



Wing Hang Bank, Limited

(incorporated with limited liability in Hong Kong)

US\$400,000,000 6.00 per cent.

Step-Up Perpetual Subordinated Notes

Issue Price: 99.318 per cent.

The US\$400,000,000 6.00 per cent. Step-Up Perpetual Subordinated Notes (the “*Notes*”) will be issued by Wing Hang Bank, Limited (the “*Bank*” or the “*Issuer*”). The Notes will bear interest at the rate of (i) 6.00 per cent. per annum from and including 19 April 2007 to but excluding 20 April 2017 and (ii) from and including 20 April 2017 at three month LIBOR plus 1.85 per cent. per annum. Interest will be payable in respect of the period from 19 April 2007 until but excluding 20 April 2017 semi-annually in arrears on 20 April and 20 October of each year (save that the first payment of interest, which will be made on 20 October 2007 will be in respect of the period from, and including 19 April 2007 to, but excluding, 20 October 2007) and thereafter quarterly in arrears on 20 January, 20 April, 20 July and 20 October of each year. See “*Terms and Conditions of the Notes — Interest*”. The Notes will have no final maturity date and may be redeemed only as set forth under “*Terms and Conditions of the Notes — Redemption and Purchase*”. Subject to satisfaction of certain regulatory approval requirements, the Issuer may redeem all but not some only of the Notes at their principal amount together with accrued and unpaid interest on 20 April 2017 or thereafter on any Interest Payment Date (as defined in “*Terms and Conditions of the Notes*”). See “*Terms and Conditions of the Notes — Redemption and Purchase*”. In addition, subject to satisfaction of certain regulatory approval requirements, the Issuer may redeem the Notes in whole but not in part at their principal amount together with accrued and unpaid interest to the date fixed for redemption upon the occurrence of certain changes in taxation in the Hong Kong Special Administrative Region of the People’s Republic of China (“*Hong Kong*”) requiring the payment of additional amounts. See “*Terms and Conditions of the Notes — Redemption and Purchase*”.

The Notes will constitute direct and unsecured obligations of the Issuer. The Notes will rank *pari passu* among themselves and upon a Winding-Up (as defined in Condition 10 of the Terms and Conditions of the Notes) will be subordinated in right of payment to the claims of the Issuer Prior Creditors (as defined in “*Terms and Conditions of the Notes*”). No payment of interest or repayment of principal in respect of the Notes may be made unless the Issuer is able to make such payment and remain solvent immediately thereafter. See “*Terms and Conditions of the Notes — Status*”. In addition, at the option of the Issuer, interest on the Notes need not be paid on any Interest Payment Date if, during the 12 calendar months preceding a date on which interest is due to be paid in respect of the Notes, no dividend has been declared or paid on any class of share capital of the Issuer. See “*Terms and Conditions of the Notes — Interest — Deferral of Interest*”.

The Notes have been rated “Baa1” by Moody’s Investors Service, Inc. (“*Moody’s*”) and “BBB+” by Fitch Ratings Ltd. (“*Fitch*”). A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.

See “*Risk Factors*” beginning on page 16 for a discussion of certain factors to be considered in connection with an investment in the Notes.

Approval in principle has been received for the listing of, and permission to deal in, the Notes on the Singapore Exchange Securities Trading Limited (the “*SGX-ST*”). The SGX-ST takes no responsibility for the correctness of any statements made or opinions expressed herein. Admission of the Notes to the official list of the SGX-ST is not to be taken as an indication of the merits of the Issuer or the Notes.

The Notes have not been and will not be registered under the United States Securities Act of 1933, as amended (the “*Securities Act*”) and, subject to certain exceptions, may not be offered or sold within the United States (as defined in Regulation S under the Securities Act (“*Regulation S*”)).

The Notes will be represented initially by a global certificate (the “*Global Certificate*”) in registered form, without interest coupons attached, which will be registered in the register of Noteholders in the name of a nominee of, and shall be deposited with a common depositary for Euroclear Bank S.A./N.V. (“*Euroclear*”) and Clearstream Banking, société anonyme (“*Clearstream*”). The Global Certificate will be exchangeable for interests in certain limited circumstances for Notes in definitive form. See “*Summary of Provisions relating to the Notes while in Global Form*”.

Joint Bookrunners and Joint Lead Managers

Citigroup

HSBC

UBS Investment Bank

Offering Circular dated 12 April 2007

No person is authorised to give any information or make any representation other than those contained in this Offering Circular and, if given or made, such information or representation must not be relied upon as having been authorised by the Bank or by any of the managers set forth in “*Subscription and Sale*” or elsewhere in this Offering Circular (the “*Managers*”). This Offering Circular does not constitute an offer to sell or a solicitation of an offer to buy any Notes by any person except in compliance with all applicable laws and regulations. No representation or warranty, express or implied, is made by the Managers, the Trustee (as defined in the “*Terms and Conditions of the Notes*”) or any of their affiliates or advisors as to the accuracy or completeness of the information contained herein, and nothing contained in this Offering Circular is, or shall be relied upon as, a promise or representation by the Managers, the Trustee or their affiliates or advisors. The Trustee and the Managers have not separately verified the information contained herein. Neither the delivery of this Offering Circular nor any sale made hereunder shall under any circumstances imply that the information herein is correct as at any date subsequent to the date hereof or constitute a representation that there has been no change or development reasonably likely to involve a material adverse change in the affairs of the Bank or the Bank’s subsidiaries or affiliates since the date hereof.

This Offering Circular is not intended to provide the basis of any credit or other evaluation and should not be considered as a recommendation by the Bank or the Managers that any recipient of this Offering Circular should purchase any of the Notes. Each investor contemplating purchasing Notes should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Bank. The Notes have not been and will not be registered under the United States Securities Act of 1933, as amended, (the “*Securities Act*”) and are subject to U.S. tax law requirements. Subject to certain exceptions, the Notes may not be offered, sold or delivered within the United States. For a further description of certain restrictions on the offering and sale of the Notes and on distribution of this Offering Circular, see “*Subscription and Sale*” below.

IN CONNECTION WITH THIS ISSUE, THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED (OR ANY PERSON ACTING ON ITS BEHALF) MAY OVER-ALLOT OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF THE NOTES AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL. HOWEVER, THERE IS NO ASSURANCE THAT THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED (OR ANY PERSON ACTING ON ITS BEHALF) WILL UNDERTAKE STABILISATION ACTION. ANY STABILISATION ACTION MAY BEGIN ON OR AFTER THE DATE ON WHICH ADEQUATE PUBLIC DISCLOSURE OF THE TERMS OF THE OFFER OF THE NOTES IS MADE AND, IF BEGUN, MAY BE ENDED AT ANY TIME, BUT IT MUST END NO LATER THAN THE EARLIER OF 30 DAYS AFTER THE CLOSING DATE AND 60 DAYS AFTER THE DATE OF THE ALLOTMENT OF THE NOTES.

The Bank, having made all reasonable inquiries, confirms that this Offering Circular contains all information with respect to the Bank and the Bank’s consolidated subsidiaries (the “*Group*”) and the Notes, which is material in the context of the issue and offering of the Notes (including all information required by applicable laws of Hong Kong), that the information contained herein is true and accurate in all material respects and is not misleading in any material respect, that the opinions or intentions expressed herein are honestly held and have been reached after considering all relevant circumstances and are based on reasonable assumptions, that there are no other facts the omission of which would, in the context of the issue and offering of the Notes, make this Offering Circular as a whole or any of such information or the expression of any such opinions or intentions misleading in any material respect, that all reasonable inquiries have been made by the Bank to verify the accuracy of such information and that this Offering Circular does not contain any untrue statement of a material fact or omit to state a material fact required to be stated herein or necessary in order to make the statements herein, in the light of the circumstances under which they are made, not misleading. The Bank accepts responsibility accordingly. Information provided herein with respect to Hong Kong and the political status, banking industry and economy of Hong Kong has been derived from information published by the Hong Kong Government and other public sources, and the Bank accepts responsibility only for the accurate extraction of information from such sources.

The distribution of this Offering Circular and the offering of the Notes in certain jurisdictions may be restricted by law. It may not be used for or in connection with any offer to, or solicitation by, anyone in any jurisdiction in which it is unlawful to make such an offer or solicitation. Persons into whose possession this Offering Circular may come are required by the Bank and the Managers to inform themselves about and to observe such restrictions. No action is being taken in any jurisdiction to permit an offering to the general public of the Notes or the distribution of this Offering Circular in any jurisdiction where action would be required for such purposes.

The SGX-ST takes no responsibility for the contents of this Offering Circular, makes no representation as to its accuracy or completeness and expressly disclaims any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this Offering Circular.

Certain Defined Terms, Conventions and Currency of Presentation

The Group publishes its financial statements in Hong Kong dollars. References to “HK\$” and “Hong Kong dollars” are to the currency of the Hong Kong Special Administrative Region of the People’s Republic of China. References to “**MOP**” and “**Macau Patacas**” are to the currency of Macau Special Administrative Region of the People’s Republic of China (“**Macau**”). References to “**US\$**” or “**US dollars**” are to the currency of the United States of America. References to “**Renminbi**” and “**RMB**” are to the currency of the People’s Republic of China (excluding Hong Kong and Macau) (“**Mainland China**”). References to the “**HKMA**” are to the Hong Kong Monetary Authority. References to the “**Hong Kong Government**” are to the government of Hong Kong. Any discrepancies in the tables in this Offering Circular between the amounts listed and the totals thereof are due to rounding. Unless otherwise specified, the financial information in this Offering Circular is presented on a consolidated basis for the Bank and its consolidated subsidiaries. Unless otherwise specified, all conversions of Macau Patacas into US dollars were made at the rate of MOP7.9861 and MOP8.0113 to US\$1.00, in respect of amounts stated as of or for the years ended 31 December 2005 and 31 December 2006 respectively. Unless otherwise specified, all conversions of Hong Kong dollars into US dollars were made at the rate of HK\$7.7535 to US\$1.00 in respect of amounts stated as of or for the year ended 31 December 2005, and all conversions of Hong Kong dollars into US dollars in respect of amounts stated as of or for the year ended 31 December 2006 were made at the rate of HK\$7.7780 to US\$1.00. In “*Summary — Recent Developments of the Group — Acquisition of Inchroy Credit Corporation Limited*” and “*Recent Developments — Acquisition of Inchroy Credit Corporation Limited*” the conversion of the Hong Kong dollar consideration paid for Inchroy Credit Corporation Limited into US dollars was made at the rate of HK\$7.8060 to US\$1.00. These translations were made for the sole purpose of the reader’s convenience and have not been audited. No representation is made that the Hong Kong dollar or US dollar amounts referred therein could have been or could be converted into Hong Kong dollars or US dollars, as the case may be, at any particular rate or at all.

This Offering Circular contains forward-looking statements regarding the intent, belief or current expectations of the Bank with respect to its financial condition and future results of operations. In many cases, but not all, words such as “anticipate”, “believe”, “estimate”, “expect”, “intend”, “may”, “plan”, “probability”, “project”, “risk”, “seek”, “should”, “target” and similar expressions are used in relation to the Bank to identify forward-looking statements. You can also identify forward-looking statements in discussions of strategy, plans or intentions. These statements reflect the current views of the Bank with respect to future events and are subject to risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialise, or should underlying assumptions prove incorrect, the Bank’s actual results may vary materially from those it currently anticipates. Given these risks and uncertainties, prospective investors are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of this Offering Circular. Any obligation to update, or to announce publicly any revision to, any of the forward-looking statements contained in this Offering Circular to reflect future actual events or developments is disclaimed. The information contained in this Offering Circular, including without limitation the information under “*Risk Factors*”, and “*Business of the Group*”, identifies important factors that might cause the forward-looking statements not to be realised.

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SUMMARY

The following summary is qualified in its entirety by, and is subject to, the detailed information contained or referred to elsewhere in this Offering Circular. For a discussion of certain matters that should be considered in evaluating an investment in the Notes, see “*Risk Factors*”.

The Bank

The Bank was first founded in 1937 in Guangzhou by the late Mr. Y.K. Fung. It moved from Guangzhou to Hong Kong in 1940 and subsequently to Cham Kiang following the outbreak of World War II. The business was reestablished in Hong Kong in 1946 with a staff of 19 and capital of HK\$300,000 (US\$38,570). In 1960, the Bank was incorporated in Hong Kong and was granted a banking licence in the same year. The Bank is the holding company and the principal operating company of the Group whose principal activities include corporate banking, retail banking, foreign exchange and treasury services. The Bank has a network of 38 branch offices located in Hong Kong, one branch office in each of Shenzhen, Guangzhou and Shanghai, a sub-branch in the Fumin district of Shenzhen and a representative office in Beijing. The Bank intends to upgrade its Beijing representative office to a branch and to increase the number of sub-branches it has in Mainland China. The Bank’s wholly-owned subsidiary in Macau, Banco Weng Hang, has been in operation since 1941 and has 13 branches. In addition, through the Bank’s subsidiaries, the Group provides nominee, deposit taking, offshore banking, hire purchase, consumer financing, insurance agency and broking and share brokerage services.

In May 2002, the Bank received approval from the People’s Bank of China to provide Renminbi services to foreign-funded enterprises and foreigners in the Mainland China. The Bank also obtained approval to extend foreign currency services to domestic Chinese corporations operating in the Mainland China. In February 2007, the Bank received approval from the China Banking Regulatory Commission (“*CBRC*”) to prepare for the establishment of a locally incorporated bank in Mainland China. See “*Recent Developments — Proposed Establishment of a Locally Incorporated Bank in Mainland China*”. The Bank expects that the establishment of a locally incorporated bank will enable the Group to further expand its business in Mainland China.

For the year ended 31 December 2006, the Group recorded a net profit of HK\$1,660.7 million (US\$213.5 million), and a final dividend of HK\$2.00 per share has been recommended by the Board of Directors of the Bank. As of 31 December 2006, the Group’s capital adequacy ratio and loan to deposit ratio were 15.2% and 54.6% respectively. For the year ended 31 December 2006, the Group achieved a return on average assets of 1.47%, a return on average shareholders’ funds of 18.9% and an average liquidity ratio of 51.6%.

As of 31 December 2006, the Group’s total assets, shareholders’ funds, advances to customers and total deposits were HK\$122,150.6 million (US\$15,704.6 million), HK\$9,296.7 million (US\$1,195.3 million), HK\$58,638.2 million (US\$7,539.0 million) and HK\$107,475.1 million (US\$13,817.8 million), respectively. As of 30 March 2007, the Bank’s market capitalisation was HK\$28,305.9 million (US\$3,622.6 million) (based on the noon buying rate in New York City for cable transfers on 30 March 2007).

The Group’s main sources of funding for its assets are shareholders’ funds, subordinated debt and customer deposits, whilst home mortgage loans and loans for property investment and development represented 47.1% of the Group’s total loans to customers as of 31 December 2006. Home mortgage loans are generally secured by a first fixed legal charge over the underlying property. Working capital loans for businesses are typically secured by fixed and floating charges over land, buildings, machinery, inventory and receivables.

As of 31 December 2006, the Group had impaired loans of an aggregate amount of HK\$364.1 million (US\$46.8 million), representing 0.62% of total loans outstanding. This compared with HK\$560.1 million (US\$72.2 million) as of one year earlier.

For the year ended 31 December 2006, the Group’s overseas operations, including Macau and Mainland China recorded a profit before taxation of HK\$358.4 million (US\$46.1 million) which accounted for 18.1% of the Group’s consolidated profit before taxation. As of 31 December 2006, the Group’s total advances to customers for use outside Hong Kong, which principally includes Macau and Mainland China, were

HK\$6,211.1 million (US\$798.5 million) in Macau and HK\$9,271.2 million (US\$1,192.0 million) in Mainland China and other overseas areas. Total deposits increased by 17.8% from HK\$91,200.8 million (US\$11,762.5 million) as of 31 December 2005 to HK\$107,475.1 million (US\$13,817.8 million) as of 31 December 2006 as a result of a substantial increase in demand and savings deposits.

Over the years, the Bank has proactively developed its treasury activities and wealth management services with a view to broadening fee and commission income. The Bank currently offers a wide array of wealth management investment instruments, including unit trust funds, certificates of deposit, bonds and notes to its customers. For the year ended 31 December 2006, other operating income and net interest income on financial instruments held for trading and measured at fair value through profit or loss of the Group represented 34.7% of the Group's operating income. It is the Bank's intention to continue to expand its treasury activities and wealth management services to broaden its income base.

The Bank's objective is to strengthen its position in the Hong Kong market, enhance its overall competitiveness and expand its international operations, particularly in Mainland China and provide its customers with quality products and excellent customer service. The Bank intends to implement its strategy through:

- further strengthening of the Bank's position in Hong Kong by enhancing and expanding its core domestic businesses and concentrating on key market segments;
- expanding its geographic coverage, in particular in Mainland China; and
- continuing to diversify its income sources. (See "*Business of the Group — Strategy*").

Recent developments of the Group

Acquisition of Inchroy Credit Corporation Limited

On 31 January 2007, the Bank completed the purchase of the entire issued share capital of Inchroy Credit Corporation Limited ("**Inchroy**") from BankAmerica International Financial Corporation and Inchcape Hong Kong Limited for a consideration of HK\$1,400 million (US\$179.3 million), satisfied by a payment in cash to the Vendors at completion. See "*Recent Developments — Acquisition of Inchroy Credit Corporation Limited*."

The consideration was determined after arm's length negotiations and represents approximately 1.61 times the published audited net asset value of Inchroy of HK\$868.7 million (US\$112.0 million) as at 31 December 2005 and 1.49 times the net asset value of Inchroy of HK\$939.0 million (US\$120.7 million) as at 31 December 2006.

The principal business activities of Inchroy comprise the provision of hire purchase and lease financing for motor vehicles and equipment, and extending personal and mortgage loans.

Inchroy is a Hong Kong registered deposit-taking company with total assets of HK\$5,741.8 million (US\$738.2 million) as at 31 December 2006. It currently operates from four offices in Hong Kong, one of which is its head office in Causeway Bay.

Net profit before tax of Inchroy amounted to HK\$94.9 million (US\$12.2 million) and HK\$102.8 million (US\$13.3 million) for the years ended 31 December 2006 and 31 December 2005 respectively. Net profit after tax amounted to HK\$78.6 million (US\$10.1 million) and HK\$84.7 million (US\$10.9 million) for the years ended 31 December 2006 and 31 December 2005 respectively. The net asset value of Inchroy was HK\$939.0 million (US\$120.7 million) and HK\$868.7 million (US\$112.0 million) for the years ended 31 December 2006 and 31 December 2005 respectively.

As a 100% owned subsidiary of the Bank, the financial results of Inchroy will in future be consolidated into the Group's financial statements. The Board of Directors of the Bank believe that the acquisition of Inchroy will enhance the prospective earnings of the Group but that it will not have a material effect on the total assets and liabilities of the Group.

Proposed Establishment of a Locally Incorporated Bank in the PRC

In February, 2007, the Bank received approval from the CBRC to prepare for the establishment of a locally incorporated bank in the PRC. The establishment of a locally incorporated subsidiary bank will enable the Bank to offer a full range of Renminbi services to Mainland China domestic residents. The Bank expects the process to be completed in the second half of 2007. Following the establishment of a locally incorporated subsidiary bank in Mainland China, the Bank intends that all but one of its Mainland China branches will become branches of the locally incorporated bank.

Implementation of the Basel II Accord in Hong Kong

The HKMA has adopted the Basel II Accord capital adequacy standards in Hong Kong from the beginning of 2007. Currently, the Bank adopts the standardised approach for credit risk and market risk, and the basic indicator approach for operational risk.

In order to enhance the Bank's credit risk management and ensure compliance with Basel II requirements, including moving in the future to foundation internal ratings-based approach for credit risk, the Bank joined a consortium of banks to engage an external consultant in late 2003 to devise a credit risk solution (the "*Solution*") on a pooled credit data basis. The Bank completed its implementation of the Solution in April 2005 and has since been using the resultant systems. The Solution, which comprises the establishment of an internal rating framework and credit risk rating tools for major asset classes of the Bank, is intended to enhance the ability of portfolio and capital management through improved evaluation of risk and return.

Furthermore, the Bank has set up a steering committee chaired by the Deputy Chief Executive for the purpose of complying with Basel II requirements and implementing best market practice for risk management within the Bank.

THE OFFERING

The following is a brief summary of certain terms of this offering. For a more detailed description of the terms of the Notes, see “Terms and Conditions of the Notes”. Capitalised terms used herein and not defined have the meanings given to them in the “Terms and Conditions of the Notes” set out in this Offering Circular.

The Issuer:	Wing Hang Bank, Limited, a company incorporated with limited liability in Hong Kong.
The Notes:	US\$400,000,000 6.00 per cent. Step-Up Perpetual Subordinated Notes.
Issue Price:	99.318 per cent.
Interest:	The Notes will bear interest at the rate of (i) 6.00 per cent. per annum from and including 19 April 2007 to but excluding 20 April 2017 and (ii) from and including 20 April 2017 at three month LIBOR plus 1.85 per cent. per annum. Interest will be payable in respect of the period from 19 April 2007 until but excluding 20 April 2017 semi-annually in arrears on 20 April and 20 October of each year, save that the first payment of interest, which will be made on 20 October 2007 will be in respect of the period from, and including 19 April 2007 to, but excluding, 20 October 2007. From and including 20 April 2017, the Notes will bear interest at the Floating Rate of Interest quarterly in arrears on 20 January, 20 April, 20 July and 20 October of each year. See “<i>Terms and Conditions of the Notes</i>”.
Deferral of Interest:	Where, during the 12 calendar months preceding a date on which interest is due to be paid in respect of the Notes, no dividend has been declared or paid on ordinary shares of the Issuer and no payment has been declared or paid on any Securities issued by the Issuer, such due date shall be referred to as an “Optional Interest Payment Date”. “Securities” shall mean preference shares and any other securities of the Issuer that qualify as “Category I — Core Capital” for the purpose of capital adequacy under Part XVII of the Banking Ordinance. The Issuer may if it so elects, but shall not be obliged to, pay on any Optional Interest Payment Date the interest that is due to be paid on such date in respect of the Notes and any failure to pay shall not constitute a default by the Issuer for any purpose. Any interest not paid on an Optional Interest Payment Date shall (except to the extent such interest shall subsequently have been paid) constitute “Arrears of Interest”.
Optional Redemption:	The Issuer may redeem all but not some only of the Notes at their principal amount together with accrued and unpaid interest on 20 April 2017 or thereafter on any Interest Payment Date at a redemption price equal to 100% of their principal amount together with accrued and unpaid interest to the date fixed for redemption and all Arrears of Interest after obtaining the prior approval of the HKMA, and upon giving not less than 30 nor more than 60 days’ notice to the Trustee and Noteholders.

It is intended that the Notes should constitute “Category II — Supplementary Capital” (for the purpose of capital adequacy under Part XVII of the Hong Kong Banking Ordinance (Cap. 155 of the Laws of Hong Kong) (the “**Banking Ordinance**”)) of the Issuer and accordingly, under statutory requirements prevailing at the date hereof relating to Category II Supplementary Capital, and by virtue of the above provisions, any redemption, purchase and cancellation of such Notes is subject to the prior consent of the HKMA at the relevant time.

Use of Proceeds:

The issuance of the Notes will strengthen the Group’s capital base and fund the growth of the Bank’s operations. See “*Use of Proceeds*”.

Subordination:

The Notes constitute direct and unsecured obligations of the Issuer, conditional as described below, ranking *pari passu* without any preference among themselves. The rights of the holders of the Notes will, in the event of the Winding-Up of the Issuer, be subordinated in right of payment to the claims of the Issuer Prior Creditors. In the event of the Winding-Up of the Issuer, there shall be payable by the Issuer in respect of each Note (in lieu of any other payment), but subject as provided in the “*Terms and Conditions of the Notes*”, such amount, if any, as would have been payable to the Noteholder thereof if, at the close of business on the day prior to the commencement of the Winding-Up of the Issuer and thereafter, such Noteholder were the holder of the highest ranking fully paid and validly issued preference share in the capital of the Issuer having a preferential right to a return of assets in the Winding-Up of the Issuer over the holders of all other classes of issued shares (including for this purpose other preference shares issued, but excluding any preference shares which are classified as “Category II — Supplementary Capital” for the purpose of capital adequacy under Part XVII of the Banking Ordinance) for the time being in the Issuer’s capital on the assumption that such preference share was entitled to receive on a return of assets in such Winding-Up of the Issuer an amount (disregarding any tax credit which would have been given in relation to dividends payable on such preference share) equal to the principal amount of such Note together with Arrears of Interest, if any, and accrued interest (other than Arrears of Interest) up to, but excluding, the date of repayment in respect thereof.

Enforcement Events:

If default is made in the payment of any amount of principal in respect of the Notes on the due date for payment thereof or of any amount of interest in respect of the Notes within seven days after the date upon which the payment of interest is compulsory (but subject to the provisions of Condition 4(10) of the Terms and Conditions of the Notes) (each an “**Enforcement Event**”) then in order to enforce the obligations of the Issuer, the Trustee at its sole discretion may and, if so requested in writing by holders of at least one quarter in principal amount of the outstanding Notes or if so directed by an Extraordinary Resolution, shall (subject to the Trustee having been indemnified and/or provided with security to its satisfaction) institute a Winding-Up Proceeding in Hong Kong against the Issuer.

If an order is made or an effective resolution is passed for the Winding-Up of the Issuer (whether or not an Enforcement Event has occurred and is continuing) (also an “**Enforcement Event**”) then the Trustee at its sole discretion may and, if so requested in writing by holders of at least one quarter in principal amount of the outstanding Notes or if so directed by an Extraordinary Resolution, shall (subject to the Trustee having been indemnified and/or provided with security to its satisfaction) give written notice to the Issuer declaring the Notes to be immediately due and payable, whereupon they shall become immediately due and payable at their principal amount together with accrued interest and all Arrears of Interest without further action or formality.

Without prejudice to the above, if the Issuer fails to perform, observe or comply with any obligation, condition or provision relating to the Notes binding on it under the Terms and Conditions of the Notes or the Trust Deed, the Trustee may at its discretion and without further notice and, if so requested in writing by holders of at least one quarter in principal amount of the outstanding Notes or if so directed by an Extraordinary Resolution, shall (subject to the Trustee having been indemnified and/or provided with security to its satisfaction) institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition or provision binding on the Issuer in respect of the Notes (other than an Enforcement Event) provided that neither the Trustee nor the Noteholders shall have any right to institute any Winding-Up Proceedings against the Issuer to enforce any obligation, condition or provision in respect of the Notes (other than an Enforcement Event) and neither the Trustee nor the Noteholders shall be entitled to enforce any award of monetary damages or other restitution made by a court against the Issuer in respect of any breach of such obligation, condition or provision until after the commencement of Winding-Up Proceedings of the Issuer and the payment of such money, damages or other restitution shall be subject to the provisions of Condition 3 of the Terms and Conditions of the Notes. Nothing in the Terms and Conditions of the Notes shall limit the right of the Trustee from taking any action to enforce any claims for amounts payable to the Trustee for its own account pursuant to the Trust Deed.

Except as provided in the Terms and Conditions of the Notes and in the Trust Deed, the Trustee and the Noteholders shall otherwise have no right to accelerate payment of any Note in the case of an Enforcement Event.

See “*Terms and Conditions of the Notes — Enforcement Events*”.

Redemption for Taxation Reasons:	The Notes may be redeemed at the option of the Issuer in whole, but not in part, at any time, on giving not less than 30 nor more than 60 days' notice to the Noteholders (which notice shall be irrevocable) at a redemption price equal to 100 per cent. of their principal amount together with interest accrued to the date fixed for redemption and all Arrears of Interest, if, immediately before giving such notice, the Issuer satisfies the Trustee that (a) the Issuer has or will become obliged to pay Additional Amounts as provided or referred to in Condition 7 of the Terms and Conditions of the Notes as a result of any change in, or amendment to, the laws or regulations of the Relevant Jurisdiction or any change in the application or official interpretation of such laws or regulations (including a holding by a court of competent jurisdiction), which change or amendment becomes effective on or after 12 April 2007; and (b) such obligation cannot be avoided by the Issuer taking reasonable measures available to it; provided, however, that (i) no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer would be obliged to pay such Additional Amounts; and (ii) prior to such notice of redemption, the prior written approval of the HKMA for such redemption shall have been obtained. See "<i>Terms and Conditions of the Notes — Redemption and Purchase; Redemption for Taxation Reasons</i>".
Trustee:	The Bank of New York
Trust Deed:	The Notes will be constituted by a Trust Deed to be dated 19 April 2007 made between the Issuer and The Bank of New York as Trustee.
Form and Denomination:	The Notes will be in registered form only and in the denominations of US\$100,000 each and integral multiples of US\$1,000 in excess thereof. The Notes will initially be in the form of a Global Certificate which will be deposited with, and registered in the Register in the name of a nominee of, a common depositary for Euroclear and Clearstream, Luxembourg. The Global Certificate will be exchangeable in certain limited circumstances in whole, but not in part, for Notes in definitive form. See "<i>Summary of Provisions Relating to the Notes while in Global Form</i>".
Payments:	Payments of principal and interest in respect of each Note will be made by transfer to the registered account of the Noteholder or by U.S. dollar cheque drawn on a bank that processes payments in U.S. dollars and mailed to the registered address of the Noteholder if it does not have a registered account. Payments of principal and payments of interest due otherwise than on an Interest Payment Date will only be made against surrender of the relevant Certificate at the specified office of any of the Agents. Interest on Notes due on an Interest Payment Date will be paid to the holder shown on the Register at the close of business on the date being the fifteenth day before the due date for the payment of interest.

All payments of principal and interest (including Arrears of Interest) in respect of the Notes by or on behalf of the Issuer shall be made without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature (**Taxes**) imposed or levied by or on behalf of the Relevant Jurisdiction, unless the withholding or deduction of the Taxes is required by law. In that event, the Issuer will pay such additional amounts (**Additional Amounts**) as may be necessary in order that the net amounts received by the Noteholders after the withholding or deduction shall equal the respective amounts which would have been receivable in respect of the Notes in the absence of the withholding or deduction, except that no Additional Amounts shall be payable in relation to any payment in respect of any Note in certain circumstances. See “*Terms and Conditions of the Notes — Taxation*”.

Governing Law:

The Notes and the Trust Deed are governed by, and shall be construed in accordance with, English law, except that the provisions of the Notes and the Trust Deed relating to subordination shall be governed by the laws of Hong Kong.

Listing:

Approval in-principle has been received for the listing of the Notes on the SGX-ST.

Rating:

The Notes have been rated Baa1 by Moody’s and BBB+ by Fitch. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning organisation.

Selling Restrictions:

There are restrictions on the distribution of this Offering Circular and the making of solicitations pursuant thereto in certain jurisdictions, including, among others, the United States, the United Kingdom, Hong Kong and Singapore. See “*Subscription and Sale*”.

SUMMARY FINANCIAL AND OTHER INFORMATION

Summary consolidated financial and other information relating to the Group

The following table sets forth the summary consolidated financial and other information relating to the Group as of and for the periods indicated. The summary consolidated historical financial data as of and for the years ended 31 December 2004, 31 December 2005 and 31 December 2006 set forth below are derived from the Group's audited consolidated financial statements. Certain items in the consolidated financial statements of the Group as of and for the years ended 31 December 2004, 31 December 2005 and 31 December 2006 have been aggregated for the purposes of presentation of the summary financial data in the table below. The Group's consolidated financial statements are prepared and presented in accordance with Hong Kong generally accepted accounting principles ("*HK GAAP*").

For details of the principle accounting policies for the years ended 31 December 2004, 31 December 2005 and 31 December 2006, please refer to pages 175 to 197 and pages 106 to 118.

