CREDIT AND COUNTRY RISK MANAGEMENT

Credit risk

Counter-party and credit risk is defined as the potential loss arising from any failure by customers to fulfill their obligations, as and when they fall due. All credit exposures, whether on-balance sheet or off-balance sheet, are assessed. These obligations may arise from lending, trade finance, investment, receivables under derivative and foreign exchange contracts and other credit-related activities undertaken by the Group.

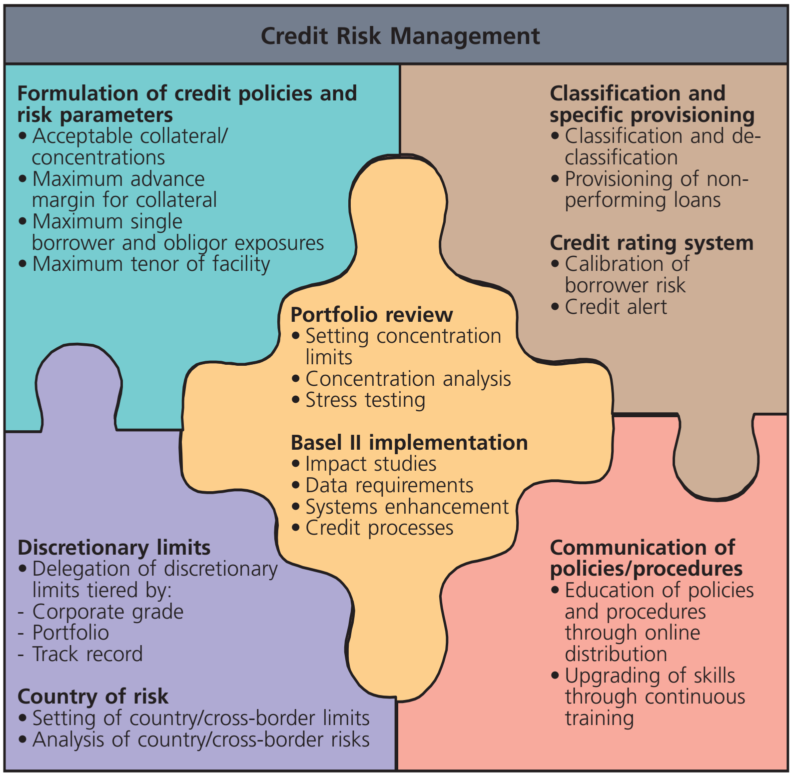
The Credit Committee, under delegated authority from the Board of Directors, approves credit policies, guidelines and procedures to control and monitor such risks. It has day-to-day responsibility for identifying and managing portfolio and risk concentration issues, including country exposure and industry sector exposure. The risk parameters for accepting credit risk are clearly defined and complemented by policies and processes to ensure that the Group maintains a well-diversified and high quality credit portfolio.

Credit discretionary limits are delegated to officers of individual business units, depending on their levels of experience. Approval of all credits is granted in accordance with credit policies and guidelines. Defined credit risk parameters include single borrower, obligor, security concentrations, identified high-risk areas, maximum tenor, acceptable structures and collateral types.

Policies are also in place to govern the approval of 'Related Parties' credit facilities. 'Related Parties' refer to individuals or companies with whom the authorised credit approving authority and/or his/her immediate family members have a relationship, whether as director, partner, shareholder or any other relationship which would give rise to a potential conflict of interest.

Credit relationships with 'Related Parties' must be established on a strictly arm's length commercial basis. An approving authority shall abstain and absent himself/herself from the deliberation and approval of credit cases where the borrower is a 'Related Party' except if the 'Related Party' is a:

- company of the Far Eastern Bank (FEB) Group;
- publicly listed company or company related to a publicly listed company;
- company formed by professional bodies, trade or clan associations, or societies.



The Board of Directors must be informed immediately in the event that any 'Related Party' borrower is in default of payment and/or in breach of any material term of the credit facility and such default or breach is not rectified within seven days of notice from the Group.

A comprehensive set of limits (country, regional, industry and counter-party) is in place to address concentration issues in the Bank's portfolio. A rigorous process is established to regularly review and report asset concentrations and portfolio quality so that risks are accurately assessed, properly approved and monitored. These cover large credit exposures by obligor group, collateral type, industry, product, country, level of non-performing loans (NPLs) and adequacy of provisioning requirements.

