

# USD Floating Booster Index Linked Deposit – Series 3

Enjoy potentially higher return with Index Linked Deposit

| Principal Brochure |

## What is Floating Booster Index Linked Deposit?

The Floating Booster Index Linked Deposit ("Linked Deposit") is a highly competitive alternate investment, which provides 100% principal protection with the 1<sup>st</sup> quarter coupon rate of Year 1 and Year 3 being fixed at 5.75% p.a., plus an opportunity to earn step-up coupons. The maximum investment period of 4 years may be shortened if the Bank exercises its callable right to call and terminate the Linked Deposit before maturity.

## Benefits of Floating Booster Structure

### Principal Protection

Investors will receive 100% of the invested capital at maturity or at any Coupon Payment Date if the Bank calls and terminates the Linked Deposit.

### Fixed 1<sup>st</sup> Quarter Coupon for Year 1 and Year 3

The 1<sup>st</sup> quarter coupon rate of Year 1 and Year 3 is fixed at 5.75% p.a., which is much higher than the current normal time deposit rate.

### Step-up Coupons

From the 2<sup>nd</sup> quarter of Year 1 onwards but except for the 1<sup>st</sup> quarter of Year 3, the mechanism of the floating coupon rate offers investors an opportunity to enjoy a rising income stream unless the interest rate rises drastically after launch or the Bank calls and terminates the Linked Deposit before maturity.

### Coupon Reset Feature

The coupon reset feature on the 1<sup>st</sup> quarter of Year 3 provides investors an opportunity to earn coupon again even if the 3-Month LIBOR rises drastically beyond 7.50% 3 months after the Settlement Date.

### Opportunity to Shorten the Investment Period

The Bank has the right to call and terminate the Linked Deposit on any Coupon Payment Date, which in turn may shorten the investment period. The shortest investment tenor will be 3 months.

## Current Market Situation

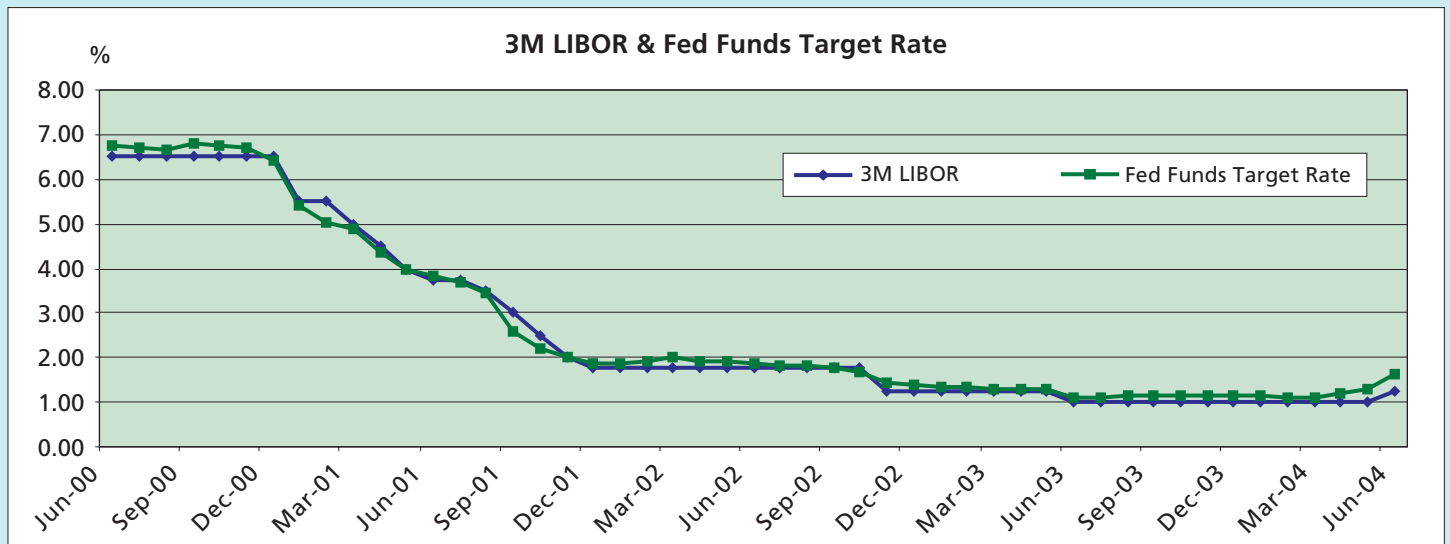
Market pundits have long been scrutinizing the words used by the Fed's chairman Alan Greenspan and it was no exception this time when chairman Greenspan made his long awaited remark in the FOMC on 30 June 2004 regarding the interest rate. Mr. Greenspan expectedly increased the Fed Funds Rate by 25bps to 1.25%. However, the important part of his testimony was his use of the word "measured". Chairman Greenspan reconfirmed that the Fed will pursue a "measured" pace of interest rate increases while staying alert for any jump in inflation that might require quicker action.