	Year ended 31 December		
	2006	2005	2004 (restated)
	(Expressed in thousands of Hong Kong dollars)		
CONSOLIDATED PROFIT AND LOSS ACCOUNT			
Interest income.....	5,818,646	4,041,779	2,877,006
Interest expense.....	(3,899,913)	(2,312,655)	(1,082,689)
Net interest income.....	1,918,733	1,729,124	1,794,317
Net interest income on financial instruments held for trading and measured at fair value through profit or loss.....	207,165	135,876	—
Other operating income.....	811,549	755,770	640,017
Operating income.....	2,937,447	2,620,770	2,434,334
Operating expenses	(1,074,369)	(975,789)	(1,033,039)
Operating profit before impairment losses and allowances charge on loans and advances	1,863,078	1,644,981	1,401,295
Impairment losses and allowances charge on loans and advances.....	(773)	(54,056)	—
Charge for bad and doubtful debts	—	—	(54,434)
Operating profit.....	1,862,305	1,590,925	1,346,861
Gains on revaluation of investment properties and disposal of tangible fixed assets and associated company.....	54,222	22,680	55,552
Gains/(losses) on disposal of held-to-maturity and available-for-sale financial assets	13,773	(9,048)	201
Profits on disposal of non-trading securities	—	—	6,307
Impairment allowances release for held-to-maturity financial assets	—	—	4,848
Share of net profits in associated companies.....	50,951	11,249	4,545
Profit before taxation	1,981,251	1,615,806	1,418,314
Taxation.....	(319,138)	(264,861)	(250,033)
Profit after taxation.....	<u>1,662,113</u>	<u>1,350,945</u>	<u>1,168,281</u>
Profit attributable to:			
Shareholders of the Bank	1,660,716	1,348,718	1,166,689
Minority interests.....	1,397	2,227	1,592
Profit after taxation.....	<u>1,662,113</u>	<u>1,350,945</u>	<u>1,168,281</u>

	As of 31 December		
	2006	2005	2004 (restated)
	(Expressed in thousands of Hong Kong dollars, except percentages)		
CONSOLIDATED BALANCE SHEET			
ASSETS			
Cash and short-term funds	28,785,949	20,053,798	20,529,318
Placements with banks and other financial institutions maturing between one and twelve months.....	3,677,234	2,657,380	1,435,527
Trade bills less impairment allowances	370,549	652,375	551,124
Certificates of deposit held	—	—	30,000
Trading assets.....	738,392	911,264	30,808
Financial assets measured at fair value through profit or loss	5,382,956	5,924,424	—
Advances to customers and other accounts less impairment allowances.....	60,704,258	55,472,883	49,693,267
Held-to-maturity and available-for-sale financial assets	19,534,360	15,909,430	18,867,918
Non-trading securities	—	—	1,520,822
Investment in associated companies	197,906	146,955	135,706
Tangible fixed assets			
— Investment properties	258,390	231,447	209,560
— Other properties, plants and equipment.....	1,635,398	1,506,041	1,563,010
Goodwill	847,422	847,422	847,713
Current tax recoverable.....	1,074	1,211	5,381
Deferred tax assets	16,679	7,986	27,950
TOTAL ASSETS	122,150,567	104,322,616	95,448,104
LIABILITIES			
Deposits and balances of banks and other financial institutions	1,692,887	1,703,026	1,209,582
Deposits from customers.....	102,066,947	85,673,452	78,569,161
Certificates of deposit issued	3,715,303	3,824,339	4,616,090
Trading liabilities	590,899	865,962	8,628
Current tax payable.....	152,706	102,798	63,381
Deferred tax liabilities	105,274	91,570	64,953
Other accounts and provisions	1,981,978	1,203,530	975,122
Loan capital	2,527,850	2,519,888	2,526,485
Total liabilities	112,833,844	95,984,565	88,033,402
EQUITY			
Share capital.....	294,221	294,021	293,911
Reserves	9,002,494	8,021,919	7,100,907
Shareholders' funds	9,296,715	8,315,940	7,394,818
Minority interests	20,008	22,111	19,884
Total equity	9,316,723	8,338,051	7,414,702
TOTAL EQUITY AND LIABILITIES	122,150,567	104,322,616	95,448,104
OTHER SELECTED FINANCIAL DATA			
Loan to Deposit Ratio.....	54.6	59.7	58.3
Capital Adequacy Ratio	15.2	14.9	15.7
Average Liquidity Ratio.....	51.6	50.8	49.1
Return on Average Assets	1.47	1.35	1.29
Return on Average Shareholders' Funds	18.9	17.1	16.7

RISK FACTORS

Prospective investors should carefully take into account the considerations described below, in addition to the other information contained herein, before investing in the Notes. The occurrence of one or more events described below could have an adverse effect on the Group's business, financial condition, or results of operations, and could affect the Bank's ability to make payments of principal and interest under the Notes. Additional considerations and uncertainties not presently known to the Bank, or which the Bank currently deems immaterial, may also have an adverse effect on an investment in the Notes.

Risks relating to the Group

Competition

The Group is subject to significant competition from many other Hong Kong incorporated banks and branches of international banks, including competitors which have significantly greater financial and other resources, greater market share and greater name recognition than the Group. In addition, the banking industry in Hong Kong is a mature market and a number of competitors of the Group have enjoyed a longer presence in this market. In particular, competition in the credit card, home mortgage loans and transport lending businesses is very aggressive. There can be no assurance that increased competition will not have a material adverse effect on the Group's business, financial condition or results of operations. Increased competition may make it difficult for the Group to increase the size of its loan portfolio and deposit base and may cause increased pricing competition, which could have an adverse effect on its growth plans, margins, ability to pass on increased costs of funding, results of operations and financial condition.

In recent years, certain banks in Hong Kong, including the Group, lowered interest rates charged on new-home mortgage loans not guaranteed by the Hong Kong Government ("**Mortgage Interest Rates**"). In many cases, Mortgage Interest Rates charged by banks in Hong Kong have been reduced to as low as approximately 3.15% below the prime rate. For the year ended 31 December 2006, the Group charged an average of 2.54% below the prime rate on its home mortgage loans. Competition among banks in Hong Kong for home mortgage loans could result in further reductions in Mortgage Interest Rates. There can be no assurance that such reductions would not have an adverse effect on the Group's business, financial condition or results of operations.

The banking industry in Mainland China is becoming increasingly competitive. The Group expects competition from foreign commercial banks to increase significantly in the future as previous restrictions on their geographical presence, customer base and operating licences in Mainland China were removed in December 2006 pursuant to Mainland China's World Trade Organisation ("**WTO**") commitments. In addition, Mainland China's Closer Economic Partnership Arrangement ("**CEPA**") arrangements with Hong Kong and Macau allow smaller banks from these jurisdictions to operate in Mainland China, which has also increased competition in the banking industry in Mainland China. Many of these banks compete with the Group for the same customer base and some of them may have greater financial, management and technical resources than the Group. The increased competition from other banks may result in an increase in the amount of the Group's loans made at a discount to the People's Bank of China benchmark rate, which may reduce the average yield on the Group's loans.

The increased competition in the markets where the Group operates may adversely affect the Group's business and prospects, the effectiveness of its strategies, its results of operations and financial condition by potentially:

- reducing the Group's market share in its principal products and services;
- reducing the growth of the Group's loan and deposit portfolios and other products and services;
- reducing the Group's interest income and decreasing its net interest margin;
- reducing the Group's fee and commission income;
- increasing the Group's non-interest expenses; and

- increasing competition for qualified managers and employees.

Maturity of the Hong Kong banking sector

The Group focuses principally on the Hong Kong market for retail and corporate customers. The banking sector in Hong Kong is extremely competitive, with approximately 138 licensed banks, both international and local, competing for a population of approximately seven million people. There is a limited market, especially for retail banking products such as home mortgage advances, credit cards and personal advances. The Group's main markets for retail and corporate advances are Hong Kong and Mainland China. Due to the maturity of the Hong Kong banking sector, the Group intends to continue to expand its retail and corporate lending portfolio by growing its Mainland China-related business. However, the Group is likely to face increased competition in Mainland China market from existing local Mainland China banks and other foreign banks entering the market. See "*Competition*". There can be no assurance that the Group can further expand or maintain its market share in Hong Kong or that it can successfully increase its Mainland China retail or corporate lending portfolios, and its failure to do so could have an adverse effect on the financial condition and results of operations of the Group.

Expansion in Hong Kong, Macau and Mainland China

The Group's strategy involves expansion of its business in the Hong Kong, Macau and Mainland China markets through organic growth and through mergers, acquisitions and alliances, if suitable opportunities arise. In February 2007, the Group received approval from the CBRC to prepare for the establishment of a locally incorporated bank in Mainland China. The establishment of a locally incorporated bank is one of the prerequisites for Renminbi retail banking service in Mainland China. See "*Recent Developments — Proposed Establishment of a Locally Incorporated Bank in Mainland China*" for further details.

Further expansion into Mainland China may present the Group with new risks and challenges, such as new regulatory environments, different market practices and competition in such markets. Expansion and integration of new mergers, acquisitions and alliances may also require significant operational, administrative and management resources. The success of any mergers, acquisitions and alliances will depend in part on the ability of the Group's management to integrate the operations of newly acquired businesses with its existing operations and, where applicable, to integrate various departments, systems and processes. Consequently, the Group's ability to implement its business strategy may be constrained and the timing of such implementation may be affected due to demands placed on existing resources by the process. There can be no assurance that the acquired entities will achieve the level of performance that the Group anticipates or the projected demand for and margins of the Group's products and services will be realised. The failure to manage expansion effectively could have an adverse effect on the Group's business, financial condition and results of operations.

Expanding range of products and services offered in Mainland China

In order to meet the needs of its customers and to expand its business, the Group intends to expand its range of products and services offered in Mainland China. Expansion of the Group's business in Mainland China is subject to certain risks and challenges, including:

- new products and services may not be accepted by customers or meet the Group's expectations for profitability;
- requirement to hire additional qualified personnel who may not be available;
- failure to obtain regulatory approval for new products or services; and
- inability to enhance risk management capabilities and information technology systems to support a broader range of products and services.

If the Group is not able to achieve the intended results with respect to its new products and services in Mainland China, this could have an adverse effect on the financial condition and results of operations of the Group.

Loan concentration; exposure to the property market

The Group has significant exposure to the property market due to its portfolio of home mortgage loans. As of 31 December 2006, home mortgage loans and loans for property development and investment in Hong Kong accounted for 27.8% and 19.3%, respectively, of the Group's total advances to customers. The Hong Kong property market is highly cyclical and property prices in general have been volatile. Property prices are affected by a number of factors, including, among other things, the supply of, and demand for, comparable properties, the rate of economic growth in Hong Kong, political and economic developments in Mainland China, and the relationship between Mainland China, Hong Kong and other countries. Accordingly, any further decreases in property values and/or liquidity of the Hong Kong property market could adversely affect the Group's business, financial condition and results of operations.

Property prices in Macau have increased substantially in recent years, but there is no assurance that prices will not decline in the future or be subject to a high degree of volatility. Any decline or volatility in property values could adversely affect the Group's business, financial condition and results of operations.

The property market in Mainland China is subject to policies implemented by the Mainland China government from time to time. In recent years, the Mainland China government has introduced measures designed to discourage excessive growth of Mainland China's high-end residential property sector and encourage the development of mass market residential property projects with a higher degree of affordability. These policies and measures may have a material impact on property prices which could adversely affect the Group's business, financial condition and results of operations.

Classification of loans; adequacy of allowance for loan losses

In accordance with guidelines set by the HKMA, the Bank classifies its problem loans into one of three categories corresponding to levels of risks; "sub-standard," "doubtful" and "loss". See "*Selected Statistical and Other Information Relating to the Group — Asset Quality — Loan Classification*". The classification of loans into one of these categories depends on various quantitative and qualitative factors, including the number of months payment is in arrears, the type of loan, the tenor of the loan and the level of collateral coverage. Prior to 1 January 2005, the Group used to designate as "non-performing" those advances on which it had ceased or suspended accruing interest. However, from 1 January 2005, following the coming into effect of Hong Kong Accounting Standard 39 "Financial Instruments: Recognition and Measurement" ("**HKAS 39**"), interest cessation or suspension is no longer permitted. The laws, regulations and guidelines governing banking in Hong Kong differ from those applicable in certain other countries in certain respects and may result in particular loans being classified at a different time or being classified in a category reflecting a different degree of risk than would be required in certain other countries. In addition, the typical procedures for writing off loans in Hong Kong may result in loans being written-off later than would be the case for banks in certain other countries. Banks in Hong Kong may accrue interest on "impaired" loans in situations where such interest would not be accrued by banks in certain other countries. While the Bank believes that its loan policies are more prudent than those which are required under Hong Kong laws and regulations, the Bank is not required to maintain such policies at levels above those generally applicable to banks in Hong Kong. For a description of the banking regulations that apply to banks in Hong Kong, see "*Regulation and Supervision*".

Liquidity; short-term funding

Most of the Group's funding requirements are met through short-term funding sources, primarily in the form of customer and interbank deposits. As of 31 December 2006, 94.9% of the Group's customer deposits had a remaining maturity of three months or less. Historically, a substantial portion of such customer deposits have been rolled over upon maturity and these deposits have been, in essence, a stable source of long-term

funding. However, no assurance can be given that this pattern will continue. If a substantial number of depositors fail to roll over deposited funds upon maturity, the Group's liquidity position would be adversely affected and it may need to seek alternative sources of short-term or long-term funding to finance its operations, which may be more expensive than current deposits.

The HKMA acts as a lender of last resort to all authorised institutions in Hong Kong to provide support for liquidity needs in the banking system generally as well as to specific institutions. Although the Hong Kong Government has in the past taken measures on a case-by-case basis to maintain or restore public confidence in individual banks with an isolated liquidity crisis, there can be no assurance that the HKMA will provide such assistance in the future or that it would elect to provide such assistance in the event of a liquidity crisis within the Group.

Currency risks

The majority of the Group's revenues are generated in Hong Kong dollars. Although the Hong Kong dollar has been linked to the US dollar since 1983, there can be no assurance that such linkage will be maintained in the future. In order to ensure continued liquidity of the Hong Kong dollar, the HKMA has entered into bilateral repurchase agreements with the central banks of Australia, Mainland China, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand. In addition, the Hong Kong Government has in the past expressed a commitment to maintain exchange rate stability under the Linked Exchange Rate System, an automatic interest rate adjustment mechanism. No assurance can be given that the Hong Kong dollar will continue to be linked to the US dollar or that, in the event of a liquidity problem affecting the Hong Kong dollar, such bilateral repurchase agreements or automatic interest rate adjustment mechanism will help to maintain adequate liquidity for the Hong Kong dollar. The Group's business, financial condition and results of operations could be adversely affected by the impact on the Hong Kong economy of the discontinuation of the link of the Hong Kong dollar to the US dollar or any devaluation of the Hong Kong dollar, Macau Patacas or Renminbi.

Interest rate risk

As with most banks, the Group's net interest income is a significant factor in determining its overall financial performance. For the years ended 31 December 2005 and 2006, the Group's net interest income represented approximately 66.0% and 65.3%, respectively, of its operating income. Interest rates in Hong Kong have remained relatively low and steady in recent years, however there can be no assurance that interest rates will not be raised or that increases in interest rates will not be frequent. The Group realises income from the margin between income earned on its assets and interest paid on its liabilities. As some of its assets and liabilities are repriced at different times, the Group is vulnerable to fluctuations in market interest rates. As a result, volatility in interest rates could have an adverse effect on the Group's financial condition, liquidity and results of operations.

An increase in interest rates could lead to a decline in the value of securities in the Group's portfolio. A sustained increase in interest rates could also raise the Group's funding costs without a proportionate increase in loan demand (if at all). Rising interest rates would therefore require the Group to re-balance its assets and liabilities in order to minimise the risk of potential mismatches and maintain its profitability. In addition, rising interest rate levels may adversely affect the economy in Hong Kong, Macau or Mainland China and the financial condition and repayment ability of its corporate and retail borrowers, including holders of credit cards, which in turn may lead to a deterioration in the Group's credit portfolio.

Different corporate disclosure, accounting and regulatory requirements

The Bank's issued shares are listed on The Stock Exchange of Hong Kong Limited (the "**Hong Kong Stock Exchange**") and, as such, the Bank is required to publish annual audited and semi-annual unaudited financial information of the Group. The amount of information publicly available for issuers in Hong Kong is less than that publicly available for comparable banks in certain other countries. In addition, all Hong Kong Stock Exchange listed companies incorporated in Hong Kong must prepare their financial statements in accordance with HK GAAP, which differs in certain significant respects from generally accepted accounting principles

in the United States (“**US GAAP**”). Thus, the accounting presentation of reported earnings of the Group may differ from those of companies in certain other countries. This Offering Circular does not include a reconciliation of the Group’s financial statements to US GAAP, and there can be no assurance that such a reconciliation would not identify material qualitative or quantitative differences.

Under the Banking Ordinance, the HKMA regulates the business activities and operations of commercial banks and has the ability to influence banking and financial markets generally. Potential investors should be aware that regulatory requirements in Hong Kong may differ from those which prevail in other countries. See “*Regulation and Supervision*”. Because the Group operates in the highly regulated banking and securities industries in Hong Kong, potential investors should also be aware that the regulatory authorities have been consistently imposing higher standards and developing new guidelines and regulatory requirements. For example, the Basel II Accord capital adequacy standards have been adopted by the HKMA in Hong Kong since the beginning of 2007. The new standards require banks to disclose key pieces of information on capital, risk exposures, risk assessment processes and hence capital adequacy. The aim of the new standards is to encourage banks to demonstrate to the market participants that their risk management systems are robust and that all relevant risks have been identified and controlled. These changes may result in the incurrence of substantial compliance and monitoring costs and there is no assurance that any breach of applicable laws and regulations will not adversely affect the Group’s reputation or its business, financial condition and results of operations.

Apart from the above, certain products and services provided by the Group are regulated by other regulators including the Securities and Futures Commission in Hong Kong. The Group carefully manages legal and compliance risks, including in relation to the sale of financial products and money laundering regulations. However, there can be no assurance that breaches of legislation or regulations by the Group will not occur and, to the extent that such a breach does occur, that significant liability or penalties will not be incurred.

Information technology systems

The Group is highly dependent on the ability of its information technology systems to accurately process a large number of transactions across numerous and diverse markets and its broad range of products in a timely manner. The proper functioning of its financial control, risk management, accounting, customer service and other data processing systems, together with the communication networks between its various branches and sub-branches and its main data processing centres, are critical to its business and its ability to compete effectively. Although there is backup data for key data processing systems and the Group has established a backup system to carry on principal functions in the event of a catastrophe or a failure of its primary systems, there can be no assurance that the Group’s operations will not be materially disrupted if there is a partial or complete failure of any of these primary information technology systems or communications networks. Such failures could be caused by, among other things, software bugs, computer virus attacks or conversion errors due to system upgrading. In addition, any security breach caused by unauthorised access to information or systems, loss or corruption of data and malfunction of software, hardware or other computer equipment could have a material adverse effect on the Group’s business, reputation, results of operations and financial condition.

In addition, the Group’s ability to remain competitive will depend in part on its ability to upgrade its information technology systems on a timely and cost-effective basis. Additionally, the information available to and received by the Group through its existing information technology systems may not be timely or sufficient for the Group to manage risks and plan for, and respond to, market changes and other developments in its current operating environment. The Group is making, and intend to continue to make, investments to improve or upgrade its information technology systems. Any substantial failure to improve or upgrade its information technology systems effectively or on a timely basis could have a material adverse effect on its competitiveness, financial condition and results of operations.

Internet banking services

The Group relies on its Internet banking services such as its eBanking and Online Trading services as a means of providing customers with greater access to its products and services and attracting new customers. The Group’s business may be adversely affected if the use of its Internet banking services does not continue to grow or grows more slowly than anticipated. Usage of the Group’s Internet banking services may be

adversely affected for a number of reasons, including inadequate network infrastructure, security concerns, inconsistent quality of service and unavailability of high-speed access to the Internet. If the market for Internet-based banking services fails to grow, grows more slowly than anticipated or becomes saturated with competitors, the Group's financial condition and results of operations may be adversely affected.

To the extent that the Group's Internet banking activities involve the storage and transmission of confidential information, security breaches could expose the Group to possible liability and damage the Group's reputation. The Group's networks may be vulnerable to unauthorised access, computer viruses and other disruptive problems. Costs incurred in rectifying any of such disruptive problems may be high and may adversely affect the Group's financial condition and results of operations. Concerns regarding security risks may deter the Group's existing and potential customers from using its Internet banking products and services. Eliminating computer viruses and alleviating other security problems may result in interruptions, delays or termination of service to users accessing the Group's eBanking services. Undetected defects in software products that the Group uses in its products and the Group's inability to sustain a high volume of traffic may materially and adversely affect the Group's Internet banking business.

Dependence on key personnel and recruitment

The Group's business and operations are substantially dependent upon key members of the Group's management. Although the Group has succeeded in maintaining the core of its senior management team over the recent years, the loss of the services of members of the Group's senior management could have a material adverse effect on the Group's business, financial condition and results of operations.

The Group's ability to sustain its growth and meet future business demands depends on its ability to attract and recruit suitably skilled and qualified staff. There can be no assurance that the Group will be able to recruit staff in sufficient numbers or of sufficient quality, or that pressure on recruitment will not lead to significant increases in the Group's employment costs. Competition for suitably skilled and qualified staff is particularly acute in Mainland China. Any of these factors could adversely affect the Group's business, financial condition and results of operations.

Major shareholder

The Bank of New York Company, Inc. ("**BONY**"), through BNY International Financing Corp. ("**The Bank of New York Group**"), presently owns 20.2% of the issued share capital of the Bank. Although the Bank is not aware of any current plans for BNY International Financing Corp. to dispose of or reduce its shareholding in the Bank, there is no guarantee that such a sale may not occur in the future. If such disposal or reduction were to take place it may adversely affect the business of the Bank as BNY International Financing Corp. provides information technology and training support and helps to maintain certain client relationships. BNY International Financing Corp. has been a shareholder of the Group since 1988. See "*Relationship with The Bank of New York Group*" and "*Principal shareholders*". BONY and Mellon Financial Corporation announced on 4 December 2006 that they have entered into a definitive agreement to merge.

Further issuance of securities

The Group's financial condition, results of operations and capital position are affected by a range of factors such as economic conditions, interest rates, the credit environment, asset quality, operating income and level of provisioning. A slowdown in the economy could lead to a deterioration in the Group's asset quality and an increase in impairment losses and allowances charges on loans and advances, which may result in a deterioration of the Group's capital adequacy position or breach capital requirements under Hong Kong law, rules and regulations (including guidelines issued by the HKMA).

In order to strengthen its capital adequacy position or to ensure that it remains in compliance with applicable capital requirements under Hong Kong law, rules and regulations (including guidelines issued by the HKMA), the Group may from time to time raise additional capital through such means and in such manner as it may consider appropriate including, without limitation, the issue of further subordinated notes (whether on terms similar to the Notes or otherwise) or other hybrid capital instruments, subject to any regulatory approval that may be required. There can be no assurance that such future capital raising activities will not adversely affect the market price of the Notes in the secondary market.

Disposal of property

The Bank is currently considering the disposal of some properties owned by the Group in order to improve operational efficiencies. Any such disposal or disposals, if they occur at all, could take place at any time and will be subject to agreement as to the consideration payable and other terms.

Risks relating to Hong Kong and Overseas

Hong Kong

On 1 July 1997, Hong Kong ceased to be a Crown Colony of the United Kingdom and became a Special Administrative Region of Mainland China. Although Hong Kong has thus far enjoyed a high degree of legislative, judicial and economic autonomy since the handover, there can be no assurance that there will not be a change in regulatory oversight as a consequence of the exercise of Mainland China sovereignty over Hong Kong or, should such change occur, that the Group's business, financial condition and results of operations will not be adversely affected.

Most of the Group's revenues are derived from its operations conducted in Hong Kong. As a result, the Group's financial condition and results of operations are influenced by the general state of the Hong Kong economy (including the level of unemployment) and the political environment in Hong Kong. The economic and political environment in Hong Kong is, in turn, significantly affected by a variety of external factors, including the economic and political environment in Mainland China and throughout Asia and the rest of the world. The 1997 Asian financial crisis and the subsequent economic downturn in Hong Kong resulted in, among other things, increased provisions which negatively affected the Group's profitability. Hong Kong's economic growth was also affected by the Severe Acute Respiratory Syndrome ("SARS") virus in the first half of 2003. See *"Recurrence of SARS, Avian Influenza or other highly contagious diseases in Asia and elsewhere"*. Although economic conditions in Hong Kong have since improved, there can be no assurance that the Group's operations will not be affected by any future deterioration in the Hong Kong economy.

Although Hong Kong's gross domestic product rose by 7.3% in 2005 and 6.8% in 2006, and is forecasted by the Hong Kong Government to increase by 4.5% to 5.5% in 2007, the Group expects the continued growth in the Hong Kong economy to depend in part upon the economic performance of the United States and Mainland China, as well as certain other developed countries. There can be no assurance that future global events will not have an impact on the Hong Kong economy and the Group.

Overseas

The Bank has branch offices in Shenzhen, Guangzhou and Shanghai, as well as a representative office in Beijing. The Bank's wholly-owned subsidiary in Macau, Banco Weng Hang, has been in operation since 1941 and has 13 branches. As of 31 December 2006, the Group's total advances to customers for use outside Hong Kong, which principally includes Macau and Mainland China, stood at HK\$6,211.1 million (US\$798.5 million) in Macau and HK\$9,271.2 million (US\$1,192.0 million) in Mainland China and other overseas areas comprising 10.6% and 15.8% of its total advances to customers. Although Macau experienced robust economic growth in 2006, the continuation of such growth is dependent on a number of external factors, including the economic and political environment in Mainland China. There can be no assurance that the Group's business in Macau will not be affected by any future downturn in the Macau economy. The Bank has targeted Mainland China as a potential market for future development, and many of the Group's commercial customers are dependent in varying degrees on trade with Mainland China. The value of the Group's loans in Mainland China, as well as its loans to companies that have business interests in Mainland China, may be influenced by the general state of Mainland China economy and may be affected by significant political, social or legal uncertainties or changes in Mainland China (including changes in political leadership, the rate of inflation and the impact on the economy of Mainland China's accession to and implementation of the WTO). There can be no assurance that the economic and political environment in Mainland China will remain favourable to and will not have a negative impact on the Group's business in Mainland China in the future.

Recurrence of SARS, Avian Influenza or other highly contagious diseases in Asia and elsewhere

During the first half of 2003, Hong Kong, along with many other countries in Asia, encountered an outbreak of Severe Acute Respiratory Syndrome (“**SARS**”), a highly contagious and potentially deadly disease. In the last few years, there have also been outbreaks of avian influenza in parts of Asia, including Hong Kong. No assurance can be given that there will not be a recurrence of the outbreak of SARS or other epidemics, or that incidents of avian influenza will not increase. The SARS outbreak caused an adverse effect on the economies of the affected countries, including Hong Kong and Mainland China. Like other financial institutions, the Group’s operations in those affected countries were influenced by a number of SARS-related factors including, but not limited to, a decline in demand for residential mortgage advances, a reduction in the number of customers visiting the Group’s branches and an adverse impact on asset quality due to weakened economy and higher unemployment rate. There can be no assurance that the Group’s business and financial condition would not be adversely affected if another outbreak of SARS or another highly contagious disease occur.

Risks relating to the Notes and the Coupons

Perpetual Notes

The Bank is under no obligation to redeem the Notes at any time and the Noteholders have no right to call for their redemption. Early redemption or purchase and cancellation of the Notes is subject to the prior written approval of the HKMA.

Deferral of Interest

The Bank is entitled to elect not to pay on any Optional Interest Payment Date (as defined in the “*Terms and Conditions of the Notes*”) the interest that is due to be paid on such date in respect of the Notes and any failure to pay shall not constitute a default by the Bank for any purpose. Any interest not so paid does not itself bear interest. See “*Terms and Conditions of the Notes — Interest — Deferral of Interest*”.

Subordination of the Notes

The Bank’s obligations under the Notes will be unsecured, and will be subordinated in right of payment to the claims of Issuer Prior Creditors (as defined in “*Terms and Conditions of the Notes*”) in the event of the Winding-Up (as defined in “*Terms and Conditions of the Notes*”) of the Issuer. Although the Notes may pay a higher rate of interest than comparable notes which are unsubordinated, an investor in the Notes may lose all or some of his investment should the Bank become insolvent.

Optional Redemption

The Terms and Conditions of the Notes (the “**Conditions**”) contain provisions for optional redemption by the Bank. This feature is likely to limit the market value of the Notes. During any period when the Bank may elect to redeem the Notes, the market value of the Notes generally will not rise substantially above the price at which they can be redeemed. This may also be true prior to any redemption period.

The Bank may be expected to redeem Notes when its cost of borrowing is lower than the interest rate on the Notes. At those times, an investor generally would not be able to reinvest the redemption proceeds at an effective interest rate as high as the interest rate on the Notes being redeemed and may only be able to do so at a significantly lower rate. Potential investors should consider reinvestment risk in light of other investments available at that time.

Restricted Remedy for Non-Payment

The sole remedy against the Bank available to the Trustee to receive any amounts owing in respect of the principal of, or interest on, the Notes will be to institute proceedings for the winding-up of the Bank and/or prove in such winding-up.

Modification, Waivers and Substitution

The Conditions contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority.

The Conditions also provide that the Trustee may, without the consent of the Noteholders (but with the prior written consent of the HKMA in the case of (i) and (ii)), agree to (subject to being indemnified and/or secured to its satisfaction) (i) any modification of, or to the waiver or authorisation of any breach or proposed breach of, any of the provisions of the Conditions or any of the provisions of the Trust Deed or (ii) determine without the consent of the Noteholders that any Enforcement Event shall not be treated as such, in the circumstances described in Condition 13 or (iii) agree to the substitution of another entity as principal debtor under the Notes in place of the Bank, in the circumstances described in Condition 14.

Change of Law

The Conditions are governed by English law (except for the provisions relating to subordination which are governed by Hong Kong law). No assurance can be given as to the impact of any possible judicial decision or change to English or Hong Kong law or administrative practice after the date of issue of the Notes.

Secondary Market

The Notes may have no established trading market when issued and one may never develop. If a market does develop, it may not be liquid. Therefore, investors may not be able to sell their Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. Illiquidity may have a material adverse effect on the market value of Notes.

Interest rate risk

Investment in the Notes involves the risk that subsequent changes in market interest rates may adversely affect the value of the Notes.

Credit Ratings

The Notes are rated by Moody's and Fitch. The ratings may not reflect the potential impact of all risks related to the structure, market, additional factors discussed above, and other factors that may affect the value of the Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time.

Certain risks relating to enforcement

To the extent that the Trustee or the holders of the Notes are entitled to any recovery with respect to the Notes in any Hong Kong proceedings, such Trustee and holders of the Notes might not be entitled in such proceedings to a recovery in US dollars and might be entitled only to a recovery in Hong Kong dollars.

In Hong Kong proceedings, if the Bank was placed in receivership by court order, interest on the Notes would cease to accrue on the date of the court order and the relevant US dollar amounts would be converted to Hong Kong dollars as of such date for purpose of claims.

USE OF PROCEEDS

The net proceeds from the issue of the Notes will be approximately US\$396,122,000, after deducting management and underwriting fees. Notes issued by the Bank on a subordinated basis are intended to qualify as “Category II Supplementary Capital” (for the purposes of capital adequacy under Part XVII of the Banking Ordinance) of the Bank. The issuance of the Notes will strengthen the Group’s capital base and fund the growth of the Bank’s operations.

CAPITALISATION

The following table sets forth the Group's consolidated liabilities and total capitalisation as of 31 December 2006 and as adjusted for the issue of the Notes. Except as disclosed below, there has been no material change in the consolidated capitalisation of the Group since 31 December 2006.