In particular, the trends and composition of exposures to property-related loans are closely monitored, analysed and reported on an on-going basis to ensure that exposures are kept within regulatory limits and internal guidelines. The exposure concentrations and NPLs by industry type are reported to the Credit Committee and Executive Committee on a monthly basis and to the Board of Directors on a quarterly basis.

Credit audits and reviews are regularly carried out to proactively identify and address potential weaknesses in the credit process and to pre-empt any unexpected deterioration in the credit quality.

FEB's parent bank, United Overseas Bank Limited (UOB) has made significant progress in its preparations for the New Basel Capital Accord (Basel II) and is already well in advance in developing, configuring and operationalising many of its systems and processes to prepare for the adoption of Basel II. UOB remains committed and will continue to invest in and strengthen its risk management systems, processes and practices to reach Internal Rating Based (IRB) compliance at the earliest date. To this end, UOB has engaged consultants in the relevant subject matters to provide advice on their fields of expertise.

Customer loans

Loans and advances are made to customers in various industry segments and business lines. The top 20 obligor group borrowers and top 100 group borrowers made up 28.9% and 61.2% of total loans and advances respectively.

Obligor groups are defined in accordance with Notice to Banks, MAS 623 to comply with Section 29 (1)(a) of the Banking Act. Where the parent company is a borrower, exposures to the parent company and companies that it has 20% or more shareholding or power to control are aggregated into a single obligor group.

As at 31 December 2004, about 57.6% of the exposure to customers resided in the personal financial services portfolio, which comprised mainly housing loans and other mortgage loans.

The composition of loans and advances to customers, contingent liabilities and corresponding non-performing portions are as follows:

By industry type (%)	Loans and advances 2004	Loans and advances 2003	Contingent liabilities 2004	Contingent liabilities 2003	Non-performing loans 2004	Non-performing loans 2003
Manufacturing	**5.9**	5.8	**6.8**	4.9	**–**	–
Building and construction	**3.6**	4.5	**5.4**	5.7	**1.0**	0.9
Housing loans	**37.6**	38.0	**–**	–	**18.5**	24.2
General commerce	**26.3**	26.1	**37.9**	52.7	**47.7**	47.9
Transport, storage and communication	**0.9**	1.0	**10.5**	8.5	**–**	–
Non-bank financial institutions	**3.6**	4.5	**21.4**	12.6	**9.3**	4.4
Professionals and private individuals	**20.0**	18.3	**8.0**	5.3	**18.6**	19.3
Other	**2.1**	1.8	**10.0**	10.3	**4.9**	3.3
Total (%)	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0
Total gross loans ($ million)	**310.1**	320.0	**17.8**	19.4	**22.1**	32.4

Classification and provision of loans

The Bank classifies its loan portfolios according to the borrower's ability to repay the loan from its normal source of income. All loans and advances to customers are classified into the categories of 'Pass', 'Special Mention' or 'Non-Performing'. Non-Performing Loans are further classified as 'Substandard', 'Doubtful' or 'Loss' in accordance with Notice to Banks, MAS 612. The Bank also practises split classifications of 'Substandard - Doubtful' and 'Substandard - Loss', whereby 'Substandard' is the secured portion. Interest income on all non-performing loans is suspended and ceases to accrue. Such loans will remain classified until servicing of the account becomes satisfactory. Where appropriate, classified loans are transferred to in-house recovery specialists to maximise recovery prospects.

Loan classification	Description
Pass	All payments are current and full repayment of interest and principal from normal sources is not in doubt.
Special Mention	There is some potential weakness in the borrower's creditworthiness, but the extent of any credit deterioration does not warrant its classification as a non-performing loan.
Non-Performing: Substandard	There is weakness in the borrower's creditworthiness that jeopardises normal repayment. Default has occurred or is likely to occur. The loan is more than 90 days past due, or the repayment schedule has been restructured.
Non-Performing: Substandard - Doubtful	The loan is partially secured by tangible collateral and the recovery rate on the unsecured portion is expected to be more than 50%.
Non-Performing: Substandard - Loss	The loan is partially secured by tangible collateral and the recovery rate on the unsecured portion is expected to be less than 50%.
Non-Performing: Doubtful	There is severe weakness in the borrower's creditworthiness, full repayment is highly questionable and no collateral is available.
Non-Performing: Loss	The chance of recovery from the loan is insignificant and no collateral is available.