We see the markets are currently pricing in Fed tightening too aggressively, mainly because market consensus is overly optimistic about the strength of U.S. economic growth.

We forecast a moderate slowing over the next year, based on the fading of fiscal and monetary stimulus, significantly higher oil prices, and higher interest rates. Key indicators such as retail sales, car sales, and payrolls growth are already softening. A slowing economy should temper the Fed's pace, as it would not want to endanger a fragile expansion. Since the Fed is now balancing the threats of inflation and deflation, we see this round of tightening will be both longer and milder than in the past.

Hence, we expect the likelihood of any drastic increase of the Fed Fund Rates in the near future is highly unlikely, not at least after the US presidential election this November or until several quarters of significant statistical showing.

## 4-Year Chart for 3M LIBOR



## Mechanism of the Floating Booster Index Linked Deposit

Coupon Rate:

Year 1	1 <sup>st</sup> Qt	5.75% p.a.
	2 <sup>nd</sup> Qt - 4 <sup>th</sup> Qt	The higher of [(Previous Coupon Rate + 1.75% - 3-Month LIBOR, in arrears) or 0%] p.a.
Year 2	1 <sup>st</sup> Qt - 4 <sup>th</sup> Qt	The higher of [(Previous Coupon Rate + 2.75% - 3-Month LIBOR, in arrears) or 0%] p.a.
Year 3	1 <sup>st</sup> Qt	5.75% p.a.
	2 <sup>nd</sup> Qt - 4 <sup>th</sup> Qt	The higher of [(Previous Coupon Rate + 3.75% - 3-Month LIBOR, in arrears) or 0%] p.a.
Year 4	1 <sup>st</sup> Qt - 4 <sup>th</sup> Qt	The higher of [(Previous Coupon Rate + 4.75% - 3-Month LIBOR, in arrears) or 0%] p.a.

**"3-Month LIBOR, in arrears"** : the 3-Month US dollar London Interbank Offered Rate as shown in the Reuters page "LIBOR01" on 5 London and New York Business Days before Coupon Payment Date(s). The 3-Month LIBOR is floored at 0%.

**"Previous Coupon Rate"** : the latest applicable Annualized Coupon Rate.

Coupon Frequency:

Quarterly

Coupon Payment Date(s):

25 Nov 2004, 25 Feb 2005, 25 May 2005, 25 Aug 2005, 25 Nov 2005, 25 Feb 2006, 25 May 2006, 25 Aug 2006, 25 Nov 2006, 25 Feb 2007, 25 May 2007, 25 Aug 2007, 25 Nov 2007, 25 Feb 2008, 25 May 2008 and 25 Aug 2008; or if such day is not a Business Day, the next following Business Day.

Bank's Callable Right:

The Bank has the absolute right to call and terminate the Linked Deposit on any of the Coupon Payment Dates.

**Once the Bank exercises its right to call the Linked Deposit, the Linked Deposit will be terminated and mature automatically.**

## Illustrative Examples

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

**Assumption: 1) current 3-Month LIBOR = 1.66%**

**2) the Bank will not exercise the Callable Right throughout the investment period**

Scenario 1: 3-Month LIBOR remains at current level **1.66%** throughout the investment period

Scenario 2: 3-Month LIBOR moves up by **0.25%** every quarter after launch

Scenario 3: 3-Month LIBOR moves up drastically by **0.50%** every quarter after launch