	As at 31 December 2006			
	Actual		As adjusted	
	HK\$ (in thousands)	US\$ (in thousands)	HK\$ (in thousands)	US\$ (in thousands)
Short-term liabilities:				
Deposits and balances of banks and financial institutions	1,692,887	217,651	1,692,887	217,651
Deposits from customers	102,066,947	13,122,518	102,066,947	13,122,518
Certificates of deposit issued, short-term portion	1,747,112	224,622	1,747,112	224,622
Total short-term liabilities	<u>105,506,946</u>	<u>13,564,791</u>	<u>105,506,946</u>	<u>13,564,791</u>
Long-term liabilities:				
Certificates of deposit issued, long-term portion	1,968,191	253,046	1,968,191	253,046
Subordinated guaranteed notes ⁽¹⁾	2,527,850	325,000	5,639,050	725,000
Total long-term liabilities	<u>4,496,041</u>	<u>578,046</u>	<u>7,607,241</u>	<u>978,046</u>
Shareholders' funds:				
Share capital	294,221	37,827	294,221	37,827
Reserve	9,002,494	1,157,430	9,002,494	1,157,430
Total shareholders' funds	<u>9,296,715</u>	<u>1,195,257</u>	<u>9,296,715</u>	<u>1,195,257</u>
Minority interests:	20,008	2,572	20,008	2,572
Total capitalization	<u>13,812,764</u>	<u>1,775,875</u>	<u>16,923,964</u>	<u>2,175,875</u>

Notes:

- (1) The aggregate principal amount of the subordinated guaranteed notes was converted from US dollars to Hong Kong dollars at the rate of US\$1.00 = HK\$7.778.

BUSINESS OF THE GROUP

INTRODUCTION

The Bank is listed on the Hong Kong Stock Exchange (Stock Code: 302). The Bank is the holding company and the principal operating company of the Group, whose principal activities include corporate banking, retail banking, foreign exchange and treasury services. The Bank has a network of 38 retail branches and 5 wealth management centres located in Hong Kong, a branch office in each of Shenzhen, Guangzhou and Shanghai, a sub-branch in the Fumin district of Shenzhen and one representative office in Beijing. The Bank's wholly-owned subsidiary in Macau, Banco Weng Hang, has been in operation since 1941 and has 13 branches. In addition, through its subsidiaries, the Group provides nominee, deposit-taking, offshore banking, hire purchase, consumer financing, insurance and share brokerage services.

As of 31 December 2006, the Group's total assets, shareholders' funds, advances to customers and total deposits were HK\$122,150.6 million (US\$15,704.6 million), HK\$9,296.7 million (US\$1,195.3 million), HK\$58,638.2 million (US\$7,539.0 million) and HK\$107,475.1 million (US\$13,817.8 million), respectively.

For the year ended 31 December 2006, the Group recorded a net profit of HK\$1,660.7 million (US\$213.5 million), and a final dividend of HK\$2.0 per share has been recommended by the Board of Directors of the Bank. As of 31 December 2006, the Group's capital adequacy ratio and loan to deposit ratio were 15.2% and 54.6% respectively. For the year ended 31 December 2006, the Group achieved a return on average assets of 1.47%, a return on average shareholders' funds of 18.9% and an average liquidity ratio of 51.6%.

As of 30 March 2007, the authorised share capital of the Bank was 450,000,000 ordinary shares of HK\$1.00 each, of which 294,240,500 ordinary shares have been issued and are fully paid. Based on the closing price of the Bank's shares on the Hong Kong Stock Exchange on 30 March 2007, the Bank's equity market capitalisation was HK\$28,305.9 million (US\$3,622.6 million) (based on the noon buying rate in New York City for cable transfers on 30 March 2007).

For the year ended 31 December 2006, the Group's overseas operations, including Macau and Mainland China recorded a profit before taxation of HK\$358.4 million (US\$46.1 million) which accounted for 18.1% of its consolidated profit before taxation. As of 31 December 2006, the Group's total advances to customers for use outside Hong Kong, which principally includes Macau and Mainland China, were HK\$6,211.1 million (US\$798.5 million) in Macau and HK\$9,271.2 million (US\$1,192.0 million) in Mainland China and other overseas areas.

In May 2002, the Bank received approval from the People's Bank of China to provide Renminbi services to foreign-funded enterprises and foreigners in Mainland China. It also obtained approval to extend foreign currency services to domestic Chinese corporations operating in Mainland China. In February 2007, the Bank received approval from the CBRC to prepare for the establishment of a locally incorporated subsidiary bank in Mainland China. See "*Recent Developments — Proposed Establishment of a Locally Incorporated Bank in Mainland China*".

HISTORY

The Bank was first founded in 1937 in Guangzhou by the late Mr. Y.K. Fung to carry on the business of a money changer. It moved from Guangzhou to Hong Kong in 1940 and subsequently to Cham Kiang following the outbreak of World War II.

The business was re-established in Hong Kong in 1946 with a staff of 19 and capital of HK\$300,000 (US\$38,570). In 1960, the Bank was incorporated in Hong Kong and was granted a banking license in the same year. In January 1973, the Irving Trust Company of New York ("*Irving Trust*"), a major international bank from New York, acquired a 51% interest in the Bank. Through this affiliation, the Bank gained access to updated technology, expertise in international banking and a firm foundation for future growth. In 1984, the Bank acquired a 98.8% interest (which increased to 100% in 1990) in Banco Weng Hang, S.A. ("*Banco Weng Hang*"), a licensed bank in Macau which provides banking and related services to local retail and

corporate customers. The acquisition of Banco Weng Hang enabled the Group to increase its customer base and provided a geographical diversification for the Bank's loan portfolio and deposit base. In 1988, Irving Trust merged with BONY to become one of the major banking groups in the United States. The Bank of New York Group continues to be a shareholder of the Bank.

In 1991, the Bank expanded its overseas operations by establishing a representative office in Shenzhen. This was followed by the setting up of further representative offices in Guangzhou in 1997, Shanghai in 2000 and Beijing in 2005.

In July 1993, the Bank was publicly listed on the Hong Kong Stock Exchange.

In June 1994, the Bank established the Auto and Equipment Division for the provision of hire-purchase financing to its customers for the acquisition of automobiles and equipment. The division is presently one of the leading hire-purchase financing operations in Hong Kong. In 1995, the Bank teamed up with Swire Insurance Holdings Ltd to acquire a 100% interest (of which 65% was acquired by the Bank) in London & Pacific Insurance Co Ltd in Hong Kong in order to engage in general insurance underwriting. After the acquisition, the company was renamed Wing Hang Swire Insurance Company Limited. Wing Hang Swire Insurance Co Ltd was subsequently renamed as Wing Hang Zurich Insurance Group in 1997 and focuses on non-life insurance products.

In 1996, the Bank established Wing Hang Credit Limited, a wholly-owned subsidiary, to provide consumer lending services in the form of unsecured personal loans and credit card loans to its customers.

In 1999, the Bank founded The Bank Consortium Trust Company Limited with nine other local banks in Hong Kong with the objective of providing quality Mandatory Provident Fund ("**MPF**") services to customers. In October 1999, the Group upgraded its MPF team into a full department focusing on preparations for the launch of the MPF in December 2000.

To provide a comprehensive range of life insurance products to take care of its customers, the Bank founded the Hong Kong Life Insurance Limited in 2001 with five other local banks in Hong Kong. With the strong support from the Hong Kong Life Insurance Limited, the Bank is able to offer a series of life insurance products, from coverage for individual life to group life and medical insurance.

In May 2002, the Bank received approval from the People's Bank of China to provide Renminbi services to foreign-funded enterprises and foreigners in Mainland China. It also obtained approval to extend foreign currency services to domestic Chinese corporations operating in Mainland China. The representative offices in Shenzhen, Shanghai and Guangzhou were upgraded to full branches in 1993, 2005 and 2006, respectively. In addition, the Bank opened a sub-branch in the Fumin district of Shenzhen in 2006. In February 2007, the Bank received approval from the CBRC to prepare for the establishment of a locally incorporated subsidiary bank in Mainland China. See "*Recent Developments — Proposed Establishment of a Locally Incorporated Bank in Mainland China*".

On 31 July 2003, the Bank entered into an agreement to acquire the entire issued share capital of Chekiang First Bank ("**CFB**"). The merger was successfully completed on 9 August 2004 and the operations of CFB have been fully integrated and merged with those of the Bank, providing the Bank with a larger operating platform and expanded customer base.

On 21 December 2006, the Bank entered into an agreement with BankAmerica, Inchcape and Inchcape International Holdings Limited to acquire Inchroy as a wholly owned subsidiary. The acquisition was completed on 31 January 2007. Inchroy is a Hong Kong registered deposit-taking company engaged in the hire purchase and lease financing business. See "*Recent Developments — Acquisition of Inchroy Credit Corporation Limited*".

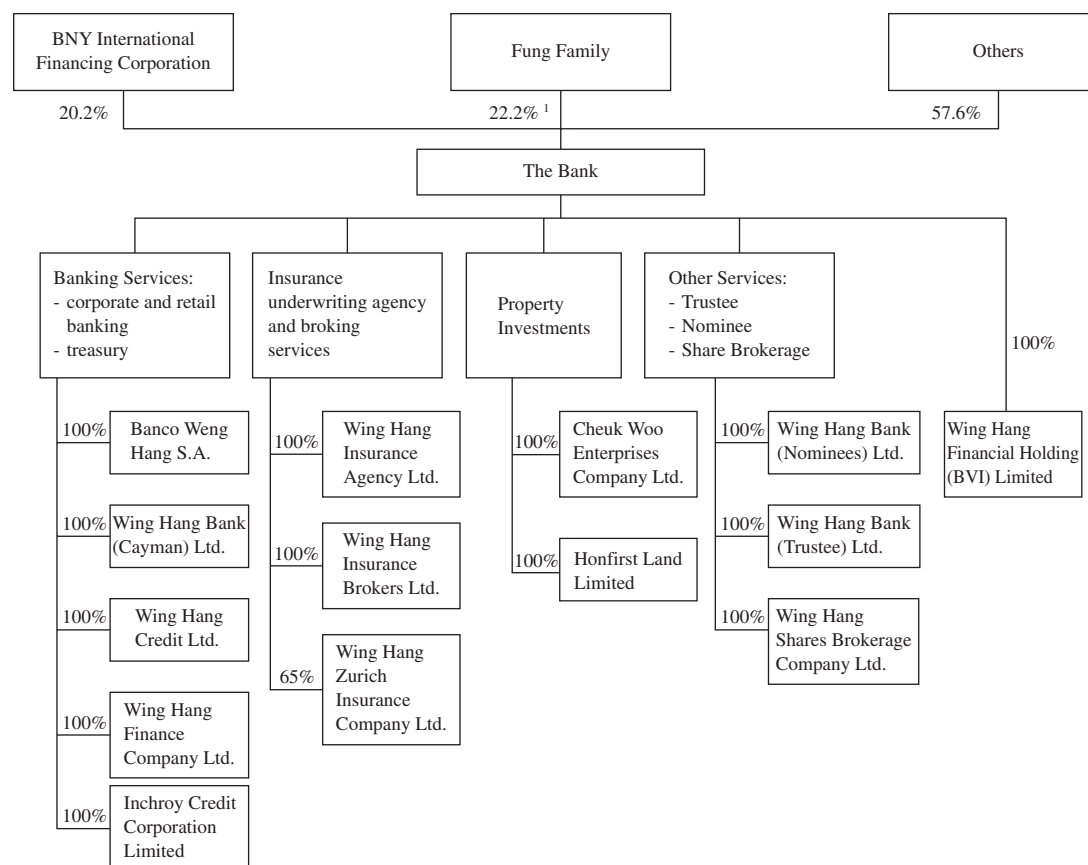
The following timeline shows major events since the Bank's establishment in 1937:

1937	—	Founded as a money changer in Guangzhou by the late Mr. Y.K. Fung.
1940	—	Business operations moved to Hong Kong.
WW II (onset)	—	Business moved to Cham Kiang, a territory under French administration.
WW II (end)	—	The Bank was re-established in Hong Kong.
1960	—	The Bank was incorporated in Hong Kong and granted a banking license.
1973	—	Irving Trust purchased a 51 % interest in the Bank.
1984	—	The Bank acquired 98.8% (increased to 100% in 1990) interest in Banco Weng Hang, a licensed bank in Macau.
1988	—	Irving Trust merged with BONY.
1991	—	BONY sold 2% interest of the Bank to the Fung Family.
	—	Opened a representative office in Shenzhen.
1993	—	Listed on The Hong Kong Stock Exchange by offering 36,850,000 shares to the public.
	—	Upgraded the Shenzhen representative office to a branch.
1994	—	Established American Depositary Receipts ("ADR") programme for trading of the Bank's shares in the US.
	—	Established a new division to expand the Bank's automobile and equipment hire-purchase businesses.
1995	—	Teamed up with Swire Insurance Holdings Ltd to acquire 100% stake of London & Pacific Insurance Co Ltd (renamed Wing Hang Swire Insurance Company Limited), of which 65% was acquired by the Bank. It was renamed Wing Hang Zurich Insurance Company Limited following the transfer of Swire's interest in it to Zurich Insurance Group in 1997.
1996	—	Established Wing Hang Credit Limited to provide consumer loans services.
1997	—	Opened a representative office in Guangzhou.
1999	—	Formed The Bank Consortium Trust Company Limited with nine other local banks for the collective promotion of Mandatory Provident Fund related products in Hong Kong. Such services were launched in December 2000.
2000	—	Opened a representative office in Shanghai.
2001	—	Established Hong Kong Life Insurance Limited, a life insurance company, with five other local banks.
2002	—	Received approval from the People's Bank of China to provide Renminbi services to foreign-funded enterprises and foreigners in Mainland China.
2003	—	Acquired the entire issued share capital of CFB.
2004	—	Completed merger with CFB.
2005	—	Upgraded the Shanghai representative office to a branch.
	—	Opened a representative office in Beijing.
2006	—	Opened a sub-branch in the Fumin district of Shenzhen.
	—	Upgraded the Guangzhou representative office to a branch.
2007	—	Acquired the entire issued share capital of Inchroy Credit Corporation Limited.
	—	Received approval from the CBRC to prepare for the establishment of a locally-incorporated bank in Mainland China.

GROUP STRUCTURE

The Bank is the holding company and the principal operating company of the Group. The Bank's main subsidiary is Banco Weng Hang. In addition, the Bank has a number of other wholly-owned operating subsidiaries which provide nominee, deposit-taking, offshore banking, insurance agency and broking, share brokerage, trustee, hire purchase and lease financing and consumer financing services.

The diagram below sets forth a summary of the Group's principal subsidiaries as of February 2007:



Notes:

1. All shares are held either directly or through corporations or trusts in which Mr. Patrick Y.B. Fung, Mr. Michael Y.S. Fung and Mr. Louis C.W. Ho's spouse together with other parties are eligible beneficiaries.

ORGANISATION

The Bank and Banco Weng Hang each has its own independent organisation structure.

The Bank's Chairman and Chief Executive, Mr. Patrick Y.B. Fung, is responsible for the day-to-day management of the Group and is accountable to the Board of Directors of the Bank. To assist the Board of Directors in managing the Group, four committees of Directors have been established. These are the Executive Committee, the Audit Committee, the Director Nomination Committee and the Remuneration Committee. The Executive Committee is responsible for reviewing the management and performance of the Group. The Audit Committee, whose members are all Non-Executive Directors, is responsible for reviewing and discussing financial performance, considering the nature and scope of audit and the effectiveness of the systems of internal control, risk management system and compliance and ensuring that all audit recommendations are implemented. The Director Nomination Committee comprises of three Non-Executive Directors and is responsible for reviewing and recommending to the Board of Directors all new appointments

of Directors, Chief Executive, Deputy Chief Executive and General Manager of the Bank. The Remuneration Committee comprises of two Non-Executive Directors and meets once a year to make recommendations to the Board of Directors on the Bank's policy and structure for remuneration of all the Directors and Senior Management of the Bank.

In addition to the Audit Committee and the Executive Committee, the Bank has a number of other committees which assist management in the operation of the Bank. These include the Credit Committee, which is responsible for the implementation and maintenance of the Group's credit risk management framework; the Management Committee, which reviews and approves the financial and business plans and major business and operational initiatives; and the Asset and Liability Management Committee, which is responsible for the implementation and maintenance of the overall risk management framework relating to balance sheet structure, market risks, trading, funding and liquidity management across the Group's banking business. The members of each committee are generally senior managers of the Bank.

The Bank has 9 business and 8 control and support divisions, each of which is responsible for a specific business or operational function. The business divisions include Loans Division, Corporate Banking Division, China Business Division, Retail Banking Division, Consumer Finance Division, Auto and Equipment Financing Division, Financial Markets Division, Treasury Division and Insurance and Trust Division. The control and support divisions include Financial Management Division, Operations Division, Risk Management Division, Legal and Compliance Division, Central Loans Division, Credit Administration Division, Information Technology Division and Human Resources Division. The Bank's Chief Executive, assisted by three Executive Directors, oversees all 17 divisions. Each division is managed by a Division Head who in turn supervises a number of departmental managers. The Bank also has an Internal Audit Division which reports directly to the Audit Committee.

Banco Weng Hang has its own Board of Directors and management structure. The General Manager of Banco Weng Hang is responsible for the day-to-day management of Banco Weng Hang and reports to the Bank's General Manager. Banco Weng Hang's Board of Directors is supported by a Supervisory Council consisting of an independent non-executive director of the Bank and two senior officers of the Bank.

STRATEGY

The Bank's objective is to strengthen its position in the Hong Kong market, enhance its overall competitiveness and expand its international operations, particularly in Mainland China and Macau and provide its customers with quality products and excellent customer service.

The major components of the Bank's strategy are as follows:

- **Further strengthening the Bank's position in Hong Kong by enhancing and expanding core domestic businesses and concentrating on key market segments.** As competition in the Hong Kong banking industry increases, the Bank believes that to compete effectively it will need to increase its market share in its core retail and corporate banking operations and cross-sell its products to its enlarged customer base. In particular, the Bank will continue to focus on expanding its consumer lending business. The Bank is also continually seeking to provide better service to its customers by selectively expanding and improving its Hong Kong branch network and broadening the scope of products and services it offers to its core retail and corporate customers. In addition, the Bank continues to evaluate additional opportunities through acquisitions, joint ventures or other forms of investments to further diversify its earnings base. The Bank believes that selective consolidation of its branch network coupled with the opening of new branches in strategic locations will enable it to realise cost savings while maintaining the geographic coverage of its branch network.

- Expand its geographical coverage in particular in Mainland China.** The Bank plans to continue to capitalise on growing opportunities in Mainland China following the full liberalisation of the banking sector and of Renminbi business in Mainland China in 2007. In particular, it is focusing on the Pearl River Delta region and extending its retail banking business in this area. It believes that it has a competitive advantage in the area given its experience operating in Hong Kong and Macau. In May 2002, the Bank received an approval from the People's Bank of China to provide Renminbi services to foreign-funded enterprises and foreigners in Mainland China. In addition, the Bank obtained approval to extend foreign currency services to domestic Chinese corporations operating in Mainland China. In February 2007, the Bank received approval from the CBRC to prepare for the establishment of a locally incorporated bank in Mainland China. See *"Recent Developments — Proposed Establishment of a Locally Incorporated Bank in Mainland China"* for further details. Following such approvals, it is the Bank's intention to set up a Mainland China-incorporated subsidiary bank in order to further expand its business in Mainland China and offer more comprehensive banking services to local residents and foreign enterprises. The Group also intends to upgrade its Beijing representative office to a branch and increase the number of sub-branches it has in Mainland China, particularly in Guangdong province.
- To continue to diversify its income sources.** The Bank has focused its efforts on broadening fee and commission income. The Bank intends to continue to diversify its income sources and focus on increasing its non-collateral based lending activities such as consumer finance, credit card and trade finance and increasing its other fee-based income by offering a wide selection of wealth management investment instruments such as unit trust funds, certificates of deposit, bonds and notes to its customers. The total amount of unit trust funds, bonds and other investment instruments sold through the Bank during 2006 exceeded HK\$12.0 billion. For the year ended 31 December 2006, other operating income and net interest income on financial instruments held for trading and measured at fair value through profit or loss of the Group amounted to HK\$1,018.7 million (US\$131.0 million), representing 34.7% of the Group's operating income, supported by increases in share brokerage commissions, treasury dealing income and wealth management commissions. The Bank plans to open more wealth management centers in strategic locations in order to provide a better service to its high net-worth customers and encourage further growth of the wealth management business. The Bank also intends to increase the number of employees of the Group in Macau, in order to facilitate the growth of its wealth management business in Macau.

BUSINESS

The principal activities of the Group are organised into four segments, based on the types of products and services that it provides. These segments are corporate banking, retail banking, treasury services and others. The corporate banking segment includes the advance of commercial and industrial loans, trade financing and institutional banking. The retail banking segment includes the acceptance of deposits, residential mortgages, wealth management, hire purchase and consumer loans. The treasury segment includes providing foreign exchange services, management of investment securities and trading securities. Other business activities of the Group include share brokerage, insurance underwriting, insurance agency and broking, bullion, nominee and trustee services and MPF services.

The table below sets forth a summary of the Group's performance by business segment for the years ended 31 December 2005 and 2006.

	Operating income			Profit before taxation		
	Year ended 31 December			Year ended 31 December		
	2006	2005	Increase/ (decrease)	2006	2005	Increase/ (decrease)
	(Expressed in thousands of Hong Kong dollars, except percentages)			(Expressed in thousands of Hong Kong dollars, except percentages)		
Corporate Banking	551,816	464,634	18.8%	424,253	300,024	41.4%
Retail Banking	1,882,365	1,628,661	15.6%	1,110,074	910,037	22.0%
Treasury	148,253	261,197	(43.2)%	131,870	217,263	(39.3)%
Others ⁽¹⁾	102,333	85,181	20.1%	100,782	52,478	92.0%
Unallocated ⁽²⁾	314,851	237,441	32.6%	214,272	136,004	57.5%
Inter-segment elimination	(62,171)	(56,344)	(10.3)%	—	—	—
Total	<u>2,937,447</u>	<u>2,620,770</u>	<u>12.1%</u>	<u>1,981,251</u>	<u>1,615,806</u>	<u>22.6%</u>

Notes:

1. “Others” include insurance business, stockbroking activities, bullion, nominee and trustee services and services for retirement schemes.
2. “Unallocated” mainly comprise shareholders’ funds, investments in premises and investment property, and results of other activities which cannot be reasonably allocated to specific business segments.

The following table is a summary of the Group’s operating income and profit before taxation by geographical location for the periods indicated.

	Operating income			Profit before taxation		
	Year ended 31 December			Year ended 31 December		
	2006	2005	Increase	2006	2005	Increase/ (decrease)
	(Expressed in thousands of Hong Kong dollars, except percentages)			(Expressed in thousands of Hong Kong dollars, except percentages)		
Hong Kong	2,648,730	2,439,037	8.6%	1,764,280	1,476,178	19.5%
Macau	416,198	328,961	26.5%	276,338	233,180	18.5%
Others ⁽¹⁾	190,956	138,562	37.8%	82,042	61,249	33.9%
Inter-segment elimination	(318,437)	(285,790)	11.4%	(141,409)	(154,801)	(8.7)%
Total	<u>2,937,447</u>	<u>2,620,770</u>	<u>12.1%</u>	<u>1,981,251</u>	<u>1,615,806</u>	<u>22.6%</u>

Note:

1. “Others” include Mainland China and other overseas locations.

HONG KONG

Corporate banking

The following table sets forth information concerning the corporate lending provided by the Group by sector as of the dates indicated.

	31 December 2006	31 December 2005	Increase/(decrease)
	(Expressed in thousands of Hong Kong dollars, except percentages)		
Property Development and Investment	11,306,638	10,281,081	10.0%
SME and Trade Finance	5,098,154	5,354,007	(4.8)%
Transport and Transport Equipment	2,416,631	2,827,696	(14.5)%
Other general corporate loans	4,488,457	3,972,020	13.0%
Total	<u>23,309,880</u>	<u>22,434,804</u>	<u>3.9%</u>

The Group’s corporate banking customers are primarily small- to medium-sized enterprises (“*SMEs*”) engaged in businesses in a broad range of industries in Hong Kong, Macau and the Pearl River Delta region. The Group’s corporate banking philosophy places a particular emphasis on “relationship banking” and as a result, the customer base includes many long-standing customers. Many of the Bank’s traditional customers have established operations in Mainland China and the Bank has continued to support these customers in connection with their activities. The Bank has also continued to participate actively in the Hong Kong Government’s SME Loan Guarantee Scheme.

For the year ended 31 December 2006, the Group’s corporate banking division recorded a 41.4% increase in profit before taxation to HK\$424.3 million (US\$54.5 million), compared with HK\$300.0 million (US\$38.7 million) for the year ended 31 December 2005.

The Group provides a wide range of services to its corporate clients, the most important of which are listed below:

(i) *Corporate loan and other services*

Corporate loans are extended to customers for a variety of purposes including financing for working capital and for investment projects. The Group's major areas of corporate lending are:

Property development and investment

The Group provides mortgage loan facilities to corporate customers to facilitate the purchase of residential, office or commercial properties, for their own use or for investment purposes. For the year ended 31 December 2006, the Group's advances to customers for property development and investment increased by 10.0% from HK\$10,281.1 million (US\$1,326.0 million) as of 31 December 2005 to HK\$11,306.6 million (US\$1,453.7 million) as of 31 December 2006.

SME and trade finance services

The Group provides its customers with personalised and customised trade finance services to meet their particular requirements. Trade finance customers of the Group include a wide range of manufacturing and trading companies in Hong Kong and Macau. In addition, the Group also provides working capital to SMEs and manufacturers, wholesalers and retail trade. The trade finance services are divided into import trade services, export trade services and other services. Import trade services include the issuance and negotiation of letters of credit, inward bills collections, shipping guarantee, storage of goods, import loans and trust receipt facilities. Export trade services include negotiation of bills under documentary credits, purchase of documents against acceptance and documents against payment bills, outward bills collection and arranging pre-export finance services. Other services include foreign exchange forward contracts, comprehensive insurance services, provision of overseas trade and credit information, financial and credit enquiry on overseas customers and introducing potential traders to the Group's clients and vice versa. For the year ended 31 December 2006, the Group recorded a 4.8% decrease in SME and trade finance advances from HK\$5,354.0 million (US\$690.5 million) as of 31 December 2005 to HK\$5,098.2 million (US\$655.5 million) as of 31 December 2006 due to repayment by a large corporate customer.

Transport and transport equipment finance services

The Bank, mainly through its wholly-owned subsidiary, Wing Hang Finance Company Limited, has achieved consistent growth in its vehicle and equipment financing provided to Hong Kong manufacturers with their operations in the Pearl River Delta region. For the year ended 31 December 2006, transport and transport equipment financing recorded a 14.5% decrease from HK\$2,827.7 million (US\$364.7 million) as of 31 December 2005 to HK\$2,416.6 million (US\$310.7 million) as of 31 December 2006 due to keen price competition in the local auto finance business. The acquisition of Inchroy is expected to strengthen the Bank's competitive position in this market.

Other general corporate loans

The Group provides loans to companies for general operating purposes. Such loans are usually supported by collateral of various types and have short maturities. For the year ended 31 December 2006, the Group's general corporate loans increased by 13.0 % from HK\$3,972.0 million (US\$512.3 million) as of 31 December 2005 to HK\$4,488.5 million (US\$577.1 million) as of 31 December 2006. In addition, the Group provides margin loans to stockbrokers to finance their trading activities as well as to enable them to extend margin facilities to their own customers. During 2006, the Bank's corporate banking division in Hong Kong, in co-operation with its Shenzhen branch, provided credit facilities to Hong Kong manufacturers that have shifted their operations to Mainland China, resulting in advances to customers for use in Mainland China for the year ended 31 December 2006 increasing by 18.7% in

comparison to the year ended 31 December 2005. The Bank also offers project financing to Hong Kong developers that are diversifying their investments across the border. Customer relations in Mainland China are also supported by the Bank's branches in Shanghai and Guangzhou, its sub-branch in Fumin, and its representative office in Beijing.

(ii) *Corporate deposits*

The Group accepts deposits in Hong Kong dollars, Macau Patacas and 17 other currencies from corporate customers.

(iii) *International banking*

The Group maintains correspondent banking relationships with over 1,100 banks worldwide and provides Hong Kong dollar clearing services for foreign banks that maintain Hong Kong dollar accounts with the Group. The Group also provides trade finance services to foreign banks, including the confirmation of and advising on letters of credit.

Retail banking

The following table sets forth a summary of the retail lending provided by the Group by sector as of the dates indicated.

	<u>31 December 2006</u>	<u>31 December 2005</u>	<u>Increase/(decrease)</u>
	(Expressed in thousands of Hong Kong dollars, except percentages)		
Loans for residential properties	16,284,115	15,418,354	5.6%
Credit card advances, personal loans and other loans to individuals	3,561,986	3,909,052	(8.9)%
Total	<u>19,846,101</u>	<u>19,327,406</u>	<u>2.7%</u>

Retail banking services provided by the Group include chequing account facilities as well as the provision of deposit accounts in Hong Kong dollars, Macau Patacas and 17 other currencies. In addition, the Group also provides retail customers with services such as foreign remittances, telegraphic transfers, issuance of bank drafts, cashiers' orders, travellers cheques, gift cheques, payment of utility bills and automated teller machine services. In the first quarter of 2006, the Bank launched a real-time Hong Kong-Macau remittance service enabling its customers to switch their funds between Hong Kong and Macau instantly.

For the year ended 31 December 2006, the Group's retail banking division recorded a 22.0% increase in operating profit before taxation to HK\$1,110.1 million (US\$142.7 million), compared with HK\$910.0 million (US\$117.4 million) for the year ended 31 December 2005, largely resulting from strong loan growth, increases in stock trading commissions and treasury dealing income, as well as growth in wealth management services.

(i) *Loans for residential properties*

The Group's retail lending business is centered around the provision of residential mortgages to customers. Its general policy in relation to new residential mortgages in Hong Kong is in line with the guidelines established by the HKMA. Such lending business is conducted through the Bank's branch network.

The types of residential mortgages offered by the Group are mainly divided into 3 types: (a) loans for the purchase of flats under the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme launched by the Hong Kong Government; (b) loans for the purchase of other residential properties and (c) loans for refinancing mortgages. Despite keen market competition in the second half of 2006, total loans for residential properties for the year ended 31 December 2006 increased by 5.6% from HK\$15,418.4 million (US\$1,988.6 million) as of 31 December 2005 to HK\$16,284.1 million (US\$2,093.6 million) as of 31 December 2006.

(ii) *Consumer finance*

The Group also engages in consumer lending in the form of unsecured personal loans and credit card loans.

During 2006, the Group continued to expand its personal loan activities through the Bank's wholly-owned subsidiary Wing Hang Credit Limited with the introduction of a series of tax and revolving loan products. For the year ended 31 December 2006, Wing Hang Credit Limited's consumer loan portfolio increased by 8.1%, from HK\$1,276.5 million (US\$164.6 million) as of 31 December 2005 to HK\$1,379.4 million (US\$177.4 million) as of 31 December 2006.

The Bank has continued to offer innovative programmes to attract customers of strong credit standing. Credit card receivables remained steady at HK\$323.1 million (US\$41.5 million) as of 31 December 2006. For the year ended 31 December 2006, annualised charge-offs for credit cards remained the same as for the year ended 31 December 2005 at 1.52% of credit card receivables.

(iii) *Deposits*

The wide range of deposit services provided to customers include savings and current accounts denominated in Hong Kong dollars as well as other foreign currencies and Hong Kong dollar and foreign currency time deposits. The Group is constantly seeking to improve and widen its range of deposit services in order to give customers maximum flexibility, high returns and the ultimate in modern banking convenience such as the introduction of the "eDeposit" service and "Currency-Linked Deposit". The "eDeposit" service allows customers to enjoy real-time fund transfer from other banks in Hong Kong to their bank accounts held with the Bank and provide fixed deposit placement, stock trading and foreign currency investment through the Internet. The "Currency-linked Deposit" is a combination of time deposit and foreign currency options in which customers are able to enjoy a fixed deposit with a higher interest rate, multiple choices of currencies and a flexible tenor ranging from 7 days to 3 months.

Total deposits and customer deposits registered 17.8% and 19.1% increases, respectively from HK\$91,200.8 million (US\$11,762.5 million) and HK\$85,673.5 million (US\$11,049.7 million), respectively as of 31 December 2005 to HK\$107,475.1 million (US\$13,817.8 million) and HK\$102,066.9 million (US\$13,122.5 million), respectively, as of 31 December 2006, with a substantial increase in demand and savings deposits. Foreign currency deposits for the year ended 31 December 2006 grew by 5.3% as compared to the year ended 31 December 2005. Deposit growth was partly supported by increased stock market activity, an expanded branch network and the successful promotion of the Elite Banking concept aimed at high net-worth customers. During the year ended 31 December 2006, the Bank issued certificates of deposits totalling HK\$1,100.0 million (US\$141.4 million), which were well received by the market.