The Bank's provisions for credit losses are intended to cover probable credit losses through charges against profit. The provisions consist of an element that is specific to the individual loan and also a general element that has not been specifically identified to individual loans. The Bank constantly reviews the quality of its loan portfolio based on its knowledge of the borrowers and, where applicable, of the relevant industry and country of operation.

A specific provision is made when the Bank believes that the creditworthiness of a borrower has deteriorated to such an extent that the recovery of the entire outstanding loan is in doubt. The amount of specific provision to be made is based on the difference between the discounted cash flows (or collateral value) of an impaired loan and the carrying value of that loan. A general provision is made to cover possible losses and could be used to cushion any losses known from experience to exist in the loan portfolio.

Specific provisions are made for each loan grade in the following manner:

Loan Classification	**Recovery Expectation**	**Provision**
Substandard	> 90% to 100%	10% to 50% of any unsecured loan outstanding
Doubtful	50% to 90%	50% to 100% of any unsecured loan outstanding
Loss	< 50%	100% of any unsecured loan outstanding

Write-off

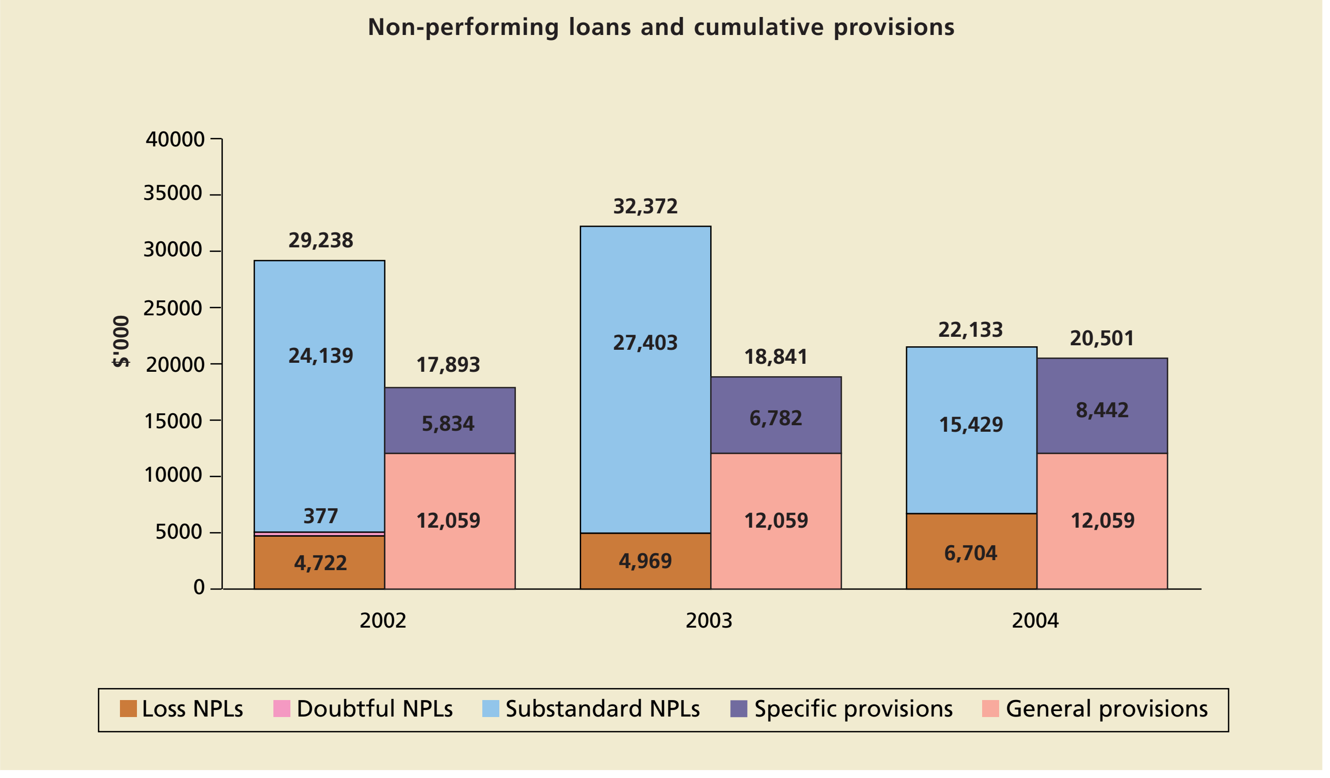
A classified account is written off where there is no realisable tangible collateral securing the account and all feasible avenues of recovery have been exhausted or where the borrower and guarantors have been bankrupted, wound-up, and/or proof of debt filed. Approval from MAS must be obtained before director-related loans and other loans, as required under Notice to Banks, MAS 606, can be written off.

