Capital Management

(This section forms an integral part of OCBC's audited financial statements)

CAPITAL POLICY

OCBC's capital management is directed towards creating and maximising shareholder value, and delivering sustainable returns to shareholders. We also strive to maintain strong credit ratings and sound capital ratios, and to nurture mutually beneficial partnerships with other capital providers and stakeholders.

Our policy is to maintain a strong capital position, consistent with our goals of maintaining investor, depositor, customer and market confidence, to meet regulatory requirements at all times, and to seize opportunities for strategic investments and business growth. To achieve our capital objectives and our target minimum credit rating of A, we maintain an optimal balance between the use of equity capital, which is costly and dilutes shareholders' return, and other forms of bank capital, which are less costly. We will continue to evaluate and pursue strategic business and investment opportunities which create value for our stakeholders, and may access international and local capital markets for different forms of additional capital if necessary.

Our capital now comprises the following:

(i) Tier 1 Capital which includes ordinary share capital, disclosed reserves, perpetual preference shares, innovative Tier 1 preference shares and minority interests; and

(ii) Tier 2 Capital which includes portfolio allowances, Upper Tier 2 subordinated notes, 45% of revaluation surplus on available-for-sale ("AFS") equity securities that are listed on recognised stock exchanges and Lower Tier 2 subordinated notes.

In our efforts to improve shareholder value, we actively manage our capital composition to achieve an efficient mix of different capital instruments in order to lower our overall cost of capital and improve return on ordinary shareholders' equity. Over the years, our capital composition has been adjusted by issuing non-dilutive perpetual preference shares, tax deductible non-dilutive innovative Tier 1 preference shares, Upper Tier 2 subordinated notes and Lower Tier 2 subordinated notes.

To-date, OCBC has issued 3 classes of preference shares: Class E preference shares, Class G preference shares and through a special purpose vehicle, OCBC Capital Corporation, innovative preference shares which are eligible for inclusion as Tier 1 Capital. OCBC has also issued subordinated notes which are eligible for inclusion as Upper Tier 2 Capital and Lower Tier 2 Capital, respectively.

The issuance and maintenance of qualified capital instruments is subject to regulatory limits prescribed by the Monetary Authority of Singapore ("MAS"), as follows:

(i) Innovative Tier 1 capital instruments shall not exceed 15% of Net Tier 1 Capital;
(ii) Perpetual non-cumulative preference shares and innovative Tier 1 capital instruments in total shall not exceed 30% of Net Tier 1 Capital;
(iii) Tier 2 Capital shall not exceed 100% of Net Tier 1 Capital; and
(iv) Lower Tier 2 Capital shall not exceed 25% of Total Capital.

Our banking and insurance subsidiaries manage their own capitals taking into account their respective business strategies, regulatory environment, risk weighted assets, capital composition and targeted growth. The banking and insurance subsidiaries also raise capital externally when needed to diversify their funding sources. For our other subsidiaries, allocation of capital is based on business needs and is centrally coordinated.

CAPITAL PLANNING, MONITORING AND ALLOCATION

We plan and monitor capital usage primarily through the annual operational planning process, as well as the monthly management reporting processes. The annual operational plan is reviewed and approved by the Board of OCBC.

From January 2008, capital usage takes into account Basel II regulatory capital covering credit, market and operational risks. In 2007, regulatory capital was used as a proxy for risk based capital.

REGULATORY CAPITAL

We are required to comply with capital ratios prescribed by the Monetary Authority of Singapore at the bank and the group levels. In addition, our banking operations in jurisdictions outside Singapore are subject to local regulations. OCBC and each of its regulated banking entities were in compliance with all prescribed capital ratios throughout the period.

In determining regulatory capital ratios, prescribed deductions from regulatory capital, including the cost of investment in subsidiaries, goodwill, intangibles and other capital investments have to be taken into account.

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Under existing regulations, the amount of regulatory capital we are required to hold is determined according to:

(i) Credit risk-weighted assets comprising:
- balance sheet assets, which include cash, claims on governments, financial institutions, corporates and individuals, private equity venture capital ("PEVC") investments, fixed assets and other assets;
- off-balance sheet assets, which include guarantees, performance bonds, standby facilities, sale and repurchase agreements with recourse, forward purchases, revolving credit facilities and other commitments; and
- derivative contracts, which include foreign exchange contracts, gold contracts, interest rate contracts, equity contracts and other commodities.

(ii) Market risk-weighted assets including assets that are subject to interest rate, equity, foreign exchange, credit, commodity price and options risks.

Credit risk-weighted assets are risk weighted from 0% for cash to 200% for PEVC investments. Market risk-weighted assets are marked to market and are risk weighted according to the instrument category, maturity period, credit quality grade and other factors.

Most of our regulatory capital requirements arise from the credit risk-weighted assets. Market risk-weighted assets generally represent less than 10% of the total risk weighted assets.

CAPITAL ADEQUACY RATIO

As of 31 December 2007, our group capital adequacy ratio[1] was:

$ million	31 Dec 07	31 Dec 06
Tier 1 Capital		
Paid-up ordinary and preference shares	**5,520**	5,481
Disclosed reserves/others	**9,366**	8,136
Goodwill/others	**(3,455)**	(3,560)
	11,431	10,057
Upper Tier 2 Capital		
Cumulative portfolio allowances	**713**	704
Subordinated term notes	**2,426**	3,112
Revaluation surplus on equity securities	**247**	205
	3,386	4,021
Lower Tier 2 Capital	**225**	–
Tier 2 Capital	**3,611**	4,021
Tier 1 and Tier 2 Capital	**15,041**	14,078
Capital investments in insurance subsidiaries	**(2,506)**	(1,889)
Others	**(124)**	(85)
Eligible Total Capital	**12,411**	12,105
Risk weighted assets including market risk	**99,381**	76,514
Tier 1 capital adequacy ratio	**11.5%**	13.1%
Total capital adequacy ratio	**12.4%**	15.8%

[1] Prepared in accordance with the MAS Notice 637 to Banks dated 28 May 2004.

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SHARE BUYBACK AND TREASURY SHARES

In addition to dividends, share buyback programmes are used to return surplus capital to shareholders. Share buybacks allow us to control the return of surplus capital with greater degree of flexibility while maintaining a more predictable dividend return to shareholders.

Shares purchased under the share buyback programme are held as treasury shares. These are recorded as a deduction against share capital, and may be subsequently sold, cancelled, distributed as bonus shares, or used to meet delivery obligations under various employee share incentive schemes.

During the financial year ended 31 December 2007, the Bank bought back approximately 5.0 million of its ordinary shares for $43.5 million, as part of its third $500 million share buyback programme which commenced in June 2006. As at the date of this report, $269 million have been utilised to purchase approximately 39.2 million shares under the programme. The shares repurchased are held as treasury shares.

DIVIDEND

Our dividend policy aims to provide shareholders with a predictable and sustainable dividend return, payable on half-yearly basis. We also target a dividend payout amounting to not less than 45% of the Group's core net profit. For the year ended 31 December 2007, the Board of Directors is recommending a final tax-exempt dividend of 14 cents per share, bringing the total net dividend for 2007 to 28 cents per share, or an estimated total net dividend of $864 million, representing 46% of the Group's core net profit of $1,878 million (2006: Total net dividend of $709 million, or 49% of core net profit of $1,443 million).