(iv) *Wealth management*

The wealth management business continued to grow in 2006 despite increases in interest rates. This was partly due to the continued expansion of the Bank's point-of-sales outlets offering a growing array of investment products and also a result of growth in private investment. The Bank currently operates 5 wealth management centres in Hong Kong and is planning to open more.

Responding to rising demand for wealth management services and the growing sophistication of the Bank's customers, during 2006, the wealth management operation offered its customers a wider range of investment instruments including unit trust funds, third-party equity-linked or credit-linked note products and retail callable certificates of deposit. For the year ended 31 December 2006, the total amount of investment instruments sold through the Bank on an agency basis, including bonds, mutual funds and callable certificates of deposit, exceeded HK\$12.0 billion (US\$1.54 billion). In addition, the wealth management operation offers share brokerage services and insurance underwriting, agency and broking services to its customers. See "*Other businesses — Share brokerage services; — Insurance underwriting, agency and broking services and MPF services*".

In keeping with its efforts to boost customer loyalty, the Group has continued to take steps to improve the quality of its service. During 2006, the Bank increased the number of customer service staff in the branches. In addition, continued on-the-job training has equipped employees to market new services and products created to suit prevailing investment conditions. Upgraded skills have also enhanced job satisfaction and career prospects for the Bank's employees.

The Group's ongoing service commitment is to offer a multi-channel one-stop solution to meet the various financial needs of its growing customer base. There continues to be a positive response to the "Elite Banking" concept introduced to selected customers in 2001. This service targets customers with higher deposits and net assets, and offers them value-added services, such as preferential interest rate for residential mortgage loans, waiver of certain transaction fees, discounts on handling charges for the subscription of bonds and remittance services.

(v) *Internet banking services*

Internet banking services provided by the Group include its eBanking and Online Trading services. The Group's eBanking service allows customers to perform banking transactions and access information using various electronic channels including the Internet and fixed-line telephones. The Group's eBanking service offers a wide variety of banking functions, including account enquiry, funds transfer, stock trading, credit card payment, bill payment, rate enquiry, change of user ID, change of PIN and personal information, cheque book requisition, account statement requisition, time deposit services, gold trading and exchange transaction. As of 31 December 2006, the Group had over 116,000 eBanking accounts and currently executes close to 23,000 transactions daily.

The Group's Online Trading service was launched in 2002. The service allows customers to trade stocks and warrants via the Internet and fixed-line telephones. As of 31 December 2006, trades completed by using the Online Trading service accounted for approximately 30.0% of the Group's total trade volume.

It is the Group's intention to continue to expand its eBanking and Online Trading services to offer more extensive Internet banking and brokerage services to its customers.

Treasury services

(i) *Foreign exchange services*

The Group's major source of foreign exchange income is generated from services provided to customers such as foreign exchange trading, forward contracts and foreign exchange margin trading. The Group's foreign exchange trading hours run until approximately 3:00 a.m. to allow trading in the New York foreign exchange market. In addition to providing foreign exchange services in most major foreign currencies, the Group's services also include the buying and selling of Renminbi banknotes, mainly for retail customers. For the year ended 31 December 2006, foreign currency deposits grew by 5.3% as compared to the year ended 31 December 2005.

The Group also takes positions for its own account in foreign exchange and treasury trading transactions. The Group adopts a conservative approach to proprietary trading and places strict limits on dealer positions. Compliance with these limits is regularly monitored by senior executives of the Group.

(ii) *Investment securities*

During the second half of 2002, the Bank established the Financial Markets Division responsible for the enhancement of yields for the Group's surplus funds by investing excess liquidity in high grade investment bonds and debt securities.

For the year ended 31 December 2006, the Bank's treasury operation recorded a 39.3% decrease in profit before taxation to HK\$131.9 million (US\$17.0 million) from HK\$217.3 million (US\$28.0 million) for the year ended 31 December 2005, mainly as a result of a flatter yield curve in 2006. It is the Bank's intention to continue to enhance and expand treasury capabilities to invest its surplus funds efficiently and prudently.

Held-to-maturity and available-for-sale financial assets increased by 22.8% from HK\$15,909.4 million (US\$2,051.9 million) as of 31 December 2005 to HK\$19,534.4 million (US\$2,511.5 million) as of 31 December 2006 due to an increase in high quality short term debt securities held in the Bank's liquidity portfolio as the Bank's deposits increase.

Other businesses

The Group's other businesses include the provision of finance-related services to corporate and retail customers in the form of share brokerage, insurance underwriting, insurance agency and broking, bullion, nominee and trustee services and MPF services.

For the year ended 31 December 2006, the Group's insurance business, stockbroking activities and services for retirement schemes recorded a 92.1% increase to HK\$100.8 million (US\$13.0 million) in profit before taxation compared with HK\$52.5 million (US\$6.8 million) for the year ended 31 December 2005.

(i) *Share brokerage services*

The Group's share brokerage subsidiaries own four seats on the Hong Kong Stock Exchange. Securities trading transactions are executed through these companies and orders can be placed through any of the Group's branches in Hong Kong. The Bank also provides financing to individual customers and stockbrokers to fund share purchases. The company introduced an IVR (Interactive Voice Response) automated share trading system in 2002 which has been well received by customers.

For the year ended 31 December 2006, the Group's shares brokerage subsidiaries recorded a 81.3% increase to HK\$105.4 million (US\$13.6 million) in stockbroking fees compared with HK\$58.1 million (US\$7.5 million) for the year ended 31 December 2005, due to active trading on the stock market stimulated by an increase in stock market turnover in the second half of 2006.

The Group's Online Trading service was launched in 2002 and allows customers to trade stocks and warrants via the Internet and fixed-line telephone. As of 31 December 2006, trades completed by using the Online Trading service accounted for approximately 30.0% of the Group's total trade volume.

(ii) *Insurance underwriting, agency and broking services and MPF services*

The Group provides agency and broking insurance services through Wing Hang Insurance Agency Limited and Wing Hang Insurance Brokers Limited, both of which are wholly-owned subsidiaries of the Bank. The Group also provides general insurance underwriting services through Wing Hang Zurich Insurance Company Limited, which is 65% owned by the Bank. The Bank's Shenzhen branch has an insurance agency license which enables the Group to also provide insurance services to customers in Mainland China.

In May 1999, the Bank founded The Bank Consortium Trust Company Ltd ("**BCT**") with other local banks in Hong Kong with the objective of providing quality MPF services to customers. In October of the same year, the Group upgraded its MPF team into a full department focusing on preparation for the launch of the MPF in December 2000. BCT manages assets worth over HK\$18.0 billion (US\$2.3 billion), providing services to more than 500,000 members. With the advanced technology, professional expertise and wide network of BCT, the Group is able to offer a comprehensive range of MPF services, including trustee, scheme administration, investment management and custody services, to employers, employees and the self-employed.

Despite increased competition, Wing Hang Insurance Agency Limited and Wing Hang Insurance Brokers Limited achieved steady results during 2006. Hong Kong Life Insurance Limited, an associated company which is 33% owned by the Bank and which offers life insurance to the Bank's customers, achieved encouraging investment results for the year 2006.

(iii) *Bullion services*

Bullion services are provided by the Group to its customers and include the trading of gold bullion through the Chinese Gold and Silver Exchange Society (the "**Society**") and other world markets. The Bank is a member of the Society and is also one of a limited number of members of that exchange which are licensed to produce and stamp gold bars in their own name. The Bank is the sole settlement bank for the Society and acts as custodian for many international bullion dealers. The Bank also provides customers with gold passbook accounts and over-the-counter retail sales of gold bars and coins.

(iv) *Nominee services*

Wing Hang Bank (Nominees) Limited, a wholly-owned subsidiary of the Bank, provides nominee, custodian and share brokerage services to the customers of the Group.

(v) *Trustee services*

The Group also provides on-shore and off-shore trustee services through its wholly-owned subsidiary Wing Hang Bank (Trustee) Limited.

BRANCHES

The Group currently has 38 branches in Hong Kong (including one branch which is located at the Bank's head office), 13 branches in Macau (including one branch located at Banco Weng Hang's head office) and 1 branch in each of Shenzhen, Guangzhou and Shanghai, and 1 sub-branch in the Fumin district of Shenzhen. The Group owns the Bank's head office building located at 161 Queen's Road Central, as well as 26 of its branch premises in Hong Kong. In addition, the Group owns the majority of its premises in Macau and Shenzhen. The Group's ownership of a large percentage of its branch premises has allowed the Group to minimise and control increases in occupancy expenses. The Group intends to expand its branch network if suitable strategic locations are identified and to continue its strategy of purchasing the premises needed for new branches whenever possible. The Group also intends to open additional sub-branches in other cities in Mainland China, such as Shenzhen and Guangzhou.

BANCO WENG HANG

Banco Weng Hang, a wholly-owned subsidiary of the Bank, has been in operation since 1941 and has 13 branches located in Macau. Banco Weng Hang is the fifth-largest bank in Macau in terms of total assets as at the end of 2006. Banco Weng Hang is regulated by the HKMA as well as the Monetary Authority of Macau. Banco Weng Hang is one of the 23 retail banks in Macau with a full banking license. Banco Weng Hang provides a wide range of banking services including corporate banking, retail banking and foreign exchange and treasury services to corporate and retail customers in Macau. The banking services offered by Banco Weng Hang include many of those offered by the Bank in Hong Kong such as:

- (i) Corporate banking — general corporate loans, credit facilities to SMEs and trade finance services.
- (ii) Retail banking — personal loans, credit card loans, residential mortgages, customer deposits and wealth management services.
- (iii) Foreign exchange services and insurance and share brokerage services.

For the year ended 31 December 2006, Banco Weng Hang recorded a 27.0% increase in profit before impairment allowances from MOP224.5 million (US\$28.1 million) for the year ended 31 December 2005 to MOP284.8 million (US\$35.5 million) for the year ended 31 December 2006, with steady growth in loans of 26.4% from MOP5,226.2 million (US\$654.4 million) as of 31 December 2005 to MOP6,605.4 million (US\$824.5 million) as of 31 December 2006. For the year ended 31 December 2006, Banco Weng Hang accounted for 13.9% of the Group's profit before taxation.

As of 31 December 2006, Banco Weng Hang's total assets, shareholders' funds, advances to customers and total deposits were MOP18,822.2 million (US\$2,349.4 million), MOP1,118.2 million (US\$139.6 million), MOP6,605.4 million (US\$824.5 million) and MOP16,425.4 million (US\$2,050.3 million), respectively.

BUSINESS IN MAINLAND CHINA

The Group currently has a branch office in each of Shenzhen, Guangzhou and Shanghai, a sub-branch in the Fumin district of Shenzhen and a representative office in Beijing. It is the Group's intention to upgrade its Beijing representative office to a branch and open further sub-branches in other cities in Mainland China, such as Guangzhou.

In May 2002, the Bank, through its Shenzhen branch, received approval from the People's Bank of China to provide Renminbi services to foreign-funded enterprises and foreigners in Mainland China as well as to extend foreign currency services to domestic Chinese corporations operating in Mainland China. The ability to lend in Renminbi enables the Group to broaden the scope of its banking activities in Mainland China and to better serve its existing and potential customers. In making Renminbi denominated loans, the Bank usually requires that the borrower has sufficient Renminbi cashflow to service such loans. In February 2007, the Bank received approval to prepare for the establishment of a locally incorporated bank in Mainland China. The establishment of a locally incorporated subsidiary bank will enable the Bank to offer a full range of Renminbi services to domestic Chinese residents and better serve its expanding customer base. The Bank expects the process to be completed in the second half of 2007. Following the establishment of a locally incorporated subsidiary bank in Mainland China, the Bank intends that all but one of its Mainland China branches will become branches of the locally incorporated bank. See *"Recent Developments — Proposed Establishment of a Locally Incorporated Bank in Mainland China"*. In addition, the Bank will continue to target its Hong Kong customers with new operations in Mainland China. For the year ended 31 December 2006, the Group's operations in Mainland China and overseas accounted for approximately 4.1% of the Group's total profit before taxation.

IMPAIRED LOANS AND CREDIT RISK MANAGEMENT

Due to the general improvement in the economy and stable property prices in Hong Kong, the level of impaired loans decreased to 0.62% of total loans outstanding, or HK\$364.1 million (US\$46.8 million), as of 31 December 2006, compared with HK\$560.1 million (US\$72.2 million) as of 31 December 2005. Impairment allowances on loans and advances decreased by 98.6% from HK\$54.1 million (US\$7.0 million) for the year ended 31 December 2005 to HK\$0.8 million (US\$0.1 million) for the year ended 31 December 2006.

Due to higher demand for residential and investment mortgages, consumer financing and share financing, as of 31 December 2006 the Group's total loans outstanding to customers increased to HK\$58,638.2 million (US\$7,539.0 million), representing a 7.8% increase from 31 December 2005. The Group's residential mortgages, which accounted for 27.8% of the total loan portfolio as of 31 December 2006 (compared with 28.3% as of 31 December 2005), increased by 5.6%. The net interest income of the Group for the year ended 31 December 2006 increased by 11.0% to HK\$1,918.7 million (US\$246.7 million) compared with HK\$1,729.1 million (US\$223.0 million) for the year ended 31 December 2005 as strong loan growth, higher returns on shareholders' funds and an increase in interest rates partially offset a reduction in income from the Bank's treasury operations and pressure from mortgage re-pricing. Net interest income also grew as a result of increased activities in Mainland China and Macau, which saw loans advanced by the Group grow by 18.7% and 28.9%, respectively, in 2006.

The Group maintains a conservative credit policy and has established a number of controls to ensure adherence to this policy. The Group's credit policy guidelines are reviewed and updated on a regular basis by the Bank's Credit Committee. Both the Bank and Banco Weng Hang have their own Credit Committees. The Bank's Credit Committee comprises the Chief Executive, Executive Directors and certain senior members of the Bank while Banco Weng Hang's Credit Committee comprises the General Manager and senior managers of Banco Weng Hang. The main responsibilities of the Credit Committees are to assist the Board of Directors to formulate the Group's risk appetite and strategies for managing the credit risk, and to implement and maintain the Group's credit risk management framework. The Credit Committee also participates in evaluating large credit applications and making credit decisions.

The Credit Committees will review the respective banks' loan portfolio's "past due" positions and their composition by industry, approve material credit applications and conduct annual reviews on such credit facilities granted to existing customers. Credit applications that exceed Banco Weng Hang's Credit Committee's authorised credit limit are required to be approved by at least two Executive Directors from the Board of Banco Weng Hang.

In addition to the two Credit Committees, the Group has in place further controls to maintain the credit quality of the Group's loans. All loan officers are given lending limits and each loan must be approved by two loan officers, one of whom must have adequate lending authority to approve the loan.

The Group follows a prudent impairment allowance policy and, as of 31 December 2006, impairment allowances on loans and advances amounted to 0.45% of the Group's total portfolio.

As of 31 December 2006, impaired loans represented HK\$364.1 million (US\$46.8 million) or 0.62% of total loans outstanding. The following outlines the impairment allowances on loans and advances:

	Individual	Collective	Total
(Expressed in thousands of Hong Kong dollars)			
As of 31 December 2006			
Trade bills	4,355	285	4,640
Advances to customers	92,317	168,717	261,034
Total	<u>96,672</u>	<u>169,002</u>	<u>265,674</u>
As of 31 December 2005			
Trade bills	961	656	1,617
Advances to customers	119,720	207,842	327,562
Total	<u>120,681</u>	<u>208,498</u>	<u>329,179</u>

The Group sets its own prudent guidelines with regard to collateral for loans. A significant proportion of the Group's loan portfolio by value is supported by collateral such as cash, listed securities and properties.

Implementation of the Basel II Accord in Hong Kong

The HKMA has adopted the Basel II Accord capital adequacy standards in Hong Kong from the beginning of 2007. Currently, the Bank adopts the standardised approach for credit risk and market risk, and the basic indicator approach for operational risk.

In order to enhance the Bank's credit risk management and ensure compliance with Basel II requirements, including moving in the future to foundation internal ratings-based approach for credit risk, the Bank joined a consortium of banks to engage an external consultant in late 2003 to devise a credit risk solution (the "**Solution**") on a pooled credit data basis. The Bank completed its implementation of the Solution in April 2005 and has since been using the resultant systems. The Solution, which comprises the establishment of an internal rating framework and credit risk rating tools for major asset classes of the Bank, is intended to enhance the ability of portfolio and capital management through improved evaluation of risk and return.

Furthermore, the Bank has set up a steering committee chaired by the Deputy Chief Executive for the purpose of complying with Basel II requirements and implementing best market practice for risk management within the Bank.

FUNDING

The Group's main sources of funding for its assets are shareholders' funds, subordinated debt and customer deposits. As of 31 December 2006, 94.9% of the Group's customer deposits had a remaining maturity of 3 months or less.

Subordinated debt in the form of US\$325 million 5.25% subordinated notes qualifying as tier 2 capital was issued during 2003 by Wing Hang Financial Holdings (BVI) Limited, a single purpose wholly-owned finance subsidiary of the Bank. The Bank unconditionally and irrevocably guarantees all amounts payable under the notes. The notes are listed on the SGX-ST and will mature on 10 October 2013.

The Group offers deposit services through the Bank, Banco Weng Hang, Wing Hang Bank (Cayman) Limited, Wing Hang Finance Company Limited and Inchroy. Wing Hang Bank (Cayman) Limited is a Cayman Islands incorporated company which provides offshore banking and deposit-taking services for the Group's customers. Wing Hang Finance Company Limited is a Hong Kong deposit-taking company which is able to accept deposits of not less than HK\$100,000 (US\$12,857) with maturities of not less than three months. Inchroy is a Hong Kong registered deposit-taking company, the entire issued share capital of which was acquired by the Bank in January 2007. See "*Recent Developments — Acquisition of Inchroy Credit Corporation Limited*". Through these five companies, the Group is able to offer its corporate and retail customers competitive deposit rates.

The Group has developed an extensive customer deposit base in Hong Kong and Macau comprising both individual and corporate depositors. Total deposits and customer deposits of the Group increased by 17.8% and 19.1%, respectively from HK\$91,200.8 million (US\$11,762.5 million) and HK\$85,673.5 million (US\$11,049.7 million), respectively as of 31 December 2005 to HK\$107,475.1 million (US\$13,817.8 million) and HK\$102,066.9 million (US\$13,122.5 million) respectively as of 31 December 2006, with a substantial increase in demand and savings deposits. Deposit growth was partly supported by increased stock market activity, an expanded branch network and the successful promotion of the Elite Banking concept aimed at high net-worth customers.

The Bank's Financial Market and Treasury Divisions help to stabilise the Group's funding operations through the interbank market, and seeks the best return for the Group's excess funds in the local and international markets.

Over the years, the Group has diversified and further supplemented its medium-term funding through the issuance of floating rate certificates of deposit in Hong Kong. During 2006, the Bank issued retail certificates of deposit totaling HK\$1,100.0 million (US\$141.4 million).

The Group has a policy of minimising its interest rate exposure by matching its floating rate liabilities with its floating rate assets.

RELATIONSHIP WITH THE BANK OF NEW YORK GROUP

BONY, through BNY International Financing Corp., presently owns 20.2% of the issued share capital of the Bank. BNY International Financing Corp. is incorporated in the United States under the Federal Reserve Act and operates under Federal Reserve Regulations.

The Bank of New York Group is represented on the board of directors through 2 director seats. The Bank of New York Group continues to provide information to the Group for credit evaluation of customers outside Hong Kong, Macau and Mainland China. Furthermore, The Bank of New York Group exchanges information with the Group on the latest developments in bank computer systems and makes available its facilities in New York for middle and senior management training.

BONY and Mellon Financial Corporation announced on 4 December 2006 that they have entered into a definitive agreement to merge.

INSURANCE

The Bank maintains insurance coverage which includes an "all risks" insurance for its money, properties and computers, public liability insurance and directors' and officers' liability insurance. The Bank generally requires borrowers to obtain appropriate insurance coverage for certain types of security, such as residential premises, provided by them.

The Bank is now a member of the Deposit Protection Scheme (the “*Scheme*”), which was launched in September 2006. Accordingly, all eligible depositors of the Bank are automatically protected under the Scheme. The implementation of the Scheme only slightly increases the costs of funding of the Bank.

LITIGATION

Neither the Bank nor any of its subsidiaries is currently involved in any material litigation or similar proceedings and the Bank is not aware of any circumstances under which any of the same is pending or threatened.

INTELLECTUAL PROPERTY

The Group relies on domain name registrations to establish and protect its Internet domain names. The Group has registered over 40 Internet domain names, including “www.whbhk.com” and “www.whbmac.com”.

As at the date of this Offering Circular, there has not been any significant infringements by the Group or by third parties against the Group.

EMPLOYEES

As of 31 December 2006, the Group had a total of 2,436 employees as set forth in the following table.

	<u>No. of employees</u>
Corporate and retail banking	1,065
Head office and operational support.....	820
Overseas (Mainland China and Macau).....	<u>551</u>
Total.....	<u><u>2,436</u></u>

As of 31 December 2006, approximately 24.6% of the Group’s employees performed supervisory and management functions, while the remaining 75.4% performed business and operational support functions.

The Group believes that investment in human resources is critical to its growth. As a result, the Group has increased emphasis on benchmarking its remuneration structure to market standards. Management believes that the Group maintains a good relationship with its employees. None of the Group’s employees are members of a trade union. The Group provides subsidised mortgages, low-interest housing loans and life and medical insurance benefits to its employees. The Group also maintains a Mandatory Provident Fund scheme for its employees. As of 31 December 2006, loans to directors totaled HK\$398.0 million (US\$51.2 million).

On 9 June 1993, the Group adopted a share option scheme (the “*Share Option Scheme*”) under which senior executives and directors of the Bank are eligible for grants of share options for subscription of shares of the Bank. Such Share Option Scheme was terminated on 24 April 2003 and replaced by a new share option scheme for a period of 10 years with amendments which complied with Chapter 17 of the Listing Rules of the Hong Kong Stock Exchange. As of 31 December 2006, the number of shares available for issue under the new share option scheme was 13,793,000 or 4.7% of the total issued share capital of the Bank.

On 22 April 2004, the Group adopted an employee incentive plan (“*Employee Incentive Plan*”), under which senior executives and directors of the Bank are eligible to take up awards to subscribe for shares of the Bank as incentive for them to remain in employment with the Bank. An award granted under the Employee Incentive Plan can be vested between the sixth and tenth anniversaries after the date of the grant of the award. As of 31 December 2006, the number of shares available for issue under the Employee Incentive Plan was 887,000 or 0.3% of the total issued share capital of the Bank.

PRINCIPAL SUBSIDIARIES

The Bank's subsidiaries are involved in the provision of general banking and related financial services. Details of the Bank's principal active subsidiaries and its effective equity interest in each, as of February 2007 are set out below.

Name of Company	Place of incorporation and operation	Nominal value of issued ordinary shares	Bank's interest (%)	Activity
Banco Weng Hang, S.A.	Macau	MOP120,000,000	100	Banking
Wing Hang Bank (Cayman) Limited	Cayman Islands	US\$25,000,000	100	Banking
Wing Hang Finance Company Limited	Hong Kong	HK\$130,000,000	100	Deposit Taking and Hire Purchase
Inchroy Credit Corporation Limited	Hong Kong	HK\$5,000,000	100	Deposit Taking and Hire Purchase
Wing Hang Credit Limited	Hong Kong	HK\$20,000,000	100	Consumer Lending
Wing Hang Zurich Insurance Company Ltd.	Hong Kong	HK\$45,000,000	65	Insurance
Wing Hang Insurance Brokers Limited	Hong Kong	HK\$100,000	100	Insurance Broker
Wing Hang Insurance Agency Limited	Hong Kong	HK\$50,000	100	Insurance Agency
Wing Hang Shares Brokerage Company Ltd.	Hong Kong	HK\$10,000,000	100	Securities Dealing
Wing Hang Bank (Trustee) Limited	Hong Kong	HK\$3,000,000	100	Trustee Services
Wing Hang Bank (Nominees) Limited	Hong Kong	HK\$10,000	100	Nominee Services
Cheuk Woo Enterprises Company Limited	Hong Kong	HK\$10,000	100	Property Investment
Honfirst Land Limited	Hong Kong	HK\$27,000,000	100	Property Investment
Wing Hang Financial Holdings (BVI) Limited	British Virgin Islands	US\$10	100	Issuer of Subordinated Notes

COMPETITION

The Hong Kong banking industry is well developed and the Group faces intense competition from many other Hong Kong banks and international banks. In addition, the Bank expects competition in Mainland China to continue to increase following the opening of banking business in Mainland China to foreign banks in 2007 as part of Mainland China's WTO commitments. For a discussion of competition faced by the Group in Hong Kong, see "*Risk Factors — Risks Relating to the Group — Competition*".

RECENT DEVELOPMENTS

Acquisition of Inchroy Credit Corporation Limited

On 31 January 2007, the Bank completed on the purchase of the entire issued share capital of Inchroy Credit Corporation Limited (“*Inchroy*”) from BankAmerica International Financial Corporation (“*BankAmerica*”) and Inchcape Hong Kong Limited (“*Inchcape*”), for a consideration of HK\$1,400 million (US\$179.3 million), satisfied by a payment in cash to the Vendors at completion.

The acquisition by the Bank of the entire issued share capital of Inchroy constituted a discloseable transaction for the Bank under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

The consideration was determined after arm’s length negotiations and represents approximately 1.61 times the published audited net asset value of Inchroy of HK\$868.7 million (US\$112.0 million) as at 31 December 2005 and 1.49 times the net asset value of Inchroy of HK\$939.0 million (US\$120.7 million) as at 31 December 2006.

Information on Inchroy

Prior to completion of the acquisition by the Bank of the entire issued share capital of Inchroy, Inchroy was a 50-50 joint venture between BankAmerica and Inchcape.

The principal business activities of Inchroy comprise the provision of hire purchase and lease financing for motor vehicles and equipment, and extending personal and mortgage loans.

Inchroy is a Hong Kong registered deposit-taking company with total assets of HK\$5,741.8 million (US\$738.2 million) as at 31 December 2006. It currently operates from four offices in Hong Kong, one of which is its head office in Causeway Bay.

Net profit before tax of Inchroy amounted to HK\$94.9 million (US\$12.2 million) and HK\$102.8 million (US\$13.3 million) for the years ended 31 December 2006 and 31 December 2005 respectively. Net profit after tax amounted to HK\$78.6 million (US\$10.1 million) and HK\$84.7 million (US\$10.9 million) for the years ended 31 December 2006 and 31 December 2005 respectively. The net asset value of Inchroy was HK\$939.0 million (US\$120.7 million) and HK\$868.7 million (US\$112.0 million) for the years ended 31 December 2006 and 31 December 2005 respectively.

As a 100% owned subsidiary of the Bank, the financial results of Inchroy will in future be consolidated into the Group’s financial statements. The Board of Directors of the Bank believe that the acquisition of Inchroy will enhance the prospective earnings of the Group but that it will not have a material effect on the total assets and liabilities of the Group.

Proposed establishment of a locally incorporated bank in Mainland China

In February, 2007, the Bank received approval from the CBRC to prepare for the establishment of a locally incorporated bank in Mainland China. The establishment of a locally incorporated subsidiary bank will enable the Bank to offer a full range of Renminbi services to domestic Chinese residents. The Bank expects the process to be completed in the second half of 2007. The Bank intends that its branches in Mainland China will become branches of the locally incorporated bank, except for one Mainland China branch which will remain a branch of the Bank in order to be able to provide foreign exchange services.

SELECTED STATISTICAL AND OTHER INFORMATION RELATING TO THE BANK AND THE GROUP

The selected statistical and other information set forth below relates only to the Group and has, except where otherwise indicated, been compiled as of and for each of the two years ended 31 December 2005 and 31 December 2006. This section should be read in conjunction with the information contained elsewhere in this Offering Circular, including “*Business of the Group*”.

Loan portfolio

Overview

As of 31 December 2006, the Group’s total advances to customers were HK\$58,638.2 million (US\$7,539.0 million) which represented 48.0% of the Group’s total assets. Home mortgage loans and loans for property investment and development represented 47.1% of the Group’s total loans to customers as of 31 December 2006.

The table below sets forth a summary of the Group’s loans by sector as of the dates indicated.

	As of 31 December			
	2006	Percentage of total	2005	Percentage of total
(Expressed in thousands of Hong Kong dollars, except percentages)				
Industrial, commercial and financial companies				
Property development	405,490	0.7%	652,264	1.2%
Property investment	10,901,148	18.6%	9,628,817	17.7%
Financial concerns	1,101,513	1.8%	508,747	0.9%
Stockbrokers	346,457	0.6%	307,150	0.6%
Wholesale and retail trade	807,723	1.4%	835,833	1.5%
Manufacturing	1,241,327	2.1%	1,460,996	2.7%
Transportation and transport equipment	2,416,631	4.1%	2,827,696	5.2%
Share financing	277,747	0.5%	256,776	0.5%
Others	2,762,740	4.7%	2,899,347	5.3%
Individuals				
Advances for the purchase of flats under Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	1,591,838	2.7%	1,500,857	2.8%
Advances for the purchase of other residential properties	14,692,277	25.1%	13,917,497	25.6%
Credit card advances	323,145	0.6%	385,932	0.7%
Others	3,238,841	5.5%	3,523,120	6.5%
Trade finance	3,049,104	5.2%	3,057,178	5.6%
Advances for use outside Hong Kong:				
Mainland China	9,257,219	15.8%	7,801,900	14.3%
Macau	6,211,056	10.6%	4,817,591	8.9%
Others ⁽¹⁾	13,981	—	20,133	—
Total	<u>58,638,237</u>	<u>100.0%</u>	<u>54,401,834</u>	<u>100.0%</u>

Note:

- Others include loans for use in other overseas areas.

Geographical concentration

As of 31 December 2006, loans advanced to entities and companies located in Mainland China accounted for 2.9% of the Group's total loans to customers. See "Asset Quality" below.

The table below sets forth a summary of the Group's loans to customers by geographical location as of the dates indicated.⁽¹⁾

	As of 31 December			
	2006	Percentage of total	2005	Percentage of total
(Expressed in thousands of Hong Kong dollars, except percentages)				
Hong Kong	48,519,063	82.7%	46,779,933	86.0%
Macau	5,819,641	9.9%	5,012,975	9.2%
Mainland China	1,673,038	2.9%	990,269	1.8%
Others ⁽²⁾	2,626,495	4.5%	1,618,657	3.0%
Total	<u>58,638,237</u>	<u>100.0%</u>	<u>54,401,834</u>	<u>100.0%</u>

Notes:

(1) The above geographical analysis has been classified by the location of the counterparties.

(2) "Others" include loans to other overseas entities.

Customer loan concentration

The Banking Ordinance generally prohibits any bank incorporated in Hong Kong from maintaining a financial exposure to any single person or group of connected persons in excess of 25% of its capital base. For a discussion of "financial exposure", see "Regulation and Supervision — Principal Obligations of Licensed Banks — Financial Exposure to Any One Customer". As of 31 December 2006, the Group's 20 largest performing borrowers (including groups of individuals and companies) accounted for HK\$10,599.1 million (US\$1,362.7 million) or 14.6% of the Group's outstanding exposure. As of 31 December 2006, the Group's five largest borrowers (including groups of individuals and companies) accounted for HK\$3,968.5 million (US\$510.2 million) or 5.4% of the Group's outstanding exposure, with the largest borrower accounting for HK\$1,054.1 million (US\$135.5 million) or 1.4% of the Group's outstanding exposure. As of 31 December 2006, around 55.4% of the total loans were represented by individual loans of an aggregate outstanding principal amount of HK\$10.0 million (US\$1.3 million) or less. The Group's largest single loan to an individual had an outstanding principal amount of HK\$159.3 million (US\$20.5 million), constituting 0.3% of the Group's total loans.