Non-performing loans (NPLs) and cumulative provisions

The Bank's non-performing loans (NPLs) decreased by $10.3 million or 31.6% to $22.1 million as at 31 December 2004, compared to $32.4 million as at 31 December 2003. The decrease was in the Substandard category which amounted to 69.7% of total NPLs.

Correspondingly, NPLs as a percentage of gross customer loans dropped to 7.1%, from 10.1% as at 31 December 2003.

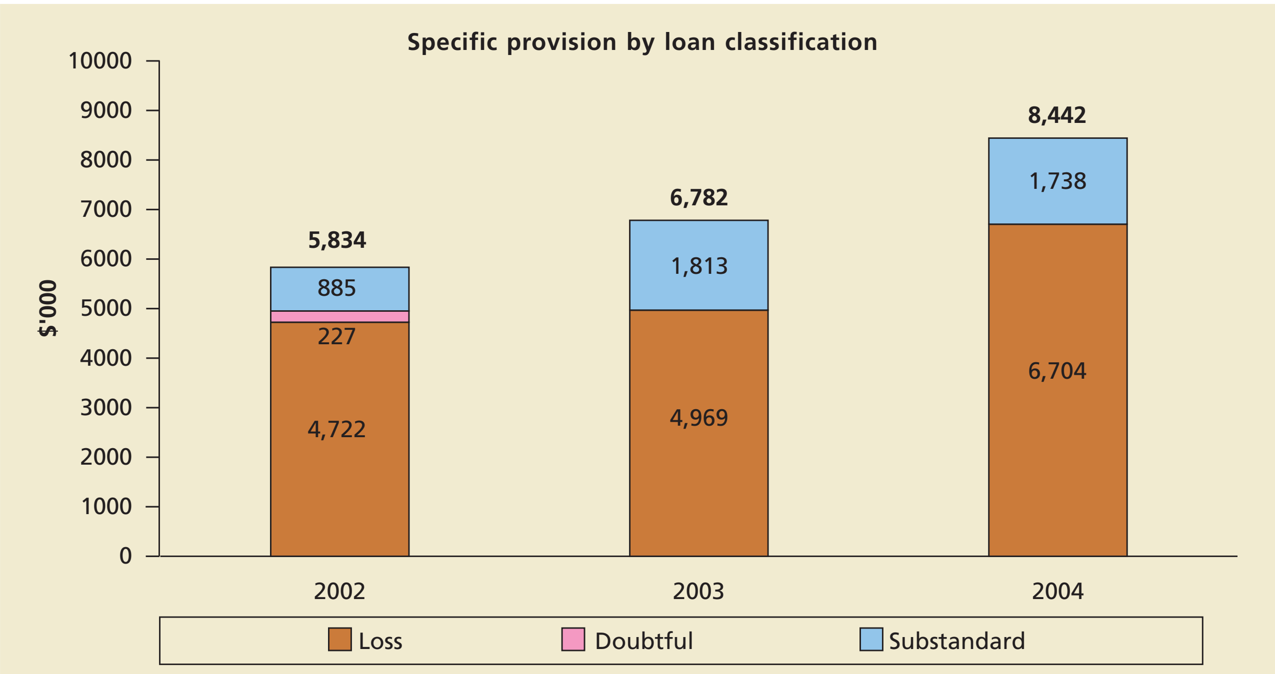
Specific provisions increased by $1.7 million or 24.5% to $8.4 million as at 31 December 2004, compared to $6.8 million as at 31 December 2003. General provisions remained unchanged at $12.1 million or 58.8% of the total cumulative provisions as at 31 December 2004. The cumulative provisions provided a coverage of 92.6% against the Bank's NPLs and 305.8% of NPLs classified as Doubtful and Loss.