	Scenario 1 3-Mth LIBOR remains at current level				Scenario 2 3-Mth LIBOR ↑ 0.25% every quarter				Scenario 3 3-Mth LIBOR ↑ 0.50% every quarter			
	LIBOR	Coupon Rate (p.a.)	Quarterly Return	Cumul. Return	LIBOR	Coupon Rate (p.a.)	Quarterly Return	Cumul. Return	LIBOR	Coupon Rate (p.a.)	Quarterly Return	Cumul. Return
1Q Year 1	1.66%	<b>5.75%</b>	1.4375%	1.4375%	1.91%	<b>5.75%</b>	1.4375%	1.4375%	2.16%	<b>5.75%</b>	1.4375%	1.4375%
2Q Year 1	1.66%	5.75% + 1.75% - 1.66% = 5.84%	1.4600%	2.8975%	2.16%	5.75% + 1.75% - 2.16% = 5.34%	1.3350%	2.7725%	2.66%	5.75% + 1.75% - 2.66% = 4.84%	1.2100%	2.6475%
3Q Year 1	1.66%	5.84% + 1.75% - 1.66% = 5.93%	1.4825%	4.3800%	2.41%	5.34% + 1.75% - 2.41% = 4.68%	1.1700%	3.9425%	3.16%	4.84% + 1.75% - 3.16% = 3.43%	0.8575%	3.5050%
4Q Year 1	1.66%	5.93% + 1.75% - 1.66% = 6.02%	1.5050%	5.8850%	2.66%	4.68% + 1.75% - 2.66% = 3.77%	0.9425%	4.8850%	3.66%	3.43% + 1.75% - 3.66% = 1.52%	0.3800%	3.8850%
1Q Year 2	1.66%	6.02% + 2.75% - 1.66% = 7.11%	1.7775%	7.6625%	2.91%	3.77% + 2.75% - 2.91% = 3.61%	0.9025%	5.7875%	4.16%	1.52% + 2.75% - 4.16% = 0.11%	0.0275%	3.9125%
2Q Year 2	1.66%	7.11% + 2.75% - 1.66% = 8.20%	2.0500%	9.7125%	3.16%	3.61% + 2.75% - 3.16% = 3.20%	0.8000%	6.5875%	4.66%	0.11% + 2.75% - 4.66% = -1.80% ⇒ 0%	0%	3.9125%
3Q Year 2	1.66%	8.20% + 2.75% - 1.66% = 9.29%	2.3225%	12.0350%	3.41%	3.20% + 2.75% - 3.41% = 2.54%	0.6350%	7.2225%	5.16%	0% + 2.75% - 5.16% = -2.41% ⇒ 0%	0%	3.9125%
4Q Year 2	1.66%	9.29% + 2.75% - 1.66% = 10.38%	2.5950%	14.6300%	3.66%	2.54% + 2.75% - 3.66% = 1.63%	0.4075%	7.6300%	5.66%	0% + 2.75% - 5.66% = -2.91% ⇒ 0%	0%	3.9125%
1Q Year 3	1.66%	<b>5.75%</b>	1.4375%	16.0675%	3.91%	<b>5.75%</b>	1.4375%	9.0675%	6.16%	<b>5.75%</b>	1.4375%	5.3500%
2Q Year 3	1.66%	5.75% + 3.75% - 1.66% = 7.84%	1.9600%	18.0275%	4.16%	5.75% + 3.75% - 4.16% = 5.34%	1.3350%	10.4025%	6.66%	5.75% + 3.75% - 6.66% = 2.84%	0.7100%	6.0600%
3Q Year 3	1.66%	7.84% + 3.75% - 1.66% = 9.93%	2.4825%	20.5100%	4.41%	5.34% + 3.75% - 4.41% = 4.68%	1.1700%	11.5725%	7.16%	2.84% + 3.75% - 7.16% = -0.57% ⇒ 0%	0%	6.0600%
4Q Year 3	1.66%	9.93% + 3.75% - 1.66% = 12.02%	3.0050%	23.5150%	4.66%	4.68% + 3.75% - 4.66% = 3.77%	0.9425%	12.5150%	7.66%	0% + 3.75% - 7.66% = -3.91% ⇒ 0%	0%	6.0600%
1Q Year 4	1.66%	12.02% + 4.75% - 1.66% = 15.11%	3.7775%	27.2925%	4.91%	3.77% + 4.75% - 4.91% = 3.61%	0.9025%	13.4175%	8.16%	0% + 4.75% - 8.16% = -3.41% ⇒ 0%	0%	6.0600%
2Q Year 4	1.66%	15.11% + 4.75% - 1.66% = 18.20%	4.5500%	31.8425%	5.16%	3.61% + 4.75% - 5.16% = 3.20%	0.8000%	14.2175%	8.66%	0% + 4.75% - 8.66% = -3.91% ⇒ 0%	0%	6.0600%
3Q Year 4	1.66%	18.20% + 4.75% - 1.66% = 21.29%	5.3225%	37.1650%	5.41%	3.20% + 4.75% - 5.41% = 2.54%	0.6350%	14.8525%	9.16%	0% + 4.75% - 9.16% = -4.41% ⇒ 0%	0%	6.0600%
4Q Year 4	1.66%	21.29% + 4.75% - 1.66% = 24.38%	6.0950%	43.2600%	5.66%	2.54% + 4.75% - 5.66% = 1.63%	0.4075%	15.2600%	9.66%	0% + 4.75% - 9.66% = -4.91% ⇒ 0%	0%	6.0600%
<b>Total return</b>	<b>USD 4,326.00</b>				<b>USD 1,526.00</b>				<b>USD 606.00</b>			
<b>Return per year</b>	<b>43.26% / 4 years = 10.8150% p.a.</b>				<b>15.26% / 4 years = 3.8150% p.a.</b>				<b>6.06% / 4 years = 1.5150% p.a.</b>			