Loan analysis

As a significant proportion of the Group's loans are advanced for the purchase of residential property, 38.8% of total loans to customers had a remaining maturity of more than five years as of 31 December 2006. The following table sets forth a summary of the Group's total loans to customers by remaining maturity as of the dates indicated.

Loans outstanding as of 31 December				
	2006	Percentage of total	2005	Percentage of total
(Expressed in thousands of Hong Kong dollars, except percentages)				
Repayable on demand.....	2,340,596	4.0%	2,421,755	4.5%
3 months or less but not prepayable on demand.....	8,044,744	13.7%	7,223,543	13.3%
1 year or less but over 3 months.....	7,609,975	13.0%	6,803,170	12.5%
5 years or less but over 1 year.....	17,445,255	29.8%	16,676,365	30.7%
More than 5 years	22,797,168	38.8%	21,021,358	38.5%
Undated	400,499	0.7%	255,643	0.5%
Total.....	<u>58,638,237</u>	<u>100.0%</u>	<u>54,401,834</u>	<u>100.0%</u>

As of 31 December 2006, 81.8% of loans to customers made by the Group was at floating rates and prime rates of interest. The Group's interest rate for home mortgage loans and commercial mortgage loans in Hong Kong typically ranges from 3.15% below the prime rate to the prime rate. The Group's interest rate for Hong Kong dollar consumer finance or personal loan products (other than overdrafts) is generally calculated on the initial principal amounts of such loans and typically ranges from 0.3% to 2.5% per month and the interest rate for overdrafts may be as high as 6% above the prime rate. The Group's interest rate for Hong Kong dollar hire purchase and equipment leasing loans is typically at prime rate or below. The interest rate for Hong Kong dollar trade finance loans made by the Group is typically at prime rate or below. The interest rate for project finance loans and syndicated loans made by the Group is typically a margin over the Hong Kong interbank offered rate ("*HIBOR*"), or in the case of US dollar facilities a margin over the London interbank offered rate. The Group may, in appropriate circumstances, offer rates which are lower than the above rates. As of 31 December 2006, 88.1% of total loans to customers made by the Group were denominated in Hong Kong dollars while the remainder were denominated primarily in US dollars.

An important component of the Group's asset and liability policy is its management of interest rate risk, which is the relationship between market interest rates and the Group's interest rates on its interest-earning assets and interest-bearing liabilities. See "*Asset and Liability Management*". The following table sets forth the amounts, in Hong Kong dollars, and percentages represented by fixed, prime and floating-rate loans denominated in Hong Kong dollars and foreign currencies, respectively, as of 31 December 2006.

Loans outstanding as of 31 December 2006						
	HK dollar loans		Foreign currency loans		Total	
	Amount	Percentage of total	Amount	Percentage of total	Amount	Percentage of total
(Expressed in thousands of Hong Kong dollars, except percentages)						
Fixed rate.....	9,122,660	17.6%	1,570,651	22.6%	10,693,311	18.2%
Prime rate	34,972,755	67.7%	2,815,219	40.5%	37,787,974	64.5%
Floating rate.....	7,587,693	14.7%	2,569,259	36.9%	10,156,952	17.3%
Total.....	<u>51,683,108</u>	<u>100.0%</u>	<u>6,955,129</u>	<u>100.0%</u>	<u>58,638,237</u>	<u>100.0%</u>

Home mortgage loans are generally secured by a first fixed legal charge over the underlying property. Working capital loans for businesses are typically secured by fixed and floating charges over land, buildings, machinery, inventory and receivables. Term loans for specific projects or developments are typically secured

against the underlying project's assets and its receivables, while the sponsors or shareholders typically provide additional guarantees. The Group also receives guarantees in relation to certain of its other loans to cover, in the case of trade finance, any shortfall in security or, in the case of consumer loans to younger or less financially secure customers, what are normally unsecured loans.

All forms of security taken as collateral against credit facilities are monitored by the respective departments which extended the loans. Collateral in the form of property is typically valued by an independent appraiser at the origination of the loan. With the exception of home mortgage loans, which are not subject to regular reviews and impaired loans in respect of which collateral is reviewed on a quarterly basis, collateral is generally reviewed on an annual basis by the department which extended the loan.

Credit policies and approval procedures

Internal policies and procedures

The Group's lending policies have been formulated on the basis of the Group's own experience, the Banking Ordinance, HKMA guidelines and policies published by the Hong Kong Association of Banks and other statutory requirements (and in the case of overseas branches and subsidiaries, the relevant local laws and regulations).

The majority of the Group's lending is on a secured basis and the Group has established loan-to-value lending limits based on the appraised market value of the relevant collateral. Loan-to-value ratios on home mortgage loans (excluding loans under the Home Ownership Scheme and the Private Sector Participation Scheme and loans under the new mortgage refinancing scheme) are limited to 70%. Underlying property values are based on the lower of the purchase price or the independently appraised value of the property. The Group's lending policies also limit the maximum monthly repayment amount to 50% of the gross household income of the borrower. For commercial mortgage loans, the Group's policy is to limit the loan to between 50% and 70% of the lower of the purchase price or independently appraised value of the property.

The Group's primary credit approval body is the Credit Committee, which comprises the Chief Executive, three Executive Directors and the Heads of the Credit Administration and Risk Management Divisions. The Credit Committee has overall responsibility for the Group's credit management and oversees the implementation of credit policies and ensures the quality of credit evaluation and approval.

Under the oversight of the Credit Committee, officers of the Group are authorised to approve credit based on the size of the loan, the collateral provided and the credit standing of the applicant. The table below sets forth the credit approval limits for various types of loans in Hong Kong.

	Hong Kong			
	Trade finance (secured)	Loans secured by real property	Loans secured by other collateral	Unsecured & consumer loans
	(Expressed in thousands of Hong Kong dollars)			
Credit Committee	Legal Limit ⁽¹⁾	Legal Limit ⁽¹⁾	Legal Limit ⁽¹⁾	Legal Limit ⁽¹⁾
Executive Director.....	30,000	30,000	10,000	3,000
Head of Corporate Banking Group.....	20,000	20,000	5,000	1,000
Head of Retail Banking Group.....	12,000	12,000	3,000	500

Note:

(1) Legal Limit means 25% of the capital base of the Bank in accordance with Section 81 of the Banking Ordinance.

Loan officers in Mainland China are also given lending limits set by the Bank's Credit Committee and each loan must be approved by two loan officers, one of whom must have adequate lending authority to approve the loan. Credit applications that exceed the loan officers' lending limits are required to pass through the Bank's Credit Committee. Banco Weng Hang has its own Credit Committee comprising of the General Manager and senior managers of Banco Weng Hang. To the extent credit applications exceed the authorised credit limit of Banco Weng Hang's Credit Committee, the application must be approved by at least two Executive Directors from the Board of Banco Weng Hang.

The extension of credit facilities requires the joint approval of two officers of the appropriate department and both officers are equally accountable for the extensions.

For its corporate commercial loans and trade finance loans, the Bank's credit assessment is based upon factors including (i) the history of the Group's dealings with the borrower in question; (ii) the borrower's financial condition; (iii) the management and operation of the borrower's business; (iv) the status of any guarantees and collateral; and (v) market conditions affecting the borrower's industry.

For the Group's retail banking loans, such as credit cards, the Retail Banking Group has in place a separate credit scoring system in addition to the credit judgment of the approving officers. This system assigns a score to a potential borrower's attributes such as (i) age of the borrower or age of the business; (ii) income; (iii) occupation or line of business; and (iv) credit history, which is ascertained by running a customer information system check for any negative credit information of the particular borrower. All credit cards and personal loans are subject to an income proof requirement and Trans Union check as part of the Bank's plans to selectively and prudently expand its retail lending business. The Bank does not implement any credit scoring system for personal loans, hire purchase and equipment financing loans. In the case of taxi and public light bus financing, the Bank approves the size of financing on the basis of the value of collateral (including the vehicle, operating licence and any dealer's guarantee) and the future cash flow of the borrower comprising rental or operating income that can be derived from the vehicle.

Asset quality

Overview

The Group recovered HK\$42.2 million (US\$5.4 million) of classified loans in 2006 and HK\$86.1 million (US\$11.1 million) of classified loans in 2005. See "*Selected Statistical and Other Information Relating to the Bank and the Group — Asset Quality — Impaired loans which have been restructured*".

Property lending accounted for 47.1% of the Group's total loans to customers as of 31 December 2006. As a result, the Group's asset quality will be affected by deflation in property prices. The ability of borrowers, including homeowners, to make timely repayment of their loans may be adversely affected by rising interest rates and/or a slowdown in economic recovery. As of 31 December 2006, home mortgage loans accounted for HK\$16,284.1 million (US\$2,093.6 million) or 27.8% of the Group's total loans to customers. Home mortgage loans accounted for the largest segment of the Group's total loans to customers. See "*Risk Factors — Risks Relating to the Group — Loan Concentration; Exposure to the Property Market*".

Loan classification

The Group classifies loans into the following categories:

- pass;
- special mention; and
- classified loans.

In determining the classification of individual loans, the Bank considers a number of factors including (i) the payment history of the loan; (ii) the history of the Group's dealings with the borrower in question; (iii) the borrower's financial condition; (iv) the management and operation of the borrower's business; (v) the status of any guarantees and collateral and (vi) market conditions affecting the borrower's industry. In general,

when a loan has a past-due record of 30 to 90 days, it will be downgraded to “special mention”, although the Group will continue to accrue interest on such loan in its profit and loss account. The prospect of recovery of the market value of the underlying security is evaluated in assessing whether individual impairment allowances should be made.

Recognition of classified loans

The Group’s classified loans are sub-divided into three categories: sub-standard, doubtful and loss. When the repayment of a loan is uncertain (for example, there is a past-due record of 91 to 180 days for an unsecured or partially secured loan or over 360 days for a secured loan), it is downgraded to sub-standard. If full recovery of the loan is in doubt (for example, there is a past-due record of over 180 days for an unsecured or partially secured loan), it is classified as doubtful. Loss loans are those for which the likelihood of recovery appears remote.

Accrual of interest

For impaired financial assets, the accrual of interest income based on the original terms of the financial assets is discontinued, but any increase in the present value of impaired financial assets due to the passage of time is reported as interest income.

The table below sets forth a summary of the Group’s impaired and non-impaired loans as of the dates indicated.

	As of 31 December			
	2006	Percentage of total	2005	Percentage of total
(Expressed in thousands of Hong Kong dollars, except percentages)				
Impaired	364,092	0.6%	560,065	1.0%
Non-impaired				
Performing and Special Mention	58,274,145	99.4%	53,841,769	99.0%
Total.....	<u>58,638,237</u>	<u>100.0%</u>	<u>54,401,834</u>	<u>100.0%</u>

Impairment allowances for loans and advances

The carrying amount of the Group’s assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, the carrying amount is reduced to the estimated recoverable amount by means of a charge to the profit and loss account.

Impairment losses on loans and receivables are measured as the difference between the asset’s carrying amount and the present value of estimated future cash flows discounted at the asset’s original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets). Receivables with a short duration are not discounted if the effect of discounting is immaterial.

The total allowance for credit losses consists of two components: individual impairment allowances, and collective impairment allowances.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

The individual impairment allowance is based upon management's best estimate of the present value of the cash flows which are expected to be received, discounted at the original effective interest rate. In estimating these cash flows, management makes judgments about the borrower's financial situation and the net realisable value of any underlying collateral or guarantees in favour of the Group. Each impaired asset is assessed on its own merits.

In assessing the need for collective loan loss allowances, management considers factors such as credit quality, portfolio size, concentrations, and economic factors. In order to estimate the required allowance, the Group makes assumptions both to define the way the Group models inherent losses and to determine the required input parameters, based on historical experience and current economic conditions.

The accuracy of the impairment allowances the Group makes depends on how well the Group can estimate future cash flows for individually assessed impairment allowances and the model assumptions and parameters used in determining collective impairment allowances. While this necessarily involves judgment, the Group believes that the impairment allowances on advances to customers are reasonable and supportable.

Any subsequent changes to the amounts and timing of the expected future cash flows compared to the prior estimates that can be linked objectively to an event occurring after the write-down, will result in a change in the impairment allowances on loans and receivables and be charged or credited to the profit and loss account. A reversal of impairment losses is limited to the loans and receivables' carrying amount that would have been determined had no impairment loss been recognised in prior years.

When there is no reasonable prospect of recovery, the advances and the related interest receivables are written off.

The table below summarises the changes in the Group's impairment allowances for loans and advances for the periods indicated.

	Years ended 31 December	
	2006	2005
	(Expressed in thousands of Hong Kong dollars, except percentages)	
Impairment allowances on loans and advances		
Beginning balance	329,179	346,309
Addition during the period	773	54,056
Loans written-off net of recovery	(61,606)	(60,721)
Unwind of discount of loan impairment loss	(2,672)	(10,465)
Closing balance	<u>265,674</u>	<u>329,179</u>
Impairment allowances on loans and advances as a percentage of:		
Total loans to customers at the year end	0.5%	0.6%
Total impaired loans at the year end	73.0%	58.8%
Write-offs net of recovery as a percentage of:		
Average total loans during the year	0.1%	0.1%
Total loans to customers at the year end	0.1%	0.1%
Total impaired loans at the year end	16.9%	10.8%

The Credit Administration Division is required to submit a monthly report to the Credit Committee to approve their assessment of individual impairment allowances for loan and advances.

Geographical and sectoral analysis of impaired loans

The following table sets forth, as of the dates indicated, the Group's gross impaired loans by the borrowers' industry or economic activity and as a percentage of the Group's gross impaired loans.

	As of 31 December			
	2006	Percentage of total	2005	Percentage of total
(Expressed in thousands of Hong Kong dollars, except percentages)				
Industrial, commercial and financial companies				
Finance related	—	—	8	—
Construction works	—	—	36,859	6.6%
Manufacturing	15,242	4.2%	51,920	9.3%
Property investment and Others	57,251	15.7%	70,033	12.5%
Individuals				
Mortgage (Home Ownership Scheme and Private Sector Participation Scheme and other Residential Properties)	49,316	13.6%	50,166	8.9%
Others	184,713	50.7%	278,473	49.7%
Trade finance	57,570	15.8%	72,606	13.0%
Gross impaired loans	364,092	100%	560,065	100%
Impairment allowances on loans and advances	(265,674)		(329,179)	
Net impaired loans	98,418		230,886	

The following table sets forth, as of the dates indicated, the Group's gross impaired loans by the borrower's geographical location and as a percentage of the Group's gross impaired loans.

	As of 31 December			
	2006	Percentage of total	2005	Percentage of total
(Expressed in thousands of Hong Kong dollars, except percentages)				
Hong Kong	297,137	81.6%	389,945	69.6%
Macau	48,677	13.4%	152,888	27.3%
Mainland China	3,824	1.0%	3,819	0.7%
Others	14,454	4.0%	13,413	2.4%
Gross impaired loans	364,092	100.0%	560,065	100.0%
Impairment allowances on loans and advances	(265,674)		(329,179)	
Net impaired loans	98,418		230,886	

Top ten impaired loans

As of 31 December 2006, the Group's ten largest impaired loans accounted for 0.2% of the Group's total loans to customers and 30.3% of the Group's gross impaired loans to customers. As of 31 December 2006, the Group's exposure from its ten largest impaired loans ranged from HK\$4.4 million (US\$0.6 million) to HK\$38.0 million (US\$4.9 million).

Impaired loans which have been restructured

The Group maintains a prudent account upgrade policy. For example, if payments under a classified loan are rescheduled, that loan may only be upgraded to a pass loan if the revised payment terms are honoured for a period of 6 months, in the case of monthly repayments, and 12 months, in the case of quarterly or semi-annual repayments.

The following table sets forth, as of the dates indicated, the Group's impaired loans including those that have been restructured through the rescheduling of principal repayments or the deferral or waiver of interest.

	As of 31 December	
	2006	2005
(Expressed in thousands of Hong Kong dollars, except percentages)		
Gross impaired loans	364,092	560,065
Impairment allowances on loans and advances	(265,674)	(329,179)
Net impaired loans.....	98,418	230,886
Gross impaired loans as a percentage of total loans to customers.....	0.6%	1.0%
Net impaired loans as a percentage of total loans to customers	0.2%	0.4%

Investments in securities

The Group's trading securities included listed and unlisted equity and debt securities. As of 31 December 2006, the book value of these securities was HK\$133.7 million (US\$17.2 million), of which debt securities represented HK\$115.2 million (US\$14.8 million) or 86.2% of the Group's trading securities. These debt securities, over 95% of which by principal amount were rated "A" (or equivalent) and above, included Hong Kong dollar denominated bonds and notes and US dollar denominated bonds and notes. Through the Financial Markets Division, the Group engages in derivative transactions primarily for hedging purposes. A minority of derivative transactions are trading transactions but are entered into mainly to test for hedging on a larger scale. See "Asset and Liability Management" below.

The Group's investments in securities, except those held either solely for the purpose of recovering advances or as investments in subsidiaries, associates or joint ventures, are classified into two categories: securities measured at fair value through profit or loss; and held-to-maturity and available-for-sale financial assets. As of 31 December 2006, the book value of the Group's securities measured at fair value through profit or loss was HK\$5,383.0 million (US\$692.1 million), held-to-maturity was HK\$9,660.6 million (US\$1,242.0 million) and available-for-sale securities was HK\$9,873.8 million (US\$1,269.4 million). As part of the Group's overall policy to diversify its assets base with high grade investment bonds and improve liquidity, the Group increased its held-to-maturity and available-for-sale financial assets by 22.8% to HK\$19,534.4 million (US\$2,511.5 million) as of 31 December 2006 from HK\$15,909.4 million (US\$2,051.9 million) as of 31 December 2005.

Asset and liability management

The Bank's Asset and Liability Management Committee ("ALMCO") comprises of the Chief Executive, three Executive Directors, Heads of the Retail Banking Division and Risk Management Division, Chief Financial Officer and the Treasurers.

Liquidity risk management

Liquidity risk is the risk of inability to fund an increase in assets or meet obligations as they fall due. The Group has established liquidity management policies for ensuring adequate liquidity is maintained at all times. The Group maintained an average liquidity ratio of 51.6% in 2006, which is well above the statutory requirement of 25%.

ALMCO, which comprises personnel from senior management, treasury function, risk management, financial management and other business areas that could affect liquidity risk, meets monthly and is responsible for overseeing the liquidity risk management, in particular implementation of appropriate liquidity policies and procedures, identifying, measuring and monitoring liquidity risk, and control over the liquidity risk management process. The Board of Directors approves the liquidity risk strategy and policies, maintaining continued awareness of the overall liquidity risk profile, and ensuring liquidity risk is adequately managed and controlled by senior management within the established risk management framework. Liquidity is managed day-to-day by the treasury under the direction of ALMCO.

To cater for funding requirements during the ordinary course of business, sufficient liquid assets are held and also access to the interbank market is maintained. In addition, adequate standby facilities are maintained in order to meet any unexpected and material cash outflow. The Group also performs regular stress tests on its liquidity position to ensure adequate liquidity is maintained at all times. The detail of the analysis on the Group's and Bank's material assets and liabilities into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date are set out in "*Appendix I — Notes to the Accounts — Note 31*".

Market risk management

Market risk is the risk arising from the movements in market prices of on- and off- balance sheet positions in interest rates, foreign exchange rates as well as equity and commodity prices and the resulting change in the profit / loss or reserve of the Group.

The Group is exposed to market risk on positions taken or financial instruments held or taken such as foreign exchange contracts, interest rate contracts, fixed income and equity securities and derivatives instruments.

The Board of Directors annually reviews and approves the policies for the management of market risks and trading authorities. ALMCO has been delegated the responsibility of controlling and monitoring market risk, including regular review of the risk exposures and the risk management framework such as the established limits and stop-losses. The limits are set by ALMCO and reviewed on a periodic basis with reference to market conditions, with any material changes requiring a review by the Board of Directors. It is the Bank's policy that no such limit should be exceeded. Middle Office has been delegated the duties of intra-day monitoring and ensuring compliance with the policy and limits.

The Group adopts a prudent approach in managing the portfolio of trading instruments. It reduces excessive market risk by offsetting trading transactions or hedging the open positions by executing derivative contracts with other market counterparties. Trading of interest rate and foreign exchange derivative contracts forms an integral part of the Group's trading activities, which are primarily for squaring the trading positions or covering the customer driven positions.

Interest rate risk

The Group's interest rate exposures arise from lending, deposit taking as well as treasury activities. Interest rate risk primarily results from the timing differences in the repricing of interest-bearing assets, liabilities and commitments, which may apply to both the banking book and trading book. It also relates to positions from non-interest bearing liabilities including shareholders' funds and current accounts, as well as from certain fixed rate loans and liabilities. The Group's interest rate risk is monitored by ALMCO within limits approved by the Board, including the interest rate gap limit, product limit and Price Value Basis Point ("*PVBP*") limit. The Group also uses interest rate swaps and other derivatives to manage interest rate risk.

Structural interest rate risk arises primarily from the deployment of non-interest bearing liabilities, including shareholders' funds and current accounts, as well as from certain fixed rate loans and liabilities. Structural interest rate risk is monitored by ALMCO.

The Group uses PVBP to monitor and limit its interest rate risk exposure. PVBP is a technique involving the calculation of the change in present value of a financial instrument or a portfolio of instruments due to a change in one basis point of interest rates. It also provides a tool to evaluate the impact on profit and loss due to a basis point movement in interest rates.

The following table sets forth the interest bearing asset-liability repricing gap position for the Group as of 31 December 2006.

As of 31 December 2006					
		3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years
(Expressed in thousands of Hong Kong dollars)					
ASSETS					
Loans and other accounts, gross	58,792,063	52,183,156	3,427,890	2,553,473	627,544
Investments	24,917,797	10,881,419	824,271	11,617,528	1,594,579
Cash and short-term funds and placements	31,714,909	31,019,249	695,660	—	—
Total interest-bearing assets	<u>115,424,769</u>	<u>94,083,824</u>	<u>4,947,821</u>	<u>14,171,001</u>	<u>2,222,123</u>
LIABILITIES					
Customer deposits	96,963,281	92,055,356	4,702,941	204,148	836
Certificates of deposit issued	3,715,303	3,475,160	86,952	153,191	—
Bank deposits	1,680,984	795,123	756,466	129,395	—
Other liabilities	72,208	72,208	—	—	—
Loan capital	2,527,850	—	—	2,527,850	—
Total interest-bearing liabilities	<u>104,959,626</u>	<u>96,397,847</u>	<u>5,546,359</u>	<u>3,014,584</u>	<u>836</u>
Interest-bearing asset-liability gap	<u>10,465,143</u>	<u>(2,314,023)</u>	<u>(598,538)</u>	<u>11,156,417</u>	<u>2,221,287</u>

The following table sets forth the impact of changes in interest rates on annualised net interest income as of 31 December 2006.

As of 31 December 2006				
Change in interest rates (in basis points)				
(100)	(50)	50	100	
(Expressed in millions of Hong Kong dollars, except percentages)				
Change on annualised net interest income	(14)	(7)	7	14
As a percentage of the Group's net interest income for the year 2006	(0.7)%	(0.4)%	0.4%	0.7%

Given the repricing position of the assets and liabilities for the Group's Hong Kong operations as of 31 December 2006, if interest rates decreased by 100 basis points, the Group would expect annualised net interest income to fall by HK\$13.5 million (US\$1.7 million). If interest rates increased by 100 basis points, the annualised net interest income would rise by HK\$13.5 million (US\$1.7 million).

The change on annualised net interest income of HK\$13.5 million (US\$1.7 million) was 0.7% of the Group's net interest income for the year ended 31 December 2006. This sensitivity analysis is performed for risk management purposes and assumes no other changes in the repricing structure. Actual changes in net interest income will vary from the model.

The Group's liquidity structure, derived from its assets, liabilities and contingent commitments, is managed so as to ensure that all of the Group's operations can meet their funding requirements and comply with the statutory liquidity ratio and regulatory requirements on maturity mismatch profile. The liquidity risk is controlled by holding sufficient quality assets, such as cash, short-term funds and liquid securities of reasonable quality. Access to interbank liquidity is maintained through sufficient counterparty money market as well as repurchase facilities. In addition, liquidity is enhanced through the issuance of long-term certificates of deposit.

As of 31 December 2006, approximately 81.8% of the Group's total loans to customers were made at floating rates and prime rates of interest. The Group's interest-earning assets have floating interest rates fixed by reference to the Group's best lending rate, prime rate and interbank rate, and the Group's interest-bearing liabilities have floating interest rates set by reference to interbank rates for Hong Kong dollar time deposits. ALMCO continuously monitors the gap between HIBOR and the prime rate and, consequently, the net interest margin. If the net interest margin declines due to the squeeze of the spread between prime rate and HIBOR, ALMCO may recommend the adjustment of the Group's best lending rate charged on loans and/or the expansion of the Group's higher margin loan products business.

The table below sets out the Group's average balances, interest and related average interest rates for the periods indicated. Average balances of interest-earning assets and interest-bearing liabilities for the years ended 31 December 2005 and 31 December 2006 are based on the arithmetic mean of the respective daily average balances. Average balances of non-interest earning assets and non-interest bearing liabilities for the years ended 31 December 2005 and 31 December 2006 are based on the arithmetic mean of the respective balances at the beginning and the end of each period.

	Year ended 31 December					
	2006			2005		
	Average balance	Interest	Average rate (%)	Average balance	Interest	Average rate (%)
(Expressed in millions of Hong Kong dollars, except percentages)						
ASSETS						
Interest-earning assets						
Loans to customers	54,255			49,214		
Trade bills	3,835			3,460		
Total	58,090	3,660	6.3%	52,674	2,516	4.8%
Placements	22,994	1,109	4.8%	22,700	914	4.0%
Debt securities	20,634	1,050	5.1%	14,695	612	4.2%
Total interest-earning assets	101,718	5,819	5.7%	90,069	4,042	4.5%
LIABILITIES						
Interest-bearing liabilities						
Deposits						
Deposits from customers	87,987	3,554	4.0%	76,285	2,052	2.7%
Deposits and balances of banks	4,870	243	5.0%	4,591	200	4.4%
Total	92,857	3,797		80,876	2,252	
Other liabilities						
Certificates of deposit issued	2,309	103	4.5%	2,056	61	3.0%
Total	2,309	103	4.5%	2,056	61	3.0%
Total interest-bearing liabilities	95,166	3,900	4.1%	82,932	2,313	2.8%
Non-interest bearing deposits	4,070			4,536		
NET INTEREST INCOME		1,919			1,729	
NET INTEREST MARGIN			1.6%			1.7%

The following table sets forth a summary of the changes in interest earned and incurred, in Hong Kong dollars, resulting from changes in volume and interest rate. Average balances (based on monthly averages) in all categories in each reported period were used in the volume computations. Variances caused by both volume and interest rate have been allocated to volume. Average yields and interest rates in each reported period were used in interest rate computations.

	Year ended 31 December					
	2005 vs 2006			2005 vs 2004		
	Increase (Decrease) due to		Net increase (decrease)	Increase (Decrease) due to		Net increase (decrease)
	Volume	Rate		Volume	Rate	
	(Expressed in millions of Hong Kong dollars)					
Interest-earning assets:						
Loans to customers and trade bills	259	885	1,144	123	624	747
Placements	12	183	195	212	158	370
Debt securities	247	191	438	(151)	199	48
Total interest-earning assets.....	<u>518</u>	<u>1,259</u>	<u>1,777</u>	<u>184</u>	<u>981</u>	<u>1,165</u>
Interest-earning liabilities:						
Deposits from customers	315	1,187	1,502	106	1,090	1,196
Deposits and balance of banks	12	31	43	27	(9)	18
Certificates of deposit issued	<u>7</u>	<u>35</u>	<u>42</u>	<u>(25)</u>	<u>41</u>	<u>16</u>
Total interest-earning liabilities	<u>334</u>	<u>1,253</u>	<u>1,587</u>	<u>108</u>	<u>1,122</u>	<u>1,230</u>

Internal auditing

The Internal Audit Division has responsibility for the internal auditing of the Group's operations. Through regular audits of all of the departments, subsidiaries and branches of the Bank, the Internal Audit Division seeks to review and evaluate the adequacy and effectiveness of internal controls, safeguard the Group's assets, improve efficiency of operations and assess compliance with established policies, procedures and relevant statutory requirements. The Internal Audit Division also plays a role in overseeing the various risks of the Group, including reviewing business initiatives of the Group and providing risk advisory support to different business and functional lines. The Internal Audit Division administers the user access control to the computer systems of the Group. The Internal Audit Division reports its findings to the Chief Executive, the Audit Committee and relevant departments of the Bank on a regular basis. Such findings are shared with the Group's external auditors and the HKMA.

MANAGEMENT

The Bank is managed by a Board of Directors which is responsible for the direction and management of the Bank. The Articles of Association of the Bank require that there are no fewer than 2 nor more than 15 Directors unless and until otherwise determined by the shareholders of the Bank. Directors are, subject to the consent of the HKMA, appointed either by shareholders at the annual general meeting or by the Board of Directors at any time. Directors appointed by the Board of Directors hold office until the next annual general meeting and shall be eligible for re-election at that meeting. The Board of Directors also rotates its Directors. At each annual general meeting, one-third of the Directors (or a number closest to but not greater than a third of all Directors) with longest tenure since their election or last re-election are required to retire from office and are eligible at the same meeting for re-election.

The aggregate emoluments, consisting of fees, salaries, allowances and benefits in kind, pension contributions and bonuses, of the Directors of the Bank for the year ended 31 December 2006 were HK\$41.0 million (US\$5.3 million), see “Appendix I — Notes to the Accounts — Note 10”. In addition, certain Directors were granted share options and awards under the Share Option Scheme and Employee Incentive Plan. See “Principal Shareholders” and “Appendix I — Notes to the Accounts — Note 38”.

Board of Directors

The current Board of Directors of the Bank is comprised of the following individuals:

Name	Age	Title
Dr. Patrick Y.B. Fung	59	Chairman
Mr. Frank J. Wang.....	55	Director
Mr. Michael Y.S. Fung	57	Director
Mr. Louis C.W. Ho	70	Secretary
Dr. Cheng Hon Kwan, GBS, JP.....	79	Director
Mr. Ambrose H.C. Lau, GBS, JP.....	59	Director
Dr. Simon K.Y. Lee, JP	79	Director
Mr. Tung Chee Chen	64	Director
Mr. Aloysius H.Y. Tse	59	Director
Mr. Kenneth A. Lopian.....	50	Director
Mr. Andrew M. Gordon	45	Director

Dr. Patrick Y.B. Fung (*Chairman and Chief Executive*)

Age 59. Obtained his MBA degree from University of Toronto in 1973 and was awarded an Honorary Doctor of Business Administration by the Hong Kong Polytechnic University in 2001 and an Honorary Doctor of Laws by the University of Toronto in 2005. Joined the Bank in 1976 and was appointed a Director in 1980. Appointed Chief Executive in 1992, Chairman and Chief Executive in April 1996. Chairman of numerous subsidiaries within the Group. A Non-Executive Director of Miramar Hotel and Investment Company Limited and an Independent Non-Executive Director of The Link Management Limited. A member of the Exchange Fund Advisory Committee (EFAC) and the EFAC Financial Infrastructure Sub-Committee, a member of the Court of the Hong Kong Polytechnic University. Chairman of the University of Toronto (Hong Kong) Foundation, a member of the Dean’s Advisory Council of the Faculty of Management at the University of Toronto, a Council member and Honorary Court member of the Hong Kong University of Science and Technology, Vice President of the Hong Kong Institute of Bankers, a Co-opt member of the Planning, Development and Conservation Committee of the Urban Renewal Authority and a member of the Board of Trustees of the Lord Wilson Heritage Trust. Son of the late Mr. Y. K. Fung, founder of the Bank.

Mr. Frank J. Wang (*Deputy Chief Executive*)

Aged 55. Obtained MBA degree from Cornell University in 1979. Joined the Bank and appointed a Director and Deputy Chief Executive in June 1999. Was previously with The Bank of New York and has extensive credit control experience. A member of the Executive Committee, Credit Committee and Management Committee of the Bank. A member of the Deposit Taking Company Advisory Committee.