Ratios (%)	**2004**	2003	2002
NPLs/Gross customer loans	**7.1**	10.1	8.7
NPLs/Total assets	**2.7**	4.0	3.7
Cumulative provisions/NPLs	**92.6**	58.2	61.2
Cumulative provisions/Doubtful & Loss NPLs	**305.8**	379.2	350.9
Cumulative provisions/Unsecured NPLs	**300.8**	312.6	281.9
Cumulative provisions/Gross customer loans	**6.6**	5.9	5.3
General provisions/Gross customer loans (net of specific provisions for loans)	**4.0**	3.8	3.6

Specific provisions by loan classification

As at 31 December 2004, about 79.4% of specific provisions made for expected loan losses is for 'Loss' accounts. The specific provisions for each classified loan grade are shown in the following chart:



Rescheduled and restructured accounts

A rescheduled account is one where repayment terms have been modified, but the principal terms and conditions of the original contract have not changed significantly. This is done to alleviate a temporary cash flow difficulty experienced by a borrower. It is expected that the problem is short-term and not likely to recur. The full amount of the debt is still repayable and no loss of principal or interest is expected.

When an account has been rescheduled three months before it meets the criteria for auto classification, the account can be graded as 'Performing'. However, if the rescheduling takes place after the account has been graded as 'Non-Performing', it remains as such and is upgraded to 'Pass' after six months and provided there are no excesses and past dues.

A restructured account is one where the original terms and conditions of the facilities have been modified significantly to assist the borrower to overcome financial difficulties where the longer-term prospect of the business or project is still deemed to be viable. A restructuring exercise could encompass a change in the credit facility type, or in the repayment schedule including moratorium, or extension of interest and/or principal payments and reduction of accrued interest, including forgiveness of interest and/or reduction in interest rate charged.

When an account has been restructured based on financial consideration, the account will be graded as 'Non-Performing'. It can only be upgraded to 'Pass' after six months when all payments are current in terms of the restructured terms and conditions and there is no reasonable doubt as to the ultimate collectability of principal and interest.

Loans that were classified and restructured during the year are as follows:

Loan classification	2004 Amount ($'000)	2004 Specific provisions ($'000)	2003 Amount ($'000)	2003 Specific provisions ($'000)
Loss	**–**	**–**	111	111

Ageing of NPLs

The full outstanding balance of an account is deemed non-current and aged when there are arrears in interest servicing or principal repayment. The ageing of NPLs is as follows:

Ageing (Days)	2004 Amount ($'000)	2004 % of total NPLs	2003 Amount ($'000)	2003 % of total NPLs
Current	**1,396**	**6.3**	2,080	6.4
≤ 90	**2,137**	**9.6**	2,580	8.0
91 to 180	**2,626**	**11.9**	7,145	22.1
≥ 181	**15,974**	**72.2**	20,567	63.5
Total	**22,133**	**100.0**	32,372	100.0

Collateral types

The majority of the classified loans are secured by properties. Properties are valued at forced sale value and such valuations are updated semi-annually. NPLs are also secured by other types of collateral such as marketable securities that include listed stocks and shares, cash and deposits, and bankers' standby letters of credit/guarantees.

As at 31 December 2004, 69.2% of NPLs was secured by collateral, compared to 81.4% as at 31 December 2003.

The secured NPLs of the Bank by collateral type are as follows:

	2004 $'000	2003 $'000
Property	**15,040**	25,815
Marketable securities	**–**	290
Cash and deposits	**278**	239
Total	**15,318**	26,344

BALANCE SHEET RISK MANAGEMENT

Balance sheet risk is defined as the potential change in earnings arising from the effect of movements in interest rates and foreign exchange rates on the structural banking book of the Group that is not of a trading nature.

The Asset Liability Committee (ALCO) approves the policies and limits for balance sheet risk. This risk is monitored and managed through the framework of approved policies and limits and reported regularly to ALCO, the Executive Committee of the Board and the Board of Directors.

In carrying out its business activities the Group strives to meet customers' demands and preferences for products with various interest rate structures and maturities. Sensitivity to interest rate movements arises from mismatches in the repricing dates, cash flows and other characteristics of assets and liabilities. As interest rates and yield curves change over time, the size and nature of these mismatches may result in a gain or loss in earnings. In managing balance sheet risk, the primary objective, therefore, is to monitor and avert significant volatility in Net Interest Income (NII) and Economic Value of Equity (EVE). For instance, when there are significant changes in market interest rates, the Group will adjust its lending and deposit rates to the extent necessary to stabilise its NII.