Scenario 4: If the Bank exercises its Callable Right to call and terminate the Linked Deposit on the 1<sup>st</sup> Coupon Payment Date, the Linked Deposit will mature and investment tenor will be shortened to 3 months.

**Total return: USD 143.75**

**Return per year: 1.4375% / 0.25 year = 5.75% p.a.**

## USD Time Deposit (for comparison basis only)

Deposit Amount	USD 10,000
1-Year Deposit Rate	1.6563% p.a. *
Deposit Period	12 months
1-Year Interest Earned	USD 165.63
Total Interest Earned for 4 Years	USD 662.52 #

\* 1.6563% is sourced from the Bank's 1-year USD Time Deposit as on 23 July 2004 for deposit amount USD 10,000.

# The Bank 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

Floating Booster Index Linked Deposit may particularly be an ideal investment tool for investors who

- believe that the 3-Month LIBOR will not move up to 7.50% after 1<sup>st</sup> quarter of Year 1 and 9.50% after 1<sup>st</sup> quarter of Year 3; and
- are willing to hold the Linked Deposit until maturity even if the interest rate rises drastically in later period.

### 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 holding the Linked Deposit until maturity (unless the Bank calls and terminates the Linked Deposit before maturity).
- The potential risk is that if the 3-Month LIBOR rises sharply and trades beyond 7.50% after the 1<sup>st</sup> quarter of Year 1 and stays at this level until the scheduled coupon reset date, investors will receive no Coupon Payment on the relevant Coupon Payment Dates after the 1<sup>st</sup> Coupon Payment Date and before the said coupon reset date. After the reset of the coupon, if the 3-Month LIBOR rises sharply again and trades beyond 9.50% after the 1<sup>st</sup> quarter of Year 3 and stays at this level for the remaining investment period, investors will then receive no further Coupon Payment after such coupon reset date and need to hold the Linked Deposit until maturity unless the Bank calls and terminates the Linked Deposit during the investment tenor. The higher the 3-Month LIBOR, the lower the investment return.
- Investors have to bear the reinvestment risk if the Bank calls and terminates the Linked Deposit.
- 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 and the guaranteed coupon. The invested capital would only be 100% protected if investors hold the Linked Deposit until the Maturity Date or upon the Bank exercises its Callable Right, 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 all the risks associated with 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 one year after the Settlement Date, subject to the Bank receiving the investors' written notice of such early redemption before the Dealing Day. Upon such early redemption, the Bank will pay to the investors 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	16 August 2004 - 20 August 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	25 August 2004
Maturity Date	25 August 2008 (subject to the Bank's Callable Right)
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 Linked Deposit.
Early Redemption	Redemption prior to maturity is only permitted from one year after the Settlement Date and is subject to costs, losses, and expenses absolutely determined by the Bank.

### Act Now

Do not miss the opportunity to obtain an attractive return on your investment. For enquiries, please contact our Marketing Officers or call the hotline **2211 1311**. Information is also available at BEA Website: [www.hkbea.com](http://www.hkbea.com).

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