Mr. Michael Y.S. Fung (*Senior General Manager*)

Aged 57. Obtained BA degree from Carlton University in Ottawa, Canada. Joined the Bank in 1978 and appointed a Director in 1992. A member of the Executive Committee, Credit Committee and Management Committee of the Bank and a Director of numerous subsidiaries within the Group. A Member of the Board of Trustees of Shaw College, The Chinese University of Hong Kong. Son of the late Mr. Y. K. Fung, founder of the Bank.

Mr. Louis C.W. Ho (*Secretary and Deputy General Manager*)

Aged 70. Obtained an engineering degree from McGill University in 1961. Joined the Bank in 1972 and appointed a Director in October 1995. A member of the Management Committee and Credit Committee of the Bank and a Director and Secretary of numerous subsidiaries within the Group. Appointed an Honorary Adviser of The Chinese Gold and Silver Exchange Society in July 2006. Brother-in-law of Dr. Patrick Y. B. Fung and Mr. Michael Y. S. Fung.

Dr. Cheng Hon Kwan, GBS, JP (*Non-Executive Director*)

Aged 79. Bachelor of Science in Engineering from Tianjin University and Fellow of Imperial College London. Honorary Fellow, Gold Medallist and Past President of The Hong Kong Institution of Engineers. Fellow and Gold Medallist of The Institution of Structural Engineers. Former Member of Executive and Legislative Councils. Past Chairman of the Land and Building Advisory Committee, Transport Advisory Committee, Hong Kong Housing Authority, Councils of City University and Open University of Hong Kong. Currently, Independent Non-Executive Director of Tianjin Development Holdings Limited, Agile Property Holdings Limited, Hang Lung Group Limited and Hang Lung Properties Limited. Joined the Board of the Bank in 1987.

Mr. Ambrose H.C. Lau, GBS, JP (*Non-Executive Director*)

Aged 59. Obtained LL.B degree from the University of London and is a Solicitor of the High Court of the HKSAR, a China-Appointed Attesting Officer and a Notary Public. The Senior Partner of Messrs Chu and Lau, Solicitors and Notaries. Awarded “Gold Bauhinia Star” by the HKSAR Government in 2001. A Standing Committee member of the National Committee of the Chinese People’s Political Consultative Conference and a member of the Board of the Hong Kong Mortgage Corporation Limited. Mr. Lau is an Independent Non-Executive Director of Beijing Enterprises Holdings Limited, Glorious Sun Enterprises Limited, Guangzhou Investment Company Limited, GZI Transport Limited, Qin Jia Yuan Media Services Company Limited and The Hong Kong Parkview Group Limited. Joined the Board of the Bank in 1996.

Dr. Simon K.Y. Lee, JP (*Non-Executive Director*)

Aged 79. Chairman of Sun Hing Group of Companies, Non-Executive Director of Pacific Basin Shipping Limited. President of the Lions Eye Bank of Hong Kong and President of the Hong Kong Society for the Deaf. Chairman of the Hong Kong Liver Foundation. A member of the Court of the University of Hong Kong. Past District Governor of Lions District 303 and Past International Director of Lions Clubs International. Awarded Honorary degree of Doctor of Social Science by the University of Hong Kong in March 2006. Joined the Board of the Bank in 1991 and currently Chairman of its Audit Committee.

Mr. Tung Chee Chen (*Non-Executive Director*)

Aged 64. Chairman and Chief Executive Officer of Orient Overseas (International) Limited. An Independent Non-Executive Director of a number of listed companies, including Zhejiang Expressway Company Limited, PetroChina Company Limited, BOC Hong Kong (Holdings) Limited, U-Ming Marine Transport Corp., Sing Tao News Corporation Limited and Cathay Pacific Airways Limited. Mr. Tung was educated at the University of Liverpool, United Kingdom, where he obtained a Bachelor's degree in Science in 1964. He later obtained a Master's degree in Mechanical Engineering from the Massachusetts Institute of Technology in 1966. Joined the Board of the Bank in January 2004.

Mr. Aloysius H Y Tse (*Non-Executive Director*)

Aged 59. A Fellow of the Institute of Chartered Accountants in England and Wales, and the Hong Kong Institute of Certified Public Accountants ("HKICPA"). A past president of the HKICPA. Joined KPMG in 1976 and became a partner in 1984 and retired in March 2003. Non-Executive Chairman of KPMG's operations in the PRC and a member of the KPMG China Advisory Board from 1997 to 2000. Also serves as Independent Non-Executive Director of a number of listed companies, including China Construction Bank Corporation, China Telecom Corporation Limited, CNOOC Limited and Linmark Group Limited. Currently Chairman of the International Advisory Council of The People's Municipal Government of Wuhan. Joined the Board of the Bank in November 2004.

Mr. Kenneth A. Lopian (*Non-Executive Director*)

Aged 50. Obtained a BS degree from the University of Scranton in 1979 and also attended The London Business School. Senior Executive Vice President of The Bank of New York, member of its Executive Committee, with responsibilities for International Client Management and Global Strategic Sales. Joined the Board of the Bank in March 2002.

Mr. Andrew M. Gordon (*Non-Executive Director*)

Aged 45. Obtained a BA degree from the University of Exeter, England in 1982. First joined The Bank of New York in 1985 in London and received credit training in New York. Has taken on assignments in Hong Kong, London, Tokyo and now in Hong Kong as Executive Vice President and General Manager of the Hong Kong Branch, and head of North Asia Division of The Bank of New York. Joined the Board of the Bank in October 2003.

Senior Management

Mr. David Fung (*General Manager*)

Aged 60. Obtained Doctor degree from HK Polytechnic University. Joined the Bank in 2004. A member of the Management Committee of the Bank.

Mr. Jack K.W. Fung (*Deputy General Manager*)

Aged 55. Obtained MBA degree from New York University. Joined the Bank in 1976. Head of Information Technology Division. A member of the Management Committee of the Bank.

Mr. Stephen C.K. Wong (*Deputy General Manager*)

Aged 53. Joined the Bank in 1972. Head of Retail Banking Division and a member of the Management Committee of the Bank. A member of the Executive and Supervisory Committee of the Chinese Gold and Silver Exchange Society.

Mr. Stephen C.W. Leung (*Deputy General Manager*)

Aged 47. Obtained MBA degree from Macquarie University. Joined the Bank in 1996. Head of Operations Division and a member of the Management Committee of the Bank. An associate member of the Institute of Chartered Accountants in Australia.

Mr. Stanley S.C. Yuen (*Deputy General Manager*)

Aged 51. Joined the Bank in 1974. Head of Financial Management Division and a member of the Management Committee of the Bank. A fellow member of The Association of Chartered Certified Accountants and an associate member of the Hong Kong Institute of Certified Public Accountants.

RELATED PARTY TRANSACTIONS

The Group enters into a number of transactions with BONY, a substantial shareholder of the Bank, its subsidiaries or its associated companies (the “**BNY Group**”) in the ordinary course of its banking business. These transactions include lending, the acceptance and placement of inter-bank deposits, participation in loan syndicates, correspondent banking transactions, and foreign exchange transactions. These contracts are entered into under normal commercial terms and are priced based on relevant market rates at the time of each transaction and are under the same terms as those available to other counterparties and customers of the Group. For more detailed information, see “*Appendix I — Notes to the Accounts — Note 38(a)*”.

The interest received from and interest paid to the BNY Group for the years ended, and the outstanding balances of amounts due from and due to them as of 31 December 2005 and 31 December 2006 are shown in the following table:

	For the year ended 31 December	
	2006	2005
	(Expressed in thousands of Hong Kong dollars)	
Interest income	8,333	2,927
Interest expense	1,454	612
Amounts due from	48,609	62,379
Amounts due to	106,807	46,539

The Group also makes a limited number of loans to companies and other persons related to the Group, including its associates, key management personnel and their close family members and companies controlled or significantly influenced by them. The Group negotiates such loans (except for staff housing loans) on an arm’s length basis and subjects such loans to the same credit approval and review process applicable to the Bank’s non-affiliated loan portfolio. Where applicable, the Group complies with disclosure requirements of the Hong Kong Stock Exchange or meets the conditions for waiver from compliance of such disclosure requirements, and where necessary, it solicits minority shareholders approval for such transactions. For more detailed information, see “*Appendix I — Notes to the Accounts — Note 38*” and “*Business of the Group — Employees*”.

PRINCIPAL SHAREHOLDERS

The following table shows the shareholders of the Bank holding more than 5% of the outstanding ordinary shares of the Bank, as shown on its register of substantial shareholders and register of members of the Bank as of 30 March 2007.

Name of shareholder	Nature of Interest	Number of shares held	Percentage of shares
BNY International Financing Corporation	Beneficial owner	59,350,000 ⁽¹⁾	20.2
The Bank of New York	Interest in controlled corporation	59,350,000 ⁽¹⁾	20.2
The Bank of New York Company, Inc.	Interest in controlled corporation	59,350,000 ⁽¹⁾	20.2
Federal Trust Company Limited	Trustee	34,737,600 ^(2 & 4)	11.8
Po Ding Company Limited	Trustee	24,156,000 ^(3 & 4)	8.2
GZ Trust Corporation	Trustee	24,156,000 ^(3 & 4)	8.2
YKF Holding Corporation	Trustee	24,098,400 ^(2 & 4)	8.2
Aberdeen Asset Management Plc and its associates	Investment manager	23,512,529 ⁽⁵⁾	8.0
Wing Hang Bank (Nominees) Limited	Nominee	23,378,400 ^(2 & 4)	7.9
Aberdeen Asset Management Asia Limited	Investment manager	22,815,000 ⁽⁵⁾	7.8
Tessel Inc.	Trustee	10,639,200 ^(2 & 4)	3.6

Notes:

- (1) BNY International Financing Corporation is a wholly-owned subsidiary of The Bank of New York. The Bank of New York is a wholly-owned subsidiary of The Bank of New York Company, Inc.
- (2) Federal Trust Company Limited is the trustee for Tessel Inc. and YKF Holding Corporation. Wing Hang Bank (Nominees) Limited is the registered holder of certain shares on behalf of YKF Holding Corporation.
- (3) Po Ding Company Limited is wholly-owned by GZ Trust Corporation.
- (4) Each of Po Ding Co. Ltd., YKF Holding Corporation and Tessel Inc. are trusts in which Patrick Y B Fung, Michael Y S Fung and Louis C W Ho's spouse (together with other parties) are eligible beneficiaries.
- (5) Aberdeen Asset Management Asia Limited is a wholly-owned subsidiary of Aberdeen Asset Management Plc.

All the interests stated above represent long positions.

The following table shows the beneficial interests of the Directors and the Chief Executive in the share capital of the Bank as shown in the Register of Directors' and Chief Executive's interests as of 30 March 2007.

Name	Number of shares held					Total
	Personal	Family	Option ⁽¹⁾	Award ⁽²⁾	Other	
Patrick Y.B. Fung ⁽³⁾						
(Chief Executive)	2,982,000	—	230,000	650,000	—	3,862,000
Michael Y.S. Fung ⁽³⁾	3,000,000	60,000	180,000	325,000	—	3,565,000
Simon K.Y. Lee	—	—	—	—	1,262,750 ⁽⁴⁾	1,262,750
Frank J. Wang	—	—	80,000	395,000	—	475,000
Louis C.W. Ho ⁽³⁾	204,000	100,000	100,000	10,000	—	414,000
Ambrose H.C. Lau	71,500	—	—	—	—	71,500

Notes:

- (1) Share options were granted to the Directors pursuant to the share option scheme adopted by the Bank on 9 June 1993 and 24 April 2003.
- (2) Share awards were granted to the Directors pursuant to the employee incentive plan adopted by the Bank on 22 April 2004.

- (3) Patrick Y.B. Fung, Michael Y.S. Fung and Louis C.W. Ho's spouse are also, together with other parties, eligible beneficiaries of the trusts of Po Ding Co. Ltd., YKF Holding Corporation and Tessel Inc. The interests of these corporations in shares of the Bank are stated above.
- (4) Shares are held through Dr. Simon K.Y. Lee's family trust.

All the interests stated above represent long positions.

THE BANKING INDUSTRY IN HONG KONG

Unless otherwise expressly stated, the information and statistics set out in this section are derived directly from publicly available information, including materials obtained from the HKMA or published in The Hong Kong Monthly Statistical Bulletin in relation to information as at 31 December 2006, which is in turn based on returns submitted to the HKMA by reporting authorised institutions. The Bank has not independently verified or checked such information and statistics and does not assume any responsibility for the accuracy or completeness thereof. Reporting authorised institutions as at 31 December 2006 comprised of all the licensed banks, restricted license banks and deposit-taking companies in Hong Kong. References to assets, liabilities, loans, advances, deposits and negotiable certificates of deposit of banks or authorised institutions relate to assets, liabilities, loans, advances, deposits and negotiable certificates of deposit of only reporting licensed banks or other reporting authorised institutions.

INTRODUCTION

The banking industry in Hong Kong has a three-tier system of authorised institutions, comprising licensed banks, restricted license banks and deposit-taking companies. As at 31 December 2006, there were 138 licensed banks, 31 restricted licence banks and 33 deposit-taking companies operating in Hong Kong; 24 of the licensed banks were incorporated in Hong Kong (including the Bank), with the balance of 114 incorporated overseas. Furthermore, there were 84 representative offices of overseas banks.

Primary supervision of Hong Kong incorporated authorised institutions is the responsibility of the HKMA, whereas overseas incorporated banks are subject both to the HKMA and home country supervision. The HKMA obtains regular returns from and sends examination teams to all authorised institutions. Off-site reviews, on-site examinations and prudential meetings are the methods usually adopted for the supervision of authorised institutions. Prudential meetings can also take the form of tripartite meetings between the management of an authorised institution, its auditors and the HKMA. In addition, all licensed banks in Hong Kong, whether incorporated overseas or locally, are required to be members of the Hong Kong Association of Banks, a statutory body, the purposes of which include representing the banking industry in banking-related matters and framing rules for the conduct of banking business in Hong Kong.

Since 31 December 1989, locally incorporated banks have been subject to capital adequacy standards similar to those set out in the Basel Accord, with a minimum risk adjusted capital adequacy ratio of 8%. As at 31 December 2006 the Group's adjusted capital adequacy ratio was approximately 15.2%. The Banking (Amendment) Ordinance 2005, enacted on 6 July 2005, has put in place a legislative framework for the implementation in Hong Kong of revised capital adequacy standards (commonly known as "**Basel II**") proposed by the Basel Committee on Banking Supervision ("**BCBS**"). In line with the timetable set by BCBS for its members, Hong Kong BCBS commenced implementation of Basel II in January 2007. A summary of banking regulation in Hong Kong is set out in "*Regulation and Supervision*".

RECENT TRENDS

Assets

The total assets of all authorised institutions in Hong Kong increased approximately 14.6% from HK\$7,246,969 million as at 31 December 2005 to HK\$8,306,915 million as at 31 December 2006.

Loans and advances

As at 31 December 2006, loans and advances to customers represented approximately 29.7% of the total assets of all authorised institutions in Hong Kong. The total Hong Kong dollar value of loans and advances to customers extended by all authorised institutions in Hong Kong has increased approximately 6.7% from HK\$1,797,350 million as at 31 December 2005 to HK\$1,917,476 million as at 31 December 2006. Approximately 77.7% of loans and advances to customers extended by all authorised institutions in Hong Kong were denominated in Hong Kong dollars as at 31 December 2006, with the rest in foreign currencies. As at that date, of the total loans and advances to customers of HK\$2,467,893 million extended by all authorized institutions, approximately 86.2% were classified as "Loans and Advances for use in Hong Kong"

and approximately 13.8% were extended for use outside Hong Kong or where the place of use was not known. The table below illustrates the breakdown of loans classified as “Loans and Advances for use in Hong Kong” by economic sector extended by all authorised institutions in Hong Kong as at 31 December 2006.

Sector	Percentage of Total
Professional and Private Individuals	39.4%
Building, Construction, Property Development and Investment	24.9%
Financial Concerns	9.4%
Wholesale and Retail Trade	5.3%
Manufacturing	5.3%
Transport and Transport Equipment	6.2%
Electricity, Gas and Telecommunications	2.6%
Others	6.9%
Total	100.0%

Other Assets

The other assets of authorised institutions in Hong Kong comprise predominantly interbank lending to both authorised institutions in Hong Kong and to banks overseas, as well as negotiable debt instruments, investments in shareholding and fixed assets. As at 31 December 2006, interbank lending represented approximately 41.5% of the total assets of all authorised institutions in Hong Kong, with approximately 85.5% of such lending being to banks outside Hong Kong.

FUNDING

Deposits from customers

As at 31 December 2006, deposits from customers represented approximately 57.4% of the total liabilities of all authorised institutions in Hong Kong. Total deposits from customers of all authorised institutions increased approximately 17.2% from HK\$4,067,901 million as at 31 December 2005 to HK\$4,766,244 million as at 31 December 2006, of which approximately 53.9% of total customer deposits with authorised institutions were denominated in Hong Kong dollars. Hong Kong dollar deposits increased approximately 20.5% while deposits denominated in foreign currencies increased approximately 13.5%, in each case from 31 December 2005 to 31 December 2006. As at 31 December 2006, deposits from customers with licensed banks represented approximately 99.3% of deposits from customers with all authorised institutions in Hong Kong. As at 31 December 2006, time deposit accounts, demand accounts and savings accounts accounted for approximately 64.1%, 7.2%, and 28.7%, respectively, of total deposits by customers with licensed banks in Hong Kong.

Interbank funds

Interbank transactions are significant in funding the Hong Kong banking system. As at 31 December 2006, interbank liabilities represented approximately 27.1% of the total liabilities of all authorised institutions in Hong Kong. A portion of the interbank funding for the Hong Kong banking system is sourced from banks outside Hong Kong and, as at 31 December 2006, approximately 77.4% of all interbank funding came from banks outside Hong Kong.

Negotiable certificates of deposit

Some banks have adopted the practice of issuing medium term negotiable certificates of deposit. As at 31 December 2006, the total outstanding value of negotiable certificates of deposit issued by authorised institutions in Hong Kong amounted to HK\$239,635 million, of which approximately 54.0% was denominated in Hong Kong dollars.

REGULATION AND SUPERVISION

The banking business in Hong Kong is regulated by and subject to the provisions of the Banking Ordinance and to the powers and functions ascribed by the Banking Ordinance to the HKMA. The Banking Ordinance provides that only banks which have been granted a banking licence (“*licence*”) by the HKMA (“*licensed banks*”) may carry on banking business (as defined in the Banking Ordinance) in Hong Kong and contains controls and restrictions on such banks. The HKMA regulates the Bank and may examine its subsidiaries.

Supervision of licensed banks in Hong Kong

The provisions of the Banking Ordinance are implemented by the HKMA, the principal function of which is to promote the general stability and effectiveness of the banking system, especially in the area of supervising compliance with the provisions of the Banking Ordinance. The HKMA supervises licensed banks through, *inter alia*, a regular information gathering process, the main features of which are as follows:

- (1) each licensed bank must submit a monthly return to the HKMA setting out the assets and liabilities of its operations in Hong Kong and a further comprehensive quarterly return relating to its principal place of business in Hong Kong and all local branches, although the HKMA has the right to allow returns to be made at less frequent intervals;
- (2) the HKMA may order a licensed bank, any of its subsidiaries, its holding company or any subsidiaries of its holding company to provide such further information (either specifically or periodically) as it may reasonably require for the exercise of its functions under the Banking Ordinance or as it may consider necessary to be submitted in the interests of the depositors or potential depositors of the licensed bank concerned. Such information shall be submitted within such period and in such manner as the HKMA may require. The HKMA may in certain circumstances also require such information or any return submitted to it to be accompanied by a certificate of the licensed bank’s auditors (approved by the HKMA for the purpose of preparing the report) confirming compliance with the main provisions of the Banking Ordinance and certain other matters;
- (3) licensed banks may be required to provide information to the HKMA regarding companies in which they have a 20% or more direct or indirect shareholding or with which they have common directors or managers (as defined in the Banking Ordinance), the same controller, a common name or a concert party arrangement to promote the licensed bank’s business;
- (4) in addition, licensed banks are obliged to report to the HKMA immediately of their likelihood to become unable to meet their obligations or of the commencement of material civil proceedings applicable only to licensed banks incorporated in Hong Kong;
- (5) the HKMA may direct a licensed bank to appoint an auditor to report to the HKMA on the state of affairs and/or profit and loss of the licensed bank or the adequacy of the systems of control of the licensed bank or other matters as the HKMA may reasonably require;
- (6) the HKMA may, at any time, with or without prior notice, examine the books, accounts and transactions of any licensed bank, and in the case of a licensed bank incorporated in Hong Kong, any local branch, overseas branch, overseas representative office or subsidiary, whether local or overseas, of such institution. Such inspections are carried out by the HKMA on a regular basis; and
- (7) licensed banks are required to give written notice to the HKMA immediately of any proposal to remove an auditor before the expiration of his term of office or replace an auditor at the expiration of his term of office.

Exercise of powers over licensed banks

The HKMA may exercise certain powers over the conduct of licensed banks in any of the following circumstances:

- (1) when a licensed bank informs the HKMA that it is likely to become unable to meet its obligations, that it is insolvent, or that it is about to suspend payment;
- (2) when a licensed bank becomes unable to meet its obligations or suspends payment;
- (3) if, after an examination or investigation, the HKMA is of the opinion that a licensed bank:
 - (a) is carrying on its business in a manner detrimental to the interests of its depositors or potential depositors or of its creditors or of holders or potential holders of multi-purpose cards issued by it or the issue of which is facilitated by it;
 - (b) is insolvent or is likely to become unable to meet its obligations or is about to suspend payment;
 - (c) has contravened or failed to comply with any of the provisions of the Banking Ordinance; or
 - (d) has contravened or failed to comply with any condition attached to its licence or certain conditions in the Banking Ordinance; and
- (4) where the Financial Secretary advises the HKMA that he considers it in the public interest to do so. In any of the circumstances described above, the HKMA, after consultation with the Financial Secretary, may exercise any of the following powers:
 - (1) to require the licensed bank, by notice in writing served on it, forthwith to take any action or to do an act or thing whatsoever in relation to its business and property as the HKMA may consider necessary;
 - (2) to direct the licensed bank to seek advice on the management of its affairs, business and property from an advisor approved by the HKMA;
 - (3) to assume control of and carry on the business of the licensed bank, or direct some other person to assume control of and carry on the business of the licensed bank; or
 - (4) to report the circumstances to the Chief Executive in Council in certain circumstances (in which case the Chief Executive in Council may exercise a number of powers including directing the Financial Secretary to present a petition to the Court of First Instance for the winding up of the licensed bank).

Revocation and suspension of banking licence

The HKMA also has powers to recommend the revocation or suspension of a licence. Both powers are exercisable after consultation with the Financial Secretary and with a right of appeal of the licensed bank concerned except in the event of temporary suspension in urgent cases. The grounds for suspension or revocation include the following:

- (1) the licensed bank no longer fulfills the criteria for authorization and the requirements for registration;
- (2) the licensed bank is likely to be unable to meet its obligations or proposes to make, or has made, any arrangement with its creditors or is insolvent;
- (3) the licensed bank has failed to provide material information required under the Banking Ordinance or has provided false information;
- (4) the licensed bank has breached a condition attached to its licence;

- (5) a person has become or continues to be a controller or chief executive or director after the HKMA makes an objection;
- (6) the interests of the depositors require that the licence be revoked; or
- (7) the licensed bank is engaging in practices likely to prejudice Hong Kong as an international financial centre or in practices (specified in the HKMA guidelines) which should not be engaged in.

Revocation or suspension of a licence means that the licensed bank can no longer conduct banking business (for the specified period in the case of a suspension).

Principal obligations of licensed banks

The obligations of a licensed bank under the Banking Ordinance, which are enforced by the HKMA through the system described above, include, but are not limited to, the following:

Capital adequacy

A licensed bank incorporated in Hong Kong must at all times maintain a capital adequacy ratio of at least 8%, calculated as the ratio (expressed as a percentage) of its capital base to its risk-weighted exposure as more fully described below. In relation to a licensed bank with subsidiaries, the HKMA may require the ratio to be calculated on a consolidated basis, or on both a consolidated and an unconsolidated basis, or on a consolidated basis only in respect of such subsidiaries of the licensed bank as may be specified by the HKMA. The HKMA may, after consultation with the licensed bank concerned, increase the ratio for any particular licensed bank. A licensed bank is under a duty to inform the HKMA immediately of a failure to maintain the required capital adequacy ratio and to provide the HKMA with such particulars as it may require. It is an indictable offence not to do so, and the HKMA is entitled to prescribe remedial action.

The capital base of a licensed bank is, broadly speaking but not limited to, all its paid-up capital and reserves, its profit and loss account including its current year's profit or loss, together with perpetual and term subordinated debt meeting prescribed conditions, general provisions against doubtful debts subject to certain limitations and a portion of its latent reserves arising from the revaluation of long-term holdings of specified equity securities or its reserves on the revaluation of real property. Investments in, loans to and guarantees of liabilities of certain connected companies, shareholdings in subsidiaries or holding companies and in other companies in which more than 20% of voting power is held and investments in other banks (except for those which are not subject to a cross-holding arrangement or not otherwise a strategic investment) must be deducted.

The risk-weighted exposure is determined by:

- (1) multiplying risk-weight factors to the book value of various categories of assets (including but not limited to notes and coins, Hong Kong government certificates of indebtedness and cash items in the course of collection);
- (2) multiplying the credit conversion factors to various off balance sheet items (including but not limited to direct credit substitutes, transaction-related contingencies, repurchase contracts, note issuance facilities and exchange rate contracts) to determine their credit equivalent amount;
- (3) aggregating the amounts determined pursuant to (1) and (2); and
- (4) subtracting from the amount determined pursuant to (3) the value of general provisions not included in the capital base of the licensed bank and the amount by which the book value of reserves on revaluation of real property exceeds the book value of such reserves as at the period-end.

Risk-weight factors are specified in the Banking Ordinance in Hong Kong as being a percentage varying between 0%, and 100% to reflect the extent to which an asset might be regarded as being at risk or the extent to which a liability might arise. Credit conversion factors are also specified in the Banking Ordinance as being percentages varying between 0% to 100% representing the percentage of the relevant item to which the risk-weight factor should be applied.

The capital adequacy standards described above (commonly known as “Basel I”) were promulgated by the BCBS and have been applied in Hong Kong since 1989. The Banking (Amendment) Ordinance 2005, enacted on 6 July 2005, has put in place a legislative framework for the implementation in Hong Kong of Basel II. In line with the timetable set by BCBS for its members, Hong Kong BCBS commenced implementation of Basel II in January 2007.

There are three approaches under Basel II to calculate credit risks, namely the basic approach, the standardised approach and the internal ratings based approach. Licensed banks in Hong Kong under Basel II are to adopt the standardised approach initially, under which expanded risk weights (0%, 20%, 35%, 75%, 100% and 150%) are used for assessing capital required.

A licensed bank, if approved by the HKMA, may adopt the basic approach in reporting its capital adequacy as a transitional measure before eventually adopting the internal ratings based approach. Under the internal ratings based approach, the capital required of a licensed bank relies on a bank’s internal ratings system (subject to supervisory validation and approval) and are based on three risk components-probability of default, loss given default and exposure at default.

Liquidity

Authorized institutions must maintain at all times a liquidity ratio of not less than 25% in each calendar month, calculated as the ratio (expressed as a percentage) of the sum of the net weighted amount of its highly liquid assets to the sum of its qualifying liabilities for each working day of the calendar month concerned as calculated in accordance with the Fourth Schedule of the Banking Ordinance. In relation to a licensed bank with subsidiaries, the HKMA may require that ratio to be calculated on a consolidated basis, or both on a consolidated basis and an unconsolidated basis, or on a consolidated basis only in respect of such subsidiaries of the licensed bank as may be specified by the HKMA. The ratio may be varied by the HKMA. A licensed bank has a duty to inform the HKMA if the ratio requirement is not fulfilled and provide it with such particulars of that contravention as it may require, and it is an indictable offence not to do so; the HKMA is entitled to prescribe remedial action. For the purpose of the liquidity ratio, in the case of a licensed bank which has places of business in Hong Kong and elsewhere, its places of business in Hong Kong are collectively treated as a separate licensed bank to which the liquidity ratio provisions would apply.

Liquefiable assets are, broadly speaking, assets held in the form of currency notes and coins, gold, loans due within one month from other banks (after deducting amounts payable to other banks within one month), certain export bills payable within one month, certain kinds of marketable debt securities or prescribed instruments (in some cases subject to a discount) and certain types of loan repayments due on fixed dates within one month for performing loans (subject to a discount).

Qualifying liabilities are, broadly speaking, liabilities which will or could or, in the case of contingent liabilities, in the opinion of the HKMA, may, fall due within one month, except that liabilities to other banks are treated on a net basis.

Financial exposure to any one customer

The financial exposure of a licensed bank incorporated in Hong Kong to any one person or group of connected persons must not (subject to certain exceptions) exceed 25% of the capital base of the licensed bank. Subject to certain exclusions, the licensed bank’s financial exposure to any one person or group of connected persons is taken to be the aggregate of:

- (1) all advances, loans and credit facilities granted to that person or group;
- (2) the value of the licensed bank’s holdings of shares, debentures and other debt securities issued by that person or group; and
- (3) the principal amount, multiplied by a factor to be specified by the HKMA, for off-balance sheet items resulting from transactions between the licensed bank and that person or group.

For these purposes, persons shall be treated as connected if one company is the subsidiary of another, they have a common holding company, they have a common controller (not being a company) or if one (not being a company) is a controller of another (being a company).

The calculation of financial exposure does not include financial exposure to the Hong Kong government or authorized institutions or financial exposure generally to the extent it is secured by a cash deposit, a guarantee, an undertaking, certain specified securities or a letter of comfort approved by the HKMA.

If a person or a company to whom an authorized institution is financially exposed is a trustee of more than one trust, the HKMA may by notice in writing extend the limit of the institution's financial exposure to that person or company.

Other restrictions on lending

The Banking Ordinance also provides that:

- (1) licensed banks may not grant any loan, advance or credit facility (including letters of credit) or give any guarantee against the security of their own shares (or, except with the approval of the HKMA, that of their respective holding companies, subsidiaries or fellow subsidiaries of such holding companies);
- (2) the amount of the facilities which a Hong Kong incorporated licensed bank may make available on an unsecured basis to its controllers, its directors, their relatives or certain of its employees and persons associated with any of them shall be subject to the restrictions set out therein; and
- (3) licensed banks may not, except with the written consent of the HKMA, provide to any one of their employees any unsecured facility of an amount in excess of that employee's salary for one year.

Restrictions on investments in land

A licensed bank incorporated in Hong Kong cannot purchase or hold any interest in land, whether situated in or outside Hong Kong, of a value or to an aggregate value in excess of 25% of its capital base. There are exceptions for land held which in the opinion of the HKMA is necessary for the operation of the business or for providing housing or amenities for staff.

Shareholding in other companies

A licensed bank incorporated in Hong Kong may not acquire or hold any part of the share capital of any other company or companies to an aggregate value which exceeds 25% of the licensed bank's capital base except for shares held by way of security for facilities and by virtue of acquisitions in satisfaction of debts due to it (which must, however, be disposed of at the earliest suitable opportunity and not later than 18 months after their acquisition unless the HKMA agrees to a longer period). Shares held by virtue of underwriting and sub-underwriting commitments are, nevertheless, permitted provided the relevant shares are disposed of within 7 working days or such longer period as the HKMA may agree.

There are other exemptions for any holding of share capital approved by the HKMA in other banks and companies carrying on nominee, executor, trustee or other functions related to banking business, the business of deposit taking, insurance, investments or other financial services.

Other restrictions on investment

The aggregate of the outstanding amounts of all facilities granted to or on behalf of a licensed bank's controllers, directors, their relatives, certain of its employees and their associates; the value of all holdings of share capital in other companies; and the value of all holdings of interests in land (including land purchased or held which is necessary for the conduct of business or the provision of housing or amenities for the staff of the institution) must not exceed 80% of its capital base.