The balance sheet interest rate risk exposure is calculated using a combination of dynamic simulation modelling techniques and static analysis tools, such as maturity/repricing schedules. The schedules provide a static indication of the potential impact on interest earnings through gap analysis of the mismatches of interest rate sensitive assets, liabilities and off-balance sheet items by time bands, according to their maturity (for fixed rate items) or remaining period to their next repricing (for floating rate items).

The table in Note 32(c) of Notes to the Financial Statements represents the Group's interest rate risk sensitivity based on repricing mismatches as at 31 December 2004. Interest rate risk will arise when more assets/liabilities than liabilities/assets are repriced in a given time band. A positive interest rate sensitivity gap exists when more interest sensitive assets than interest sensitive liabilities reprice during a given time period. This tends to benefit NII when interest rates are rising. Conversely, a negative interest rate sensitivity gap exists when more interest sensitive liabilities than interest sensitive assets reprice during a given time period. This tends to benefit NII when interest rates are falling. Interest rate sensitivity may also vary during repricing periods and among the currencies in which the Group has positions. As at 31 December 2004, the Group had an overall positive interest rate sensitivity gap of $228.1 million, excluding non-interest sensitive items. The actual effect on NII will depend on a number of factors, including variations in interest rates within the repricing periods, variations among currencies, and the extent to which repayments are made earlier or later than the contracted dates. The interest rate repricing profile, which includes lending, funding and liquidity activities, typically leads to a negative interest rate sensitivity gap in the shorter term.

Complementing the static analysis is the dynamic simulation modelling process. In this process, the Group applies both the earnings and the EVE approaches to measuring interest rate risk. The potential effects of changes in interest rates on NII are estimated by simulating the future course of interest rates, expected changes in the Group's business activities over time, as well as the effect of embedded options in the form of loans subject to prepayment and of deposits subject to preupliftment. The changes in interest rates include the simulation of changes in the shape of the yield curve, high and low rates, and implied forward interest rates.

EVE is simply the present value of the Group's assets less the present value of the Group's liabilities, currently held by the Group. In EVE sensitivity simulation modelling, the present values for all the Group's cash flows are computed, with the focus on changes in EVE under various interest rate environments. This economic perspective measures interest rate risk across the entire time spectrum of the balance sheet.

Stress testing is also performed regularly on balance sheet risk to determine the sensitivity of the Group's capital to the impact of more extreme interest rate movements. This stress testing is to show that even under more extreme market movements, for example the Asian financial crisis, its capital will not deteriorate beyond its approved risk tolerance. Such tests are also performed to provide early warning of potential worst-case losses so as to facilitate proactive management of these risks in the rapidly changing financial markets. The results of these stress testing are presented to ALCO, the Executive Committee and the Board of Directors.

LIQUIDITY RISK MANAGEMENT

Liquidity risk is defined as the potential loss arising from the Group's inability to meet its contractual obligations when due. Liquidity risk arises in the general funding of the Group's activities and in the management of its assets. The Group maintains sufficient liquidity to fund its day-to-day operations, meet customer deposit withdrawals either on demand or at contractual maturity, meet customers' demand for new loans, participate in new investments when opportunities arise, and repay borrowings as they mature. Hence liquidity is managed to meet known as well as unanticipated cash funding needs.

Liquidity risk is managed in accordance with a framework of liquidity policies, controls and limits approved by ALCO. These policies, controls and limits ensure that the Group maintains well diversified sources of funding, as well as sufficient liquidity to meet all its contractual obligations when due. This distribution of sources and maturities of deposits is managed actively in order to ensure cost effectiveness and continued access to funds and to avoid a concentration of funding needs from any one source. Important factors in assuring liquidity are competitive pricing in interest rates and the maintenance of customers' confidence. Such confidence is founded on the Group's good reputation, the strength of its earnings, and its strong financial position and credit rating.

The management of liquidity risk is carried out throughout the year by a combination of cash flow management, maintenance of high quality marketable securities and other short-term investments that can be readily converted to cash, diversification of the funding base, and proactive management of the Group's "core deposits". "Core deposits" is a major source of liquidity for the Group. These "core deposits" are generally stable non-bank deposits, like current accounts, savings accounts and fixed deposits. The Group monitors the stability of its "core deposits" by analyzing their volatility over time.

