Interest Rate is higher than the 10-Year Interest Rate) in the coming few years; and
- are willing to hold the Linked Deposit until the Maturity Date even if the USD 2-Year Interest Rate rises substantially over the USD 10-Year Interest Rate in later periods.

## Risk Factors

- This Linked Deposit is not the same as nor should it be treated as a substitute for normal time deposits.
- By participating in such Linked Deposit, the investors are committed to hold the Linked Deposit until the Maturity Date (unless the accumulated coupon payment reaches the Target Coupon Rate of the Deposit Amount prior to the Maturity Date).
- If the USD 2-Year Interest Rate rises sharply beyond the USD 10-Year Interest Rate 2 years afterwards (i.e. negative spread) and the spread never returns to positive again, investors will then receive no coupon payment on the relevant Coupon Payment Dates and need to hold the Linked Deposit for 10 years until the Maturity Date. The remaining coupon up to the Target Coupon Rate will be paid at the Maturity Date.
- Investors should note that in case of early redemption of the Linked Deposit before the Maturity Date, they may not receive the full original invested capital nor the Target Coupon Rate. The invested capital and the Target Coupon Rate would only be 100% protected if investors hold the Linked Deposit until the Maturity Date or the occurrence of the Target Redemption Event, as the case may be.
- This Linked Deposit is denominated in USD. Investors who wish or intend to convert the Deposit Amount and / or Coupon Amount into a different currency (e.g. Hong Kong Dollar) are subject to the relevant foreign exchange risk.
- Investors should fully understand about all the risks associated in the Linked Deposit before making an investment decision.
- Investors should seek independent legal and financial advice.

## Overdraft Facility

Overdraft facility can be offered to investors. For the terms of overdraft facility, please contact our Marketing Officers.

## Early Redemption

Investors may early redeem the Linked Deposit (in whole but not in part) on the 3<sup>rd</sup> Business Day of March, June, September and December ("Dealing Day") starting from the 3<sup>rd</sup> year onwards, subject to the Bank receiving the investor's written notice of such early redemption before the Dealing Day. Upon such early redemption, the Bank will pay to the investor an amount equals to 100% of the Deposit Amount less all costs, losses and expenses incurred by the Bank in discharging any related hedging or other underlying arrangement, as may be absolutely determined by the Bank, without any further coupon payment. Please contact our Marketing Officers for details.

## Linked Deposit Details

Offer Period	8 March 2004 - 19 March 2004
Minimum Deposit Amount for each Investor	USD 10,000 or in the multiple
Minimum Aggregate Amount For all Investors	USD 10,000,000
Settlement Date	24 March 2004
Maturity Date	24 March 2014 (Subject to Target Redemption Event)
Fees & Charges	No fees and charges are payable by investors. All related charges incurred by the Bank are already inherently contained in and subsumed into the calculation of the interest rate and other variables under the deposit.
Early Redemption	Redemption prior to maturity is only permitted from the 3 <sup>rd</sup> year onwards and is subject to costs, losses and expenses absolutely determined by the Bank.

## Act Now

Do not miss the opportunity to secure an attractive return on your investment. For enquiries, please contact our Marketing Officers or call the hotline at **2211 1311**.

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