Charges

A licensed bank incorporated in Hong Kong is not permitted to create any charges over its assets if either the aggregate value of all charges existing over its total assets is 5% or more of the value of those total assets or creating that charge would cause the aggregate value of all charges over its total assets to be more than 5% of the value of those total assets.

Restrictions on overseas activities

A licensed bank which is incorporated in Hong Kong is subject to a condition that it shall not establish or maintain any overseas branch or overseas representative office without the approval of the HKMA. The HKMA is empowered by the Banking Ordinance to require financial and other information regarding any such overseas branch to be supplied to it.

Further, a licensed bank incorporated in Hong Kong or its Hong Kong incorporated holding company may not without the consent of the HKMA own a company incorporated outside Hong Kong which may (whether or not in or outside Hong Kong) lawfully take deposits from the public. The HKMA may at any time attach in respect of any such approved overseas companies any conditions as the HKMA may think proper.

Shareholders, chief executives and directors

Limitations on shareholders

The HKMA has the power to object, on certain specified grounds, to persons becoming or being “controllers” of licensed banks incorporated in Hong Kong. “**Controller**” in this context means:

- (1) a person who, either alone or with any associate(s), is entitled to exercise, or control the exercise of, 10% or more, but not more than 50%, of the voting power at any general meeting of the licensed bank or of another company of which it is a subsidiary; or
- (2) a person who, either alone or with any associate(s), is entitled to exercise, or control the exercise of, more than 50% of the voting power at any general meeting of the licensed bank or of another company of which it is a subsidiary; or
- (3) a person in accordance with whose directions or instructions the directors of the licensed bank or of another company of which it is a subsidiary are accustomed to act (but does not include any professional advisors or managers appointed by the HKMA to manage the licensed bank).

A person may not become a controller of a licensed bank incorporated in Hong Kong unless he has served a written notice on the HKMA of his proposal to that effect and the HKMA consents to his becoming such a controller or does not object within three months.

Within the three-month period, the HKMA may object to the applicant’s proposal, unless it is satisfied that the applicant is a fit and proper person to become a controller; that depositors’ or potential depositors’ interests will not be threatened by that person being such a controller; and having regard to the applicant’s likely influence on that institution as a controller, the licensed bank is likely to continue to conduct its business prudently or that the applicant is likely to undertake adequate remedial action to ensure that the licensed bank will conduct its business prudently.

The HKMA may also object to the continuation of a person as a controller on similar grounds as in respect of new controllers.

Where a person becomes a controller (by virtue of being able to exercise or control the exercise of certain voting power in a licensed bank) after a notice of objection has been served on him or otherwise in the contravention of the procedure prescribed by the Banking Ordinance, the HKMA may notify the controller that until further notice any specified shares are subject to one or more of the following restrictions:

- (1) any transfer of the shares or, in the case of unissued shares, any transfer of the right to be issued with them, and any issue of such shares, shall be void;
- (2) voting rights in respect of those shares shall not be exercisable;
- (3) no further shares in right or pursuant to any offer made to the shareholder shall be issued; or
- (4) except in a liquidation, no payments of any sums due from the licensed bank or other company on the shares shall be paid.

In addition, the HKMA may apply to court for an order that the shares be sold. Once the shares are sold, the proceeds (less the costs of sale) shall be paid into court and held for the benefit of the persons beneficially interested in them.

In the case of an indirect controller who does not have the approval of the HKMA, the person concerned is prohibited from giving directions or instructions to the directors of the licensed bank.

Limitations on persons becoming chief executives or directors

All licensed banks must have a chief executive ordinarily resident in Hong Kong. A person requires the written consent of the HKMA before becoming a chief executive.

The consent of the HKMA is also required for a person to become a director of a Hong Kong incorporated licensed bank.

Supervision of securities business

The Securities and Futures Ordinance (the “SFO”), which came into operation in April 2003, introduced a substantial change to the conduct of securities business by banks. Banks are no longer exempted from the relevant regulations when they engage in securities business. Instead they are required to apply for registration with the Securities and Futures Commission (the “SFC”), which means they will have to meet the Fit and Proper Criteria set by the SFC. Likewise, staff engaged by banks in securities business will have to meet the Fit and Proper Criteria applicable to staff of brokerage firms. It is a statutory condition of registration for banks that each member of staff engaged by them in securities business is a fit and proper person. Banks will also have to comply with the various regulatory requirements set by the SFC in relation to their securities business, including the subsidiary legislation and the business conduct codes. Under the SFO, banks and their securities staff will be subject to the same range of disciplinary actions that are applicable to brokers and their staff in case they are guilty of misconduct or otherwise not fit and proper.

With the introduction of a new licensing regime under the SFO, corresponding changes have been made to the Banking Ordinance by way of the introduction of the Banking (Amendment) Ordinance 2002. Such ordinance came into operation simultaneously with the SFO and has enabled the HKMA to enhance their regulatory functions in relation to the securities businesses of authorised institutions that are registered under the SFO.

TERMS AND CONDITIONS OF THE NOTES

The following is the text of the Conditions of the Notes which (subject to modification and completion and except for the paragraphs in italics) will be endorsed on each Note in definitive form (if issued):

The US\$400,000,000 6.00 per cent. Step-Up Perpetual Subordinated Notes (the **Notes**, which expression shall in these Conditions, unless the context otherwise requires, include any further Notes issued pursuant to Condition 16 and forming a single series with the Notes) of Wing Hang Bank, Limited (the **Issuer**) are constituted by a Trust Deed dated 19 April 2007 (as amended or supplemented from time to time, the **Trust Deed**) made between the Issuer, and The Bank of New York (the **Trustee**, which expression shall include its successors(s)) as trustee for the holders of the Notes (the **Noteholders**).

The issue of the Notes was authorised by a resolution of the Executive Committee of the Issuer on 12 April 2007.

The statements in these Conditions include summaries of, and are subject to, the detailed provisions of and definitions in the Trust Deed. Copies of the Trust Deed and the Registrar and Paying Agency Agreement dated 19 April 2007 (the **Agency Agreement**) made between the Issuer, the Trustee, The Bank of New York, as initial calculation agent (the **Calculation Agent**) and as initial principal paying agent (the **Principal Paying Agent** and, together with any further paying agents appointed from time to time pursuant to the terms of the Agency Agreement, unless the context otherwise requires, the **Paying Agents** and each a **Paying Agent**), The Bank of New York as registrar (the **Registrar**) and The Bank of New York as transfer agent (the **Transfer Agent**) are available for inspection during normal business hours by the Noteholders at the principal office for the time being of the Trustee, being at the date of issue of the Notes at One Canada Square, 40th Floor, London E14 5AL, United Kingdom and at the specified office of each of the Paying Agents. The Noteholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and the Agency Agreement applicable to them. The Paying Agents, Registrar and Transfer Agent are together referred to as the **Agents** and each as **Agent**. References in these Conditions to an Agent shall include any successor appointed under the Agency Agreement.

*The owners shown in the records of Euroclear Bank S.A./N.V. (**Euroclear**) and Clearstream Banking, société anonyme (**Clearstream, Luxembourg**) of book-entry interests in Notes are entitled to the benefits of, are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and the Agency Agreement applicable to them.*

1. **Form, Denomination and Title**

(1) *Form and Denomination*

The Notes are in registered form, serially numbered, in the denominations of US\$100,000 and integral multiples of US\$1,000 in excess thereof. A note certificate (each a **Certificate**) will be issued to each Noteholder in respect of its registered holding of Notes. Each certificate will be numbered serially with an identifying number which will be recorded on the relevant Certificate and in the register of Noteholders (the **Register**) which the Issuer will procure to be kept by the Registrar.

The Notes are not issuable in bearer form.

(2) *Title*

Title to the Notes passes only by registration in the Register. The holder of any Note will (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any interest or any writing on, or the theft or loss of, the Certificate issued in respect of it) and no person will be liable for so treating the holder. In these Conditions **Noteholder** and (in relation to a Note) **holder** means the person in whose name a Note is registered in the Register.

The Notes will initially be represented by a Global Certificate which will be deposited with, and registered in the Register in the name of a nominee of, a common depositary for Euroclear and Clearstream. The Global Certificate will be exchangeable in certain limited circumstances in whole, but not in part, for Notes in definitive form.

2. Transfers of Notes and Issue of Certificates

(1) Transfers

A Note may be transferred by depositing the Certificate issued in respect of that Note, with the form of transfer on the back duly completed and signed, at the specified office of the Registrar or the Transfer Agent.

(2) Delivery of new Certificates

Each new Certificate to be issued upon transfer of Notes will, within five business days of receipt by the Registrar or the Transfer Agent of the duly completed form of transfer endorsed on the relevant Certificate, be mailed by insured pre-paid mail at the risk of the holder entitled to the Note to the address appearing on the Register or as specified in the form of transfer. For the purposes of this Condition, **business day** shall mean a day on which banks are open for business in the city in which the specified office of the Registrar or, as the case may be, the Transfer Agent.

Except in the limited circumstances described herein (see “Summary of provisions relating to the Notes whilst in global form”), owners of interests in the Notes will not be entitled to receive physical delivery of Certificates.

Where some but not all of the Notes in respect of which a Certificate is issued are to be transferred, a new Certificate in respect of the Notes not so transferred will, within five business days of receipt by the Registrar or the Transfer Agent of the original Certificate, be mailed by insured pre-paid mail at the risk of the holder of the Notes not so transferred to the address of such holder appearing on the Register or as specified in the form of transfer.

(3) Formalities free of charge

Registration of transfer of Notes will be effected without charge by or on behalf of the Issuer or any Agent but upon payment (or the giving of such indemnity as the Issuer or the relevant Agent may require) in respect of any tax or other governmental charges which may be imposed in relation to such transfer.

(4) Closed Periods

No Noteholder may require the transfer of a Note to be registered during the period of 15 days ending on the due date for any payment of principal, premium or interest on that Note.

(5) Regulations

All transfers of Notes and entries on the Register will be made subject to the detailed regulations concerning transfer of Notes scheduled to the Agency Agreement. The regulations may be changed by the Issuer with the prior written approval of the Registrar. A copy of the current regulations will be mailed (free of charge) by the Registrar to any Noteholder who requests one.

3. Status

(1) Subordination

The Notes constitute direct and unsecured obligations of the Issuer, conditional as described below, ranking *pari passu* without any preference among themselves. The rights of the holders of the Notes will, in the event of the Winding-Up (as defined in Condition 10) of the Issuer, be subordinated in right of payment to the claims of the Issuer Prior Creditors. In the event of the Winding-Up of the Issuer, there shall be payable by the Issuer in respect of each Note (in lieu of any other payment), but subject as provided in this Condition,

such amount, if any, as would have been payable to the Noteholder thereof if, at the close of business on the day prior to the commencement of the Winding-Up of the Issuer and thereafter, such Noteholder were the holder of the highest ranking fully paid and validly issued preference share in the capital of the Issuer having a preferential right to a return of assets in the Winding-Up of the Issuer over the holders of all other classes of issued shares (including for this purpose other preference shares issued, but excluding any preference shares which are classified as “Category II-Supplementary Capital” for the purpose of capital adequacy under Part XVII of the Banking Ordinance (as defined below)) for the time being in the Issuer’s capital on the assumption that such preference share was entitled to receive on a return of assets in such Winding-Up of the Issuer an amount (disregarding any tax credit which would have been given in relation to dividends payable on such preference share) equal to the principal amount of such Note together with Arrears of Interest (as defined in Condition 4(10)), if any, and accrued interest (other than Arrears of Interest) up to, but excluding, the date of repayment in respect thereof.

(2) *Solvency*

The Issuer’s obligation to make any payment of interest and, where applicable, any repayment of principal in respect of any Notes is conditional upon the Issuer being able to make such payment and remain Solvent immediately thereafter.

For the purposes of this Condition 3(2) and Condition 3(3), **Solvent** and **Solvency** means that the Issuer:

- (i) is able to pay its debts as they fall due; and
- (ii) has Assets that exceed its Liabilities (other than its Liabilities to persons in respect of the Issuer Primary Capital Indebtedness).

(3) *Certificate of Solvency*

The Trust Deed contains provisions requiring a certificate or report as to the Solvency of the Issuer to be signed by (a) two directors of the Issuer or (b) in certain circumstances as provided in the Trust Deed, the Auditors or (c) if the Issuer is in Winding-Up, the liquidator of the Issuer, to be delivered to the Trustee prior to any payment of principal or interest and also prior to the purchase of any Notes beneficially by or for the account of the Issuer or any of its Subsidiaries. Any such certificate or report shall, in the absence of manifest error, be treated and accepted by the Issuer, the Trustee and the Noteholders as correct and sufficient evidence of such Solvency.

(4) *Application to principal and interest only*

The provisions of this Condition 3 apply only to the principal and interest in respect of the Notes and nothing in this Condition 3 shall affect or prejudice the payment of the costs, charges, expenses, liabilities or remuneration of the Trustee or the rights and remedies of the Trustee in respect of thereof.

(5) *Definitions*

In these Conditions, the following expressions have the following meanings:

Assets means the unconsolidated gross assets of the Issuer and **Liabilities** means the unconsolidated gross liabilities (including contingent liabilities) of the Issuer, all as shown in the latest published audited balance sheet of the Issuer having the benefit of an unqualified Auditors’ report, but with such adjustments as the Auditors or, if the Issuer is in Winding-Up, the liquidator, shall determine to be appropriate;

Auditors means the independent certified public accountants for the time being of the Issuer;

Issuer Primary Capital Indebtedness means (a) any principal and interest payable in respect of the Notes and (b) Issuer Subordinated Indebtedness, the right to payment by the Issuer by the terms whereof is, or is expressed to be, subordinated in the event of a Winding-Up of the Issuer to the claims of all or any of the

creditors of the Issuer (including all or any of the creditors in respect of any other Issuer Subordinated Indebtedness) so that it ranks *pari passu* with, or junior to, claims against the Issuer in respect of the Notes or is required by the terms of any agreement entered into by the Issuer at any time to be so subordinated but is not so subordinated;

Issuer Prior Creditors means creditors of the Issuer (including creditors in respect of the principal and interest payable in respect of notes issued by the Issuer which do not constitute Issuer Primary Capital Indebtedness) except creditors in respect of Issuer Primary Capital Indebtedness;

Issuer Subordinated Indebtedness means any liability of the Issuer howsoever arising for the payment of money (including (a) the principal and interest payable in respect of dated subordinated notes and (b) the principal and interest payable in respect of undated subordinated notes) the right to payment of which by the Issuer by the terms whereof is, or is expressed to be, subordinated in the event of a Winding-Up of the Issuer to the claims of all or any of the creditors of the Issuer; and

Subsidiary means a subsidiary or subsidiary undertaking of the Issuer whose affairs are for the time being required to be fully consolidated in the consolidated accounts of the Issuer.

(6) *No Set-off*

Each Noteholder by virtue of being the holder of any Note irrevocably agrees and acknowledges that:

- (i) it may not exercise, claim or plead any right of set-off, counter-claim or retention in respect of any amount owed to it by the Issuer arising under or in connection with the Notes; and
- (ii) it shall, to the fullest extent permitted by applicable law, waive and be deemed to have waived all such rights of set-off, counter-claim or retention.

The obligations of the Issuer in respect of the Notes are conditional upon the Issuer being Solvent for the purpose of this Condition 3 immediately before and after payment by the Issuer. If this Condition 3 is not satisfied, any amounts which might otherwise have been allocated in or towards payment of principal and interest in respect of the Notes may be used to absorb losses without the Issuer being obliged to cease trading.

4. **Interest**

(1) *Interest Payment Dates*

The Notes bear interest from and including 19 April 2007 (the **Issue Date**) to but excluding 20 April 2017 at the Fixed Rate of Interest (as defined below) payable semi-annually in equal instalments in arrears on 20 April and 20 October in each year (each, an **Interest Payment Date**), subject as provided in Condition 3, Condition 4(10) and Condition 5, (except that the first payment of interest, to be made on 20 October 2007, will be in respect of the period from and including 19 April 2007 to but excluding 20 October 2007).

From and including 20 April 2017 the Notes bear interest at the Floating Rate of Interest (as defined below) payable quarterly in arrears on 20 April, 20 July, 20 October and 20 January in each year (each also, an **Interest Payment Date**), subject as provided in Condition 3, Condition 4(10) and Condition 5 and provided however that, if any Interest Payment Date would otherwise fall on a day which is not a Business Day, it will be postponed to the next Business Day unless it would thereby fall into the next calendar month, in which case it will be brought forward to the preceding Business Day.

(2) *Accrual of Interest*

Each Note will cease to bear interest from the due date for redemption unless, upon due presentation, payment of principal is improperly withheld or refused or unless default is otherwise made in respect of the payment, in which case it will continue to bear interest at the prevailing Rate of Interest (both before and after judgment) until whichever is the earlier of (a) the day on which all sums due in respect of such Note up to

that day are received by or on behalf of the relevant Noteholder and (b) the day which is seven days after the Principal Paying Agent or the Trustee has notified the Noteholders that it has received all sums due in respect of the Notes up to such seventh day (except to the extent that there is any subsequent default in payment).

The period beginning on (and including) the Issue Date and ending on (but excluding) the first Interest Payment Date and each successive period beginning on an Interest Payment Date and ending on (but excluding) the next succeeding Interest Payment Date is called an **Interest Period**.

(3) *Calculation of Interest*

In respect of the period from and including the Issue Date to but excluding 20 April 2017, where interest is required to be calculated in respect of a period of less than a full half-year, it shall be calculated on the basis of a 360-day year consisting of 12 months of 30 days each and, in the case of an incomplete month, the number of days elapsed on the basis of a month of 30 days.

In respect of the period from and including 20 April 2017, interest in respect of any Note shall be calculated per US\$1,000 in principal amount of the Notes (the **Calculation Amount**). The amount of interest payable per Calculation Amount shall be calculated by applying the Floating Rate of Interest to the Calculation Amount and multiplying such product by the actual number of days in the Interest Period concerned divided by 360 and rounding the resulting figure to the nearest US\$0.01 (US\$0.005 being rounded upwards).

(4) *Rates of Interest*

For the period from and including the Issue Date to but excluding 20 April 2017, the rate of interest in respect of the Notes (the **Fixed Rate of Interest**) will be 6.00 per cent. per annum.

For the period from and including 20 April 2017, the rate of interest in respect of the Notes (the **Floating Rate of Interest**) will be a rate per annum equal to LIBOR plus 1.85 per cent. per annum.

LIBOR shall mean:

- (i) the rate for three-month U.S. dollar deposits which appears on the display page designated “LIBOR01” on the Reuter Monitor Money Rates Service (or such other page as may replace that page on that service, or such other service as may be nominated as the information vendor, for the purpose of displaying comparable rates) as at 11.00 a.m. (London time) on the Interest Determination Date;
- (ii) if such rate does not appear on that page, or if the relevant page is unavailable, the Calculation Agent will:
 - (A) request the principal London office of each of four major banks in the U.S. dollar interbank market in London as selected by the Calculation Agent to provide the Calculation Agent with its offered quotation to leading banks in the London interbank market for three-month U.S. dollar deposits as at 11.00 a.m. (London time) on the Interest Determination Date in question; and
 - (B) determine the arithmetic mean (rounded, if necessary, to the nearest one hundred-thousandth of a percentage point, 0.000005 per cent. being rounded upwards) of such offered quotations; and
- (iii) if fewer than two such quotations are provided as requested, the Calculation Agent will determine the arithmetic mean (rounded, if necessary, as aforesaid) of the U.S. dollar lending rates which leading banks in New York City selected by the Calculation Agent are quoting, on the relevant Interest Determination Date, to leading banks in Europe for a period of three months as at 11.00 a.m. (New York City time),

provided, however, that if the Calculation Agent is unable to determine LIBOR in accordance with the above provisions in relation to any Interest Period, the rate of LIBOR applicable to the Notes during such Interest Period shall be the rate determined in relation to the Notes in respect of the last preceding Interest Period.

Banking Day means, in respect of any city, any day on which commercial banks are open for business (including dealings in foreign exchange and foreign currency deposits) in that city.

Business Day means a day on which commercial banks are open for general business (including dealings in foreign exchange and foreign currency deposits) in Hong Kong, London and New York City.

Interest Determination Date means, in relation to each Interest Period from and including the Interest Period beginning on 20 April 2017, the second London Banking Day before the commencement of the relevant Interest Period.

(5) Determination of Floating Rate of Interest and Floating Interest Amount

If the Notes are not to be redeemed in accordance with Condition 6(a), the Calculation Agent will, as soon as practicable after 11.00 a.m. (London time) on each Interest Determination Date, determine the Floating Rate of Interest in respect of the Interest Period commencing on that Interest Determination Date and calculate the amount of interest payable per Calculation Amount on the Interest Payment Date for that Interest Period (the **Floating Interest Amount**). Absent manifest error, the Calculation Agent's determination of the Floating Rate of Interest for any Interest Period will be final and binding.

(6) Publication of Floating Rate of Interest and Floating Interest Amount

The Issuer shall cause notice of the Floating Rate of Interest in respect of each relevant Interest Period, the Floating Interest Amount in respect of each relevant Interest Period and the relevant date scheduled for payment to be given to the Trustee, the Agents, any stock exchange or other relevant authority on which the Notes are for the time being listed or admitted to trading and, in accordance with Condition 12, the Noteholders, in each case as soon as practicable after its determination but in any event not later than the fourth Business Day thereafter. The Floating Interest Amount, the Floating Rate of Interest and the date scheduled for payment so notified may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without notice in the event of any extension or shortening of the relevant period in accordance with these Conditions or in the event of proven or manifest error.

(7) Determination by the Trustee

The Trustee (or an agent appointed by the Trustee at the expense of the Issuer) shall, if the Calculation Agent defaults at any time in its obligation to determine the Floating Rate of Interest and Floating Interest Amount in accordance with the above provisions, determine the Floating Rate of Interest and Floating Interest Amount, the former at such rate as, in its absolute discretion (having such regard as it shall think fit to the procedure described above), it shall deem fair and reasonable in all the circumstances and the latter in the manner provided in paragraph (5) and the determinations shall be deemed to be determinations by the Calculation Agent.

(8) Notifications, etc. to be Final

All notifications, opinions, determinations, certificates, calculations, quotations and decisions given, expressed, made or obtained for the purposes of the provisions of this Condition, whether by the Calculation Agent or the Trustee, will (in the absence of wilful default, bad faith or manifest error) be binding on the Issuer, the Trustee, the Calculation Agent, the Registrar, the Transfer Agent, the Paying Agents and all Noteholders and (in the absence of wilful default and bad faith) no liability to the Issuer, or the Noteholders shall attach to the Calculation Agent or, if applicable, the Trustee in connection with the exercise or non-exercise by any of them or their powers, duties and discretions under this Condition.

(9) Calculation Agent

The Issuer will procure that, so long as any Note is outstanding, there shall at all times be a Calculation Agent for the purposes of the Notes and the Issuer may, subject to the prior written approval of the Trustee, terminate the appointment of the Calculation Agent. If any such bank (acting through its relevant office) is unable or unwilling to continue to act as the Calculation Agent, or if the Calculation Agent fails duly to

establish the Floating Rate of Interest for any Interest Period or to calculate the Floating Interest Amount, the Issuer shall (with the prior written approval of the Trustee) appoint some other leading bank engaged in the London interbank market (acting through its principal London office) to act as such in its place. The Calculation Agent may not resign its duties without a successor having been so appointed.

(10) *Deferral of Interest*

- (i) Where, during the 12 calendar months preceding a date on which interest is due to be paid in respect of the Notes, no dividend has been declared or paid on ordinary shares of the Issuer and no payment has been declared or paid on any Securities issued by the Issuer, such due date shall be referred to as an **Optional Interest Payment Date**. **Securities** for the purpose of this Condition shall mean preference shares and any other securities of the Issuer that qualify as “Category I — Core Capital” for the purpose of capital adequacy under Part XVII of the Banking Ordinance.
- (ii) The Issuer may, if it so elects, but shall not be obliged to, pay on any Optional Interest Payment Date the interest that is due to be paid on such date in respect of the Notes and any failure to pay shall not constitute a default by the Issuer for any purpose. Any interest not paid on an Optional Interest Payment Date shall (except to the extent such interest shall subsequently have been paid) constitute **Arrears of Interest**.
- (iii) In relation to the Notes, Arrears of Interest may, prior to the commencement of the Winding-Up of the Issuer, be paid in whole or in part upon the expiration of not less than seven days’ notice given to the holders of the Notes in accordance with Condition 12, but payment in respect of Interest Periods during which Arrears of Interest have accrued shall be made taking the earliest Interest Period first. Arrears of Interest shall otherwise only become payable on (i) the due date for repayment of the Notes to which such Arrears of Interest relate, (ii) the date on which any declaration or payment of any dividend on any class of share capital of the Issuer is made or (iii) the commencement of the Winding-Up of the Issuer (except for the purposes of a reconstruction, amalgamation or otherwise the terms of which have previously been approved by an Extraordinary Resolution of Noteholders or which is permitted under Condition 14). If notice is given by the Issuer of its intention to pay any Arrears of Interest, the Issuer shall be obliged to do so upon the expiration of such notice. Arrears of Interest shall not themselves bear interest.
- (iv) The Issuer shall give notice in accordance with Condition 12:
 - (i) not more than 30 days nor less than seven days prior to any Optional Interest Payment Date in respect of which it will elect not to make any payment of interest in accordance with the above provisions, of such election; and
 - (ii) of any date on which Arrears of Interest shall have become payable.

5. **Payments**

(1) *Payments in respect of Notes*

Payments of principal and interest in respect of each Note will be made by transfer to the registered account of the Noteholder or by U.S. dollar cheque drawn on a bank that processes payments in U.S. dollars mailed to the registered address of the Noteholder if it does not have a registered account. Payments of principal and payments of interest due otherwise than on an Interest Payment Date will only be made against surrender of the relevant Certificate at the specified office of any of the Agents. Interest on Notes due on an Interest Payment Date will be paid to the holder shown on the Register at the close of business on the date (the **record date**) being the fifteenth day before the due date for the payment of interest.

For the purposes of this Condition, a Noteholder’s **registered account** means the U.S. dollar account maintained by or on behalf of it with a bank that processes payments in U.S. dollars, details of which appear on the Register at the close of business, in the case of principal and interest due otherwise than on an Interest Payment Date, on the second business day before the due date for payment and, in the case of interest due on an Interest Payment Date, on the relevant record date, and a Noteholder’s **registered address** means its address appearing on the Register at that time.

(2) *Payments subject to Applicable Laws*

Payments in respect of principal and interest on the Notes are subject in all cases to any fiscal or other laws and regulations applicable in the place of payment, but without prejudice to the provisions of Condition 7.

(3) *Payment only on Business Day*

Where payment is to be made by transfer to a registered account, payment instructions (for value the due date or, if that is not a business day, for value the first following day which is a business day) will be initiated and, where payment is to be made by cheque, the cheque will be mailed, on the due date for payment or, in the case of a payment of principal or a payment of interest due otherwise than on an Interest Payment Date, if later, on the business day on which the relevant Certificate is surrendered at the specified office of an Agent.

Noteholders will not be entitled to any interest or other payment for any delay after the due date in receiving the amount due if the due date is not a business day, if the Noteholder is late in surrendering its Certificate (if required to do so) or if a cheque mailed in accordance with this Condition arrives after the due date for payment.

In this Condition, **business day** means a day (other than a Saturday or Sunday) on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency) in Hong Kong, New York, London and, in the case of presentation of a Certificate, in the place in which the Certificate is presented.

(4) *Initial Agents*

The names of the initial Agents and their initial specified offices are set out at the end of these Conditions. The Issuer reserves the right, subject to the prior written approval of the Trustee, at any time to vary or terminate the appointment of any Agent and to appoint additional or other Agents provided that it will at all times maintain:

- (i) a Principal Paying Agent;
- (ii) a Calculation Agent;
- (iii) a Paying Agent in a Member State of the European Union that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive;
- (iv) for so long as the Notes are listed on the Singapore Exchange Securities Trading Limited (the **Singapore Stock Exchange**) and the rules of the Singapore Stock Exchange so require, and provided only if the Notes are issued in definitive form, a Paying Agent in Singapore where the Notes may be presented or surrendered for payment or redemption unless the Issuer obtains an exemption from the Singapore Stock Exchange; and
- (v) a Registrar.

Notice of any termination or appointment and of any changes in specified offices will be given to the Noteholders promptly by the Issuer in accordance with Condition 12.

In relation to paragraph (iv) above, in the event that definitive Notes are issued, an announcement of such issue shall be made by or on behalf of the Issuer through the Singapore Stock Exchange and such announcement will include all material information with respect to the delivery of the definitive Notes, including details of the Paying Agent in Singapore.

(5) *No commissions*

No commissions or expenses shall be charged to the Noteholders in respect of any payments made in accordance with this Condition.

(6) *Partial payments*

If the amount of principal or interest which is due on the Notes is not paid in full, the Registrar will annotate the Register with a record of the amount of principal, or interest in fact paid.

6. **Redemption and Purchase**

The Notes are undated and, accordingly, have no final maturity date and may not be repaid except in accordance with the provisions of this Condition 6 or Condition 10.

(1) *Redemption at the option of the Issuer*

Subject to Condition 6(6), the Notes may be redeemed at the option of the Issuer in whole, but not in part, on the Interest Payment Date falling on 20 April 2017 or on any Interest Payment Date thereafter (the **Optional Redemption Date**) at a redemption price equal to 100 per cent. of their principal amount together with accrued and unpaid interest to the date fixed for redemption and all Arrears of Interest on (a) the obtaining of the prior written approval of the Hong Kong Monetary Authority (the **HKMA**) and (b) on the Issuer's giving not less than 30 nor more than 60 days' notice to the Trustee and the Noteholders (which notice shall be irrevocable and shall oblige the Issuer to redeem the Notes on the Optional Redemption Date at such price plus accrued interest and all Arrears of Interest to such date) provided that prior to giving any such notice two directors of the Issuer have certified to the Trustee that the Issuer will have sufficient funds available on the Optional Redemption Date to discharge all of its liabilities in respect of the Notes.

(2) *Redemption for tax reasons*

The Notes may be redeemed at the option of the Issuer in whole, but not in part, at any time, on giving not less than 30 nor more than 60 days' notice to the Noteholders (which notice shall be irrevocable) at a redemption price equal to 100 per cent. of their principal amount together with interest accrued to the date fixed for redemption and all Arrears of Interest, if, immediately before giving such notice, the Issuer satisfies the Trustee that (a) the Issuer has or will become obliged to pay Additional Amounts as provided or referred to in Condition 7 as a result of any change in, or amendment to, the laws or regulations of the Relevant Jurisdiction (as defined in Condition 7 below) or any change in the application or official interpretation of such laws or regulations (including a holding by a court of competent jurisdiction), which change or amendment becomes effective on or after 12 April 2007; and (b) such obligation cannot be avoided by the Issuer taking reasonable measures available to it; provided, however, that (i) no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer would be obliged to pay such Additional Amounts; and (ii) prior to such notice of redemption, the prior written approval of the HKMA for such redemption shall have been obtained.

Prior to the giving of any notice of redemption pursuant to this Condition 6(2), the Issuer shall deliver or procure that there is delivered to the Trustee:

- (i) a certificate signed by two Directors of the Issuer stating that the circumstances referred to in this Condition 6(2)(a) above prevail and cannot be avoided by the Issuer taking reasonable measures available to it and setting out the details of such circumstances together with a copy of the approval of the HKMA referred to in this Condition 6(2) in form and substance satisfactory to the Trustee; and
- (ii) an opinion in form and substance satisfactory to the Trustee of independent legal advisers of recognised standing (satisfactory to the Trustee) to the effect that the Issuer has or would become obliged to pay such Additional Amounts as a result of such change or amendment.

The Trustee shall be entitled to accept such certificate, approval and opinion as sufficient evidence of the satisfaction of the conditions precedent set out in this Condition 6(2), in which event they shall be conclusive and binding on the Noteholders. Upon the expiry of any such notice as is referred to in this Condition 6(2), the Issuer shall be bound to redeem the Notes in accordance with this Condition 6(2).