In accordance with the regulatory liquidity risk management framework, liquidity risk is measured and managed on a projected cash flow basis. The Group is required to monitor liquidity under "business as usual" and "bank-specific crisis" scenarios. Liquidity cash flow mismatch limits have been established to limit the Group's liquidity exposure. The Group has also identified certain early warning indicators and established the trigger points for possible contingency situations. These early warning indicators are monitored closely so that immediate action can be taken. On a tactical daily liquidity management level, Global Treasury – Asset Liability Management is responsible for effectively managing the overall liquidity cash flows in accordance with the Group's approved liquidity risk management policies and limits.

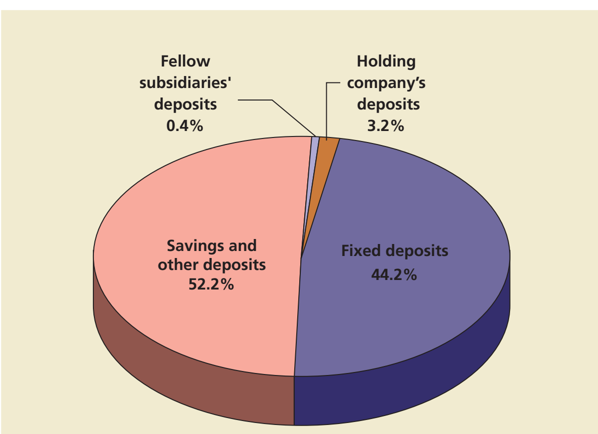
Liquidity contingency funding plans have been drawn up to ensure that alternative funding strategies are in place and can be implemented on a timely basis to minimise the liquidity risks that may arise upon the occurrence of a bank-specific crisis or dramatic change in market conditions. Under the plans, a team comprising senior management and representatives from all relevant units will direct the business units to take certain specified actions to create liquidity and continuous funding for the Group's operations.

The table in Note 32(d) of Notes to the Financial Statements shows the maturity mismatch analysis of the Bank's nearer and longer-term time bands relating to the cash inflows and outflows based on contractual classifications arising from business activities. The projected net cash outflow in the 'Up to 7 Days' time band of $257.9 million comprises mainly customers' current accounts and savings accounts that are repayable on demand. However, when these customer deposits are adjusted for behavioural characteristics, the projected net cash outflow in the 'Up to 7 Days' time band is very much reduced as they are adjusted out to the longer-term time bands due to the stable nature of these customer deposits.

Sources of Deposits

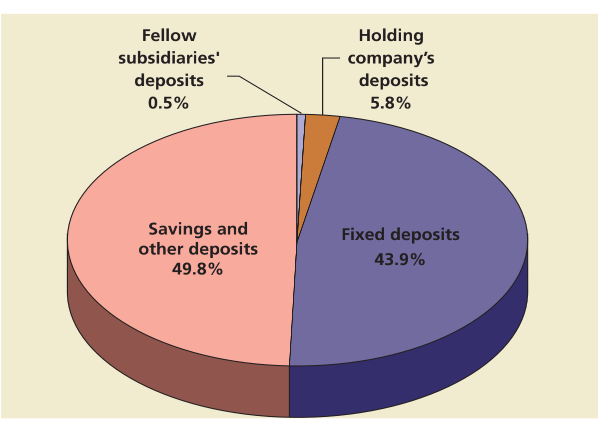
The Group has access to diverse funding sources. Liquidity is provided by a variety of both short-term and long-term instruments. The diversity of funding sources enhances funding flexibility, limits dependence on any one source of funds, and generally lowers the overall cost of funds. In making funding decisions, management considers market conditions, prevailing interest rates, liquidity needs, and the desired maturity profile of its liabilities.

Non-bank customers' fixed deposits, savings and other deposits continued to form a significant part of the Group's overall funding base in the year under review. As at 31 December 2004, customer deposits amounted to $637.2 million and accounted for 96.4% of total deposits. Fellow subsidiaries' and holding company's deposits on the other hand amounted to only $23.8 million and formed the remaining 3.6% of total deposits. In terms of deposits' mix, savings and other deposits comprised the majority of the funding base at 52.2% followed by fixed deposits at 44.2%.



Sources of deposits – 2004

	$'000	%
Customer deposits		
Fixed deposits	**292,362**	**44.2**
Savings and other deposits	**344,810**	**52.2**
Fellow subsidiaries' deposits	**2,463**	**0.4**
Holding company's deposits	**21,310**	**3.2**
Total deposits	**660,945**	**100.0**



Sources of deposits – 2003

	$'000	%
Customer deposits		
Fixed deposits	283,254	43.9
Savings and other deposits	320,875	49.8
Fellow subsidiaries' deposits	3,338	0.5
Holding company's deposits	37,252	5.8
Total deposits	644,719	100.0

OPERATIONAL RISK MANAGEMENT

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Potential loss may be in the form of financial loss or other damages, for example, loss of reputation and public confidence that will impact the Group's credibility and ability to transact, maintain liquidity and obtain new business.

Operational risk is managed through a framework of policies, techniques and procedures as approved by the Group's Management Committee (MC).

This framework of techniques and procedures encompasses the following:

- building of Operational Risk Profiles (ORPs);
- conduct of Operational Risk Self Assessment (ORSA) based on the ORPs;
- development of an Operational Risk Action Plan (ORAP);
- monitoring of Key Operational Risk Indicators (KORIs);
- collection and analysis of operational risk events/loss data;
- monitoring and reporting of operational risk issues.

The building of ORPs involves risk identification, the assessment of inherent or absolute risks, as well as the identification and classification of management controls. The methodology provides the tool for the profiling of significant operational risks to which business and support units are exposed. These units then define the key management policies/procedures/controls that have been established to address the identified operational risks.

As part of the continual assessment, ORSA provides the business/support heads with an analytical tool to identify the wider operational risks, assess the adequacy of controls over these risks, and identify control deficiencies at an early stage so that timely action can be taken.

Where actions need to be taken, these are documented in the form of an ORAP for monitoring and reporting to top management.

KORIs are statistical data that are collected and monitored regularly by business units on an on-going basis for the early detection of potential areas of operational control weakness. Trend analysis is carried out to determine whether there are systemic issues to be addressed.

A database of operational risk events and losses has been established to enable the future use of advanced approaches for quantification of operational risks. Additionally, the analysis of operational risk events and sharing of lessons learnt help to further strengthen the operational risk management capability of the business units.

Included in the overall framework of operational risk is the disciplined product programme process. This process aims to ensure that the risks associated with each new product/service are identified, analysed and managed.

For the implementation of all online products and services, extra care and precautionary measures are taken to address and protect customers' confidentiality and interests. Clear instructions are also posted on the Group's website to advise and educate customers on the proper use and safekeeping of their access identification and passwords.

As part of the Group's comprehensive operational risk framework, an enhanced Group-wide Business Contingency Plan has been developed. In addition, in line with the increasing need to outsource internal operations in order to achieve cost efficiency, a Group Outsourcing Policy has been established to regulate the outsourcing of services to third parties.

Risk transfer mechanisms, such as insurance, to mitigate the risk of high impact loss events also form part of this framework. Identified operational risks with relatively high residual risk assessment ratings and new risks that are beyond the control of the Group will be scrutinised for insurability.

Legal risk is part of operational risk. Legal risk arises from inadequate documentation, legal or regulatory incapacity or insufficient authority of customers and uncertainty in the enforcement of contracts. This is managed through consultation with the Group's legal counsel and external counsel to ensure that legal advice is appropriately taken where necessary.

As part of preparations to comply with Basel II, the Group has started mapping all its business activities to the eight Business Lines as defined by the Basel Committee on Banking Supervision.

GROUP COMPLIANCE

Risk Management & Compliance sector – Group Compliance is an independent function that helps to identify, assess and monitor the Bank's compliance risk, that is, the risk of financial or reputational loss arising from failure to comply with all applicable laws, regulations, codes of conduct and standards of good practice relating to the business activities of the Bank. Group Compliance also advises and reports on the Bank's compliance risk.

To fulfil its role, Group Compliance has drawn up policies, guidelines and procedures in line with applicable laws, rules and standards to provide guidance to business units in their day-to-day activities. These include guidelines and procedures for the sale of investment products, opening of accounts and prevention of money laundering and terrorist financing activities. Additional guidelines and procedures are implemented in business units to avoid and mitigate conflicts of interests. Regular training sessions are held to create and heighten staff awareness of applicable laws, rules and standards.

Group Compliance achieves its objectives through a team of dedicated compliance officers in key business lines and support units, and works closely with business units to manage the Bank's compliance risks.