(3) *No other redemption*

The Issuer shall not be entitled to redeem the Notes otherwise than as provided in Condition 6(1) and Condition 6(2).

(4) *Purchase*

Subject to Condition 6(6), the Issuer or any of the Issuer's Subsidiaries (as defined in Condition 3(5)) may at any time purchase Notes in the open market or otherwise and at any price.

(5) *Cancellation*

All Notes so redeemed or purchased by the Issuer or any of the Issuer's Subsidiaries shall be cancelled and may not be reissued or resold.

(6) *Conditions of Redemption for Subordinated Notes*

Notwithstanding any other provision in these Conditions, the Notes (subject as provided below) may not be redeemed or purchased and cancelled without the prior consent of the HKMA (or any successor thereto). Accordingly the Issuer shall not redeem any of such Notes or none of the Issuer and the Issuer's Subsidiaries shall purchase and cancel the Notes unless the prior written consent of the HKMA thereto shall have been obtained provided, however, that if from time to time the consent of the HKMA is not a requirement of any such Notes to constitute "Category II-Supplementary Capital" for the purpose of capital adequacy under Part XVII of the Banking Ordinance (Cap. 155) of Hong Kong (the **Banking Ordinance**), or any successor legislation, then the condition to the redemption or purchase and cancellation of the relevant Notes shall not apply for so long as such consent is not so required.

Holders of the Notes should note that it is intended that the Notes should constitute "Category II-Supplementary Capital" (for the purpose of capital adequacy under Part XVII of the Banking Ordinance) of the Issuer and accordingly, under statutory requirements prevailing at the date hereof relating to Category II Supplementary Capital, and by virtue of the above provisions, any redemption or purchase and cancellation of such Notes is subject to the prior consent of the HKMA at the relevant time.

7. **Taxation**

(1) *Payment without Withholding or Deduction*

All payments of principal and interest (including Arrears of Interest) in respect of the Notes by or on behalf of the Issuer shall be made without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature (**Taxes**) imposed or levied by or on behalf of the Relevant Jurisdiction, unless the withholding or deduction of the Taxes is required by law. In that event, the Issuer will pay such additional amounts (**Additional Amounts**) as may be necessary in order that the net amounts received by the Noteholders after the withholding or deduction shall equal the respective amounts which would have been receivable in respect of the Notes in the absence of the withholding or deduction; except that no Additional Amounts shall be payable in relation to any payment in respect of any Note:

- (i) presented for payment by or on behalf of, a holder who is liable to the Taxes in respect of the Note by reason of his having some connection with the Relevant Jurisdiction other than the mere holding of the Note;

- (ii) presented for payment more than 30 days after the Relevant Date except to the extent that a holder would have been entitled to Additional Amounts on presenting the same for payment on the last day of the period of 30 days assuming, whether or not such is in fact the case, that day to have been a business day (as defined in Condition 5(3));
- (iii) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- (iv) presented for payment by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Note to another Paying Agent, if any, in a Member State of the European Union.

(2) *Interpretation*

In these Conditions:

- (i) **Relevant Date** means the date on which the payment first becomes due but, if the full amount of the money payable has not been received by the Principal Paying Agent or the Trustee on or before the due date, it means the date on which, the full amount of the money having been so received, notice to that effect shall have been duly given to the Noteholders by the Issuer in accordance with Condition 12; and
- (ii) **Relevant Jurisdiction** means the Hong Kong Special Administrative Region of the People's Republic of China (**Hong Kong**) or any political subdivision or any authority thereof or therein having power to tax or any other jurisdiction or any political subdivision or any authority thereof or therein having power to tax to which the Issuer becomes subject in respect of payments made by it of principal and interest of the Notes.

(3) *Additional Amounts*

Any reference in these Conditions to any amounts in respect of the Notes (including Arrears of Interest) shall be deemed also to refer to any additional amounts which may be payable under this Condition or under any undertaking given in addition to, or in substitution for, this Condition pursuant to the Trust Deed.

8. **Prescription**

Notes will become void unless presented for payment within periods of ten years (in the case of principal) and five years (in the case of interest) from the Relevant Date (as defined in Condition 7).

9. **Enforcement Events**

- (1) If default is made in the payment of any amount of principal in respect of the Notes on the due date for payment thereof or of any amount of interest in respect of the Notes within seven days after the date upon which the payment of interest is compulsory (but subject to the provisions of Condition 4(10)) (each an **Enforcement Event**) then in order to enforce the obligations of the Issuer, the Trustee at its sole discretion may and, if so requested in writing by holders of at least one quarter in principal amount of the outstanding Notes or if so directed by an Extraordinary Resolution (as defined in the Trust Deed), shall (subject to the Trustee having been indemnified and/or provided with security to its satisfaction) institute a Winding-Up Proceeding in Hong Kong against the Issuer but may take no further action in respect of such default (but without prejudice to (2) below).
- (2) If an order is made or an effective resolution is passed for the Winding-Up of the Issuer (whether or not an Enforcement Event has occurred and is continuing) (also an **Enforcement Event**) then the Trustee at its sole discretion may and, if so requested in writing by holders of at least one quarter in principal amount of the outstanding Notes or if so directed by an Extraordinary Resolution, shall

(subject to the Trustee having been indemnified and/or provided with security to its satisfaction) give written notice to the Issuer declaring the Notes to be immediately due and payable, whereupon they shall become immediately due and payable at their principal amount together with accrued interest and all Arrears of Interest without further action or formality.

10. Enforcement

Without prejudice to Condition 9, if the Issuer fails to perform, observe or comply with any obligation, condition or provision relating to the Notes binding on it under these Conditions or the Trust Deed, the Trustee may at its discretion and without further notice and, if so requested in writing by holders of at least one quarter in principal amount of the outstanding Notes or if so directed by an Extraordinary Resolution, shall (subject to the Trustee having been indemnified and/or provided with security to its satisfaction) institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition or provision binding on the Issuer in respect of the Notes (other than an Enforcement Event) provided that neither the Trustee nor the Noteholders shall have any right to institute any Winding-Up Proceedings against the Issuer to enforce any obligation, condition or provision in respect of the Notes (other than an Enforcement Event) and neither the Trustee nor the Noteholders shall be entitled to enforce any award of monetary damages or other restitution made by a court against the Issuer in respect of any breach of such obligation, condition or provision until after the commencement of Winding-Up Proceedings of the Issuer and the payment of such money, damages or other restitution shall be subject to the provisions of Condition 3. Nothing herein shall limit the right of the Trustee from taking any action to enforce any claims for amounts payable to the Trustee for its own account pursuant to the Trust Deed. Except as provided herein and in the Trust Deed, the Trustee and the Noteholders shall otherwise have no right to accelerate payment of any Note in the case of an Enforcement Event.

In these Conditions:

Winding-Up shall mean, with respect to the Issuer, a final and effective order or resolution for the bankruptcy, winding-up, liquidation, receivership or similar proceeding in respect of the Issuer; and

Winding-Up Proceeding shall mean, with respect to the Issuer, proceedings in Hong Kong for the bankruptcy, liquidation, winding-up, receivership, or other similar proceeding of the Issuer.

No Noteholder shall be entitled to proceed directly against the Issuer unless the Trustee having become bound so to proceed, fails to do so within a reasonable period and such failure is continuing. No Noteholder shall be entitled either to institute Winding Up Proceedings in Hong Kong against the Issuer or to submit a claim in such Winding Up except that, if the Trustee, having become bound to institute such Winding Up Proceedings as aforesaid, fails to do so, or, being able and bound to submit a claim in such Winding Up, fails to do so, in each case within a reasonable period and such failure is continuing, then any such holder may, on giving an indemnity satisfactory to the Trustee, in the name of the Trustee (but not otherwise), himself institute Winding Up Proceedings against the Issuer and/or submit a claim in such Winding Up to the same extent (but not further or otherwise) that the Trustee would have been entitled to do.

11. Replacement of Certificates

Should any Certificate be lost, stolen, mutilated, defaced or destroyed it may be replaced at the specified office of the Registrar or such other place of which notice shall be given in accordance with Condition 12, subject to all applicable laws and stock exchange requirements upon payment by the claimant of the expenses incurred in connection with the replacement and on such terms as to evidence and indemnity as the Issuer may reasonably require. Mutilated or defaced Certificates must be surrendered before replacements will be issued.

12. Notices

All notices to the Noteholders will be valid if mailed to them at their respective addresses in the Register maintained by the Registrar. The Issuer shall also ensure that notices are duly published in a manner which complies with the rules and regulations of any stock exchange on which the Notes are for the time being listed. Any such notice will be deemed to have been given on the second day after being so mailed or on the date of publication or, if so published more than once or on different dates, on the date of the first publication..

So long as the Notes are represented by a Global Certificate and the Global Certificate is held on behalf of Euroclear or Clearstream, Luxembourg, or an alternative Clearing System, notices required to be given to Noteholders may be given by their being delivered to the relevant clearing system for communication by it to entitled accountholders in substitution for notification, as required by these Conditions.

13. Meeting of Noteholders, Modification etc.

(1) Provisions for Meetings

The Trust Deed contains provisions for convening meetings of the Noteholders to consider any matter affecting their interests, including the modification by Extraordinary Resolution of any of these Conditions or any of the provisions of the Trust Deed. The quorum at any meeting for passing an Extraordinary Resolution will be one or more persons present holding or representing more than 50 per cent. in principal amount of the Notes for the time being outstanding, or at any adjourned meeting one or more persons present whatever the principal amount of the Notes held or represented by him or them, except that at any meeting the business of which includes the modification of certain of these Conditions and certain of the provisions of the Trust Deed the necessary quorum for passing an Extraordinary Resolution will be one or more persons present holding or representing not less than two-thirds, or at any adjourned meeting not less than one-third, of the principal amount of the Notes for the time being outstanding. An Extraordinary Resolution passed at any meeting of the Noteholders will be binding on all Noteholders, whether or not they are present at the meeting.

In addition, a resolution in writing signed by or on behalf of the holders of not less than 90 per cent. in principal amount of the Notes will take effect as it were an Extraordinary Resolution. Such a resolution in writing may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Noteholders.

(2) Modification

The Trustee may agree, without the consent of the Noteholders but with the prior written consent of the HKMA, to any modification of, or to the waiver or authorisation of any breach or proposed breach of, any of these Conditions or any of the provisions of the Trust Deed, or determine, without any such consent as aforesaid, that any Enforcement Event shall not be treated as such, which in any such case is not, in the opinion of the Trustee, materially prejudicial to the interests of the Noteholders or may agree, without any such consent as aforesaid, to any modification which is of a formal, minor or technical nature or to correct a manifest error or an error which, in the opinion of the Trustee, is proven. Any modification, waiver, authorisation, determination or substitution in accordance with Condition 14 shall be binding on the Noteholders and, unless the Trustee agrees otherwise, any such modification, waiver, authorisation, determination or substitution shall be notified by the Issuer to the Noteholders as soon as practicable thereafter in accordance with Condition 12.

(3) Exercise of Powers by Trustee

In connection with the exercise by it of any of its trusts, powers, authorities or discretions (including, without limitation, any modification, waiver, authorisation, determination or substitution), the Trustee shall have regard to the general interests of the Noteholders as a class but shall not have regard to any interests arising from circumstances particular to individual Noteholders (whatever their number) and, in particular but without limitation, shall not have regard to the consequences of any such exercise for individual Noteholders (whatever their number) resulting from their being for any purpose domiciled or resident in, or otherwise

connected with, or subject to the jurisdiction of, any particular territory and the Trustee shall not be entitled to require, nor shall any Noteholder be entitled to claim, from the Issuer or any other person any indemnification or payment in respect of any tax consequences of any such exercise upon individual Noteholders except to the extent already provided for in Condition 7 and/or any undertaking given in addition to, or in substitution for, Condition 7 pursuant to the Trust Deed.

14. Substitution

The Trustee may, without the consent of the Noteholders, agree with the Issuer to the substitution in place of the Issuer (or of any previous substitute under this Condition) as the principal debtor under the Notes and the Trust Deed (on a subordinated basis equivalent to that set out in Condition 3) of a subsidiary of the Issuer, or a holding company of the Issuer or any other subsidiary of any such holding company, subject to:

- (i) prior written approval of the HKMA;
- (ii) the Trustee being satisfied that the interests of the Noteholders will not be materially prejudiced by the substitution; and
- (iii) certain other conditions set out in the Trust Deed being complied with.

In the case of a substitution pursuant to this Condition, the Trustee may in its absolute discretion agree, without the consent of the Noteholders, to a change of the law governing the Notes and/or the Trust Deed and/or the Agency Agreement provided that such change would not in the opinion of the Trustee be materially prejudicial to the interests of the Noteholders.

15. Indemnification of the Trustee and its Contracting with the Issuer

The Trust Deed contains provisions for the indemnification of the Trustee and for its relief from responsibility, including provisions relieving it from taking action unless indemnified and/or secured to its satisfaction.

The Trust Deed also contains provisions pursuant to which the Trustee is entitled, *inter alia*, (i) to enter into business transactions with the Issuer and/or any of the Issuer's Subsidiaries and to act as trustee for the holders of any other securities issued or guaranteed by, or relating to, the Issuer and/or any of the Issuer's Subsidiaries, (ii) to exercise and enforce its rights, comply with its obligations and perform its duties under or in relation to any such transactions or, as the case may be, any such trusteeship without regard to the interests of, or consequences for, the Noteholders, and (iii) to retain and not be liable to account for any profit made or any other amount or benefit received thereby or in connection therewith.

16. Further Issues

The Issuer is at liberty from time to time without the consent of the Noteholders to create and issue further notes or bonds either (a) ranking *pari passu* in all respects (or in all respects save for the first payment of interest thereon) and so that the same shall be consolidated and form a single series with the outstanding notes or bonds of any series (including the Notes) constituted by the Trust Deed or any supplemental deed or (b) upon such terms as to ranking, interest, conversion, redemption and otherwise as the Issuer may determine at the time of the issue. Any further notes or bonds which are to form a single series with the outstanding notes or bonds of any series (including the Notes) constituted by the Trust Deed or any supplemental deed shall, and any other further notes or bonds may (with the consent of the Trustee), be constituted by a deed supplemental to the Trust Deed. The Trust Deed contains provisions for convening a single meeting of the Noteholders and the holders of notes or bonds of other series in certain circumstances where the Trustee so decides.

17. **Contracts (Rights of Third Parties) Act 1999**

The Notes confer no rights under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of the Notes, but this does not affect any right or remedy of a third party which exists or is available apart from that Act.

18. **Governing Law and Submission to Jurisdiction**

(1) *Governing Law*

The Trust Deed and the Notes are governed by, and will be construed in accordance with, English law, save for Condition 3 and Clause 7 of the Trust Deed which are governed by, and will be construed in accordance with, Hong Kong law.

(2) *Jurisdiction of English Courts*

The Issuer has in the Trust Deed irrevocably and unconditionally agreed for the exclusive benefit of the Trustee and the Noteholders that the courts of England are to have jurisdiction to settle any disputes which may arise out of or in connection with the Trust Deed or the Notes and that accordingly any suit, action or proceedings arising out of or in connection therewith (together referred to as **Proceedings**) may be brought in the courts of England. The Issuer has in the Trust Deed irrevocably and unconditionally waived and agreed not to raise any objection which it may have now or subsequently to the laying of the venue of any Proceedings in the courts of England and any claim that any Proceedings have been brought in an inconvenient forum and has further irrevocably and unconditionally agreed that a judgment in any Proceedings brought in the courts of England shall be conclusive and binding upon it and may be enforced in the courts of any other jurisdiction. Nothing in this Condition shall limit any right to take Proceedings against the Issuer in any other court of competent jurisdiction, nor shall the taking of Proceedings in one or more jurisdictions preclude the taking of Proceedings in any other jurisdiction, whether concurrently or not.

(3) *Appointment of Process Agent*

The Issuer has in the Trust Deed irrevocably and unconditionally appointed Law Debenture Corporate Services Limited at its registered office for the time being (now at Fifth Floor, 100 Wood Street, London EC2V 7EX) as its agent for service of process in England in respect of any Proceedings and has undertaken that in the event of such agent ceasing so to act it will appoint such other person as the Trustee may approve as its agent for that purpose.

SUMMARY OF PROVISIONS RELATING TO THE NOTES WHILE IN GLOBAL FORM

The Global Certificate contains the following provisions which apply to the Notes in respect of which they are issued whilst they are represented by the Global Certificate, some of which modify the effect of the Conditions. Terms defined in the Conditions have the same meaning in paragraphs 1 to 6 below.

1. **Accountholders**

For so long as all of the Notes are represented by the Global Certificate and such Global Certificate is held on behalf of a clearing system, each person (other than another clearing system) who is for the time being shown in the records of Euroclear or Clearstream, Luxembourg (as the case may be) as the holder of a particular aggregate principal amount of such Notes (each an “**Accountholder**”) (in which regard any certificate or other document issued by Euroclear or Clearstream, Luxembourg (as the case may be) as to the aggregate principal amount of such Notes standing to the account of any person shall, in the absence of manifest error, be conclusive and binding for all purposes) shall be treated as the holder of such aggregate principal amount of such Notes (and the expression “**Noteholders**” and references to “**holding of Notes**” and to “**holder of Notes**” shall be construed accordingly) for all purposes other than with respect to payments on such Notes, the right to which shall be vested, as against the Issuer and the Trustee, solely in the nominee for the relevant clearing system (the “**Relevant Nominee**”) in accordance with and subject to the terms of the Global Certificates. Each Accountholder must look solely to Euroclear or Clearstream, Luxembourg, as the case may be, for its share of each payment made to the Relevant Nominee.

2. **Cancellation**

Cancellation of any Note following its redemption or purchase by the Issuer or any of its Subsidiaries will be effected by reduction in the aggregate principal amount of the Notes in the register of Noteholders and by the annotation of the appropriate schedule to the relevant Global Certificate.

3. **Payments**

Payments of principal and interest in respect of Notes represented by a Global Certificate will be made upon presentation or, if no further payment falls to be made in respect of the Notes, against presentation and surrender of such Global Certificate to or to the order of the Registrar or such other Agent as shall have been notified to the holder of the Global Certificate for such purpose.

Distributions of amounts with respect to book-entry interests in the Notes held through Euroclear or Clearstream, Luxembourg will be credited, to the extent received by the Principal Paying Agent, to the cash accounts of Euroclear or Clearstream, Luxembourg participants in accordance with the relevant system’s rules and procedures.

A record of each payment made will be endorsed on the appropriate schedule to the relevant Global Certificate by or on behalf of the Registrar and shall be prima facie evidence that payment has been made.

4. **Notices**

So long as all the Notes are represented by the Global Certificate and such Global Certificate is held on behalf of a clearing system, notices to Noteholders may be given by delivery of the relevant notice to that clearing system for communication by it to entitled Accountholders in substitution for notification as required by the Conditions. The Issuer shall also ensure that notices are duly given in a manner which complies with the rules and regulations of any stock exchange on which the Notes are for the time being listed.

5. Registration of Title

Registration of title to Notes in a name other than that of the Relevant Nominee will not be permitted unless Euroclear or Clearstream, Luxembourg, as appropriate, notifies the Issuer that it is unwilling or unable to continue as a clearing system in connection with a Global Certificate, and a successor clearing system approved by the Trustee is not appointed by the Issuer within 90 days after receiving such notice from Euroclear, Clearstream, Luxembourg. In these circumstances, title to a Note may be transferred into the names of holders notified by the Relevant Nominee in accordance with the Conditions, except that Certificates in respect of Notes so transferred may not be available until 21 days after the request for transfer is duly made.

The Registrar will not register title to the Notes in a name other than that of the Relevant Nominee for a period of 15 calendar days preceding the due date for any payment of principal, or interest in respect of the Notes.

6. Transfers

Transfers of book-entry interests in the Notes will be effected through the records of Euroclear, Clearstream, Luxembourg and their respective participants in accordance with the rules and procedures of Euroclear, Clearstream, Luxembourg and their respective direct and indirect participants.

TAXATION

The statements herein regarding taxation are based on the laws in force as at the date of this document and are subject to any changes in law occurring after such date, which changes could be made on a retroactive basis. The following summary does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a decision to purchase, own or dispose of the Notes and does not purport to deal with the tax consequences applicable to all categories of investors, some of which (such as dealers in securities or commodities) may be subject to special rules.

Hong Kong

The following summary of certain Hong Kong tax consequences of the purchase, ownership and disposition of the Notes is based upon laws, regulations, decisions and practice now in effect, all of which are subject to change (possibly with retroactive effect). The summary does not purport to be a comprehensive description of all the tax considerations that may be relevant to a decision to purchase, own or dispose of the Notes and does not purport to deal with the consequences applicable to all categories of investors, some of which may be subject to special rules. Persons considering the purchase of the Notes should consult their own tax advisors concerning the application of Hong Kong tax laws to their particular situation as well as any consequences of the purchase, ownership and disposition of the Notes arising under the laws of any other taxing jurisdiction.

Withholding tax

Under current Hong Kong legislation, no tax in Hong Kong is required to be withheld from or chargeable on payments of principal or interest in respect of the Notes or in respect of any capital gains arising from the sale of the Notes.

Profits tax

Hong Kong profits tax is chargeable on every person carrying on a trade, profession or business in Hong Kong in respect of profits arising in or derived from Hong Kong from such trade, profession or business (excluding profits arising from the sale of capital assets).

Under the Inland Revenue Ordinance (Cap. 112 of the Law of Hong Kong) (the “**Inland Revenue Ordinance**”) as it is currently applied by the Inland Revenue Department, interest on the Notes is not subject to Hong Kong profits tax except under the following circumstances:

- (i) interest on the Notes is derived from Hong Kong and is received by or accrues to a corporation (other than a financial institution) carrying on a trade, profession or business in Hong Kong; or
- (ii) interest on the Notes is derived from Hong Kong and is received by or accrues to a person, other than a corporation, carrying on a trade, profession or business in Hong Kong and is in respect of the funds of that trade, profession or business; or
- (iii) interest on the Notes is received by or accrues to a financial institution (as defined in the Inland Revenue Ordinance) and arises through or from the carrying on by the financial institution of its business in Hong Kong.

Pursuant to the Exemption from Profits Tax (Interest Income) Order, interest income accruing to a person other than a financial institution on deposits (denominated in any currency and whether or not the deposit is evidenced by a certificate of deposit) placed with, inter alia, a financial institution in Hong Kong (within the meaning of section 2 of the Banking Ordinance (Cap. 155) of Hong Kong) is exempt from the payment of Hong Kong profits tax. This exemption does not apply, however, to deposits that are used to secure or guarantee money borrowed in certain circumstances.

Sums derived from the sale, disposal or redemption of Notes will be subject to Hong Kong profits tax where received by or accrued to a person, other than a financial institution, who carries on a trade, profession or business in Hong Kong and the sum has a Hong Kong source. The source of such sums will generally be determined by having regard to the manner in which the Notes are acquired and disposed of, including where such activities were undertaken.

Sums received by or accrued to a financial institution by way of gains or profits arising through or from the carrying on by the financial institution of its business in Hong Kong from the sale, disposal and redemption of Notes will be subject to profits tax.

Stamp duty

No Hong Kong stamp duty will be chargeable upon the issue or subsequent transfer of a Note.

Estate duty

The Revenue (Abolition of Estate Duty) Ordinance 2005 commenced operation on 11 February 2006. Estates of persons who pass away on or after the commencement date of that ordinance are not subject to Hong Kong estate duty.

EU Savings directive

The European Union has adopted a Directive regarding the taxation of savings income. The Directive requires Member States of the European Economic Area to provide to the tax authorities of other Member States details of payments of interest or other similar income paid by a person to or for an individual in another Member State, except that Austria, Belgium and Luxembourg will instead impose a withholding system for a transitional period unless during such period they elect otherwise.

SUBSCRIPTION AND SALE

Citigroup Global Markets Limited, The Hongkong and Shanghai Banking Corporation Limited and UBS AG (together the “**Managers**”) have, pursuant to a Subscription Agreement dated 12 April 2007, jointly and severally agreed with the Bank, subject to the satisfaction of certain conditions, to subscribe for the Notes at 99.318 per cent. of their principal amount less a combined management and underwriting fee. In addition, the Bank has agreed to reimburse the Managers for certain of their expenses in connection with the issue of the Notes. The Subscription Agreement entitles the Managers to terminate it in certain circumstances prior to payment being made to the Bank.

The Bank has agreed that from the date of this Offering Circular until the date falling 30 days after the Closing Date, it shall ensure that no other international offering of foreign currency denominated debt instruments or debt securities (other than certificates of deposit and for the avoidance of doubt, any financial products offered in the ordinary course of its business by the Bank to its customers) issued or guaranteed by the Bank are either placed or syndicated, directly or on its behalf, in any manner which might, in the opinion of the Managers, have a detrimental effect on the successful placement of the Notes.

United States

The Notes have not been and will not be registered under the Securities Act, and may not be offered or sold within the United States except in accordance with Regulation S or pursuant to any other exemption from, the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S.

Each Manager has represented, warranted and agreed that:

- (1) it has not offered or sold, and will not offer or sell, any Notes constituting part of its allotment except in accordance with Rule 903 of Regulation S; and
- (2) neither it, its affiliates nor any person acting on its or their behalf have engaged or will engage in any directed selling efforts with respect to the Notes.

Terms used in the paragraph above have the meanings given to them by Regulation S under the Securities Act.

In addition, until 40 days after the commencement of the offering of the Notes, an offer or sale of the Notes within the United States by a dealer that is not participating in the offering may violate the registration requirements of the Securities Act.

United Kingdom

Each Manager has represented and agreed that:

- (1) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000 (the “**FSMA**”), received by it in connection with the issue or sale of any Notes in circumstances in which section 21(1) of the FSMA does not apply to the Issuer; and
- (2) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

Hong Kong

Each Manager has represented and agreed that:

- (1) it has not offered or sold and will not offer or sell in Hong Kong, by means of any document, any Notes other than (a) to “professional investors” as defined in the Securities and Futures Ordinance (Cap. 571) (the “SFO”) of Hong Kong and any rules made under the SFO; or (b) in other circumstances which do not result in the document being a “prospectus” as defined in the Companies Ordinance (Cap. 32) (the “CO”) of Hong Kong or which do not constitute an offer to the public within the meaning of the CO; and
- (2) it has not issued or had in its possession for the purposes of issue, and will not issue or have in its possession for the purposes of issue, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to the Notes, which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to Notes which are or are intended to be disposed of only to persons outside Hong Kong or only to “professional investors” as defined in the SFO and any rules made under the SFO.

Singapore

Each Manager has represented and agreed that this Offering Circular has not been registered as a prospectus with the Monetary Authority of Singapore under the Securities and Futures Act, Chapter 289 of Singapore, as amended (the “SFA”). Each Manager has represented, warranted and agreed that the Notes may not be offered or sold or made the subject of an invitation for subscription or purchase nor may the Offering Circular or any other document or material in connection with the offer or sale or invitation for subscription or purchase of any Notes be circulated or distributed, whether directly or indirectly, to any person in Singapore other than (a) to an institutional investor pursuant to Section 274 of the SFA, (b) to a relevant person, or any person pursuant to Section 275(1A) of the SFA, and in accordance with the conditions specified in Section 275 of the SFA, or (c) pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

Note:

Where Notes are subscribed or purchased under Section 275 of the SFA by a relevant person which is:

- (a) a corporation (which is not an accredited investor) (as defined in Section 4A of the SFA) the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or
- (b) a trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary of the trust is an individual who is an accredited investor,

shares, debentures and units of shares and debentures of that corporation or the beneficiaries’ rights and interest (howsoever described) in that trust shall not be transferred within six months after that corporation or that trust has acquired the Notes pursuant to an offer made under Section 275 of the SFA except:

- (i) to an institutional investor (for corporations, under Section 274 of the SFA) or to a relevant person defined in Section 275(2) of the SFA, or to any person pursuant to an offer that is made on terms that such shares, debentures and units of shares and debentures of that corporation or such rights and interest in that trust are acquired at a consideration of not less than S\$200,000 (or its equivalent in a foreign currency) for each transaction, whether such amount is to be paid for in cash or by exchange of securities or other assets, and further for corporations, in accordance with the conditions specified in Section 275 of the SFA;
- (ii) where no consideration is or will be given for the transfer; or
- (iii) where the transfer is by operation of law.

Japan

Each Manager has represented, warranted and undertaken that the Notes have not been and will not be registered under the Securities and Exchange Law of Japan (the “*Securities and Exchange Law*”) and that it has not offered or sold and will not offer or sell any Notes, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organised under the laws of Japan) or to others for re-offering or resale, directly or indirectly, in Japan or to a resident of Japan, except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Securities and Exchange Law and any other applicable laws, regulations and ministerial guidelines of Japan.

Italy

Each Manager has represented, warranted and undertaken that the offering of the Notes has not been registered pursuant to Italian securities legislation and, accordingly, that it has not offered, sold or delivered, and will not offer, sell or deliver, the Notes, and has not and will not distribute copies of the Offering Circular or of any other document relating to the Notes in the Republic of Italy.

GENERAL INFORMATION

- 1 The Notes have been accepted for clearance through Euroclear and Clearstream with the Common Code of 029664501. The International Securities Identification Number (the “*ISIN*”) for the Notes is XS0296645012.
- 2 Application has been made to list the Notes on the SGX-ST. The Notes will be traded on the SGX-ST in a minimum board lot size of US\$200,000 for so long as the Notes are listed on the SGX-ST.
- 3 The Bank has obtained all necessary consents, approvals and authorisations as may be required in connection with the issue and performance of the Notes, including, but not limited to, approval by the HKMA. The issue of the Notes was authorised by resolutions of the Executive Committee of the Bank passed on 12 April 2007.
- 4 Except as disclosed in this Offering Circular, there has been no significant change in the financial or trading position of the Bank or of the Group since 31 December 2006 and there has been no material adverse change in the financial position or prospects of the Bank or of the Group since 31 December 2006.
- 5 Except as disclosed in this Offering Circular, neither the Bank nor any of the Bank’s subsidiaries is involved in any litigation or arbitration proceedings relating to claims or amounts which are material in the context of the issue of the Notes, nor is the Bank or any of the Bank’s subsidiaries aware that any such proceedings are pending or threatened.
- 6 Copies of the following documents may be inspected (and items (a) through (e) inclusive will be made available free of charge) at the office of the Principal Paying Agent in London:
 - (a) Memorandum and Articles of Association of the Bank;
 - (b) copies of the auditors’ reports from KPMG dated 16 March 2006 and 15 March 2007 and the consolidated audited financial statements of the Group for the years ended 31 December 2005 and 31 December 2006;
 - (c) the Trust Deed and the Agency Agreement to be dated on or about 19 April 2007.

Copies of the accountants’ reports and the audited consolidated financial statements referred to above, will be made available in English free of charge at the office of the Principal Paying Agent in London.

- 7 The financial statements of the Bank as at and for the years ended 31 December 2005 and 31 December 2006 included in this Offering Circular have been audited by KPMG, certified public accountants.

KPMG has given and not withdrawn its written consent to the issue of this Offering Circular with references to its auditors’ reports on the published annual consolidated financial statements of the Issuer for the years ended 31 December 2005 and 31 December 2006 in the form and context in which they appear.

KPMG has audited and rendered unqualified audit reports on the consolidated financial statements of the Issuer for the years ended 31 December 2005 and 31 December 2006.

- 8 The Bank publishes annual reports containing the audited consolidated financial statements of the Bank not later than four months after the date upon which the financial period ended. The Bank publishes interim reports containing the unaudited consolidated results of the Bank for the first six months of each financial year not later than three months after the end of that six-month period. The Bank does not publish audited interim consolidated financial statements. The Bank does not publish unconsolidated financial statements other than unconsolidated balance sheets and certain notes to the financial statements which it includes in its annual reports.

Copies of the annual and interim reports (including the financial statements) published by the Bank will be made available free of charge at the office of the Principal Paying Agent in London.

- 9 For so long as the Notes are listed on the SGX-ST and the rules of the SGX-ST so require, and provided only in the event that definitive Notes are issued, the Issuer will appoint and maintain a paying agent in Singapore, where the Notes may be presented or surrendered for payment or redemption. In addition, in the event that definitive Notes are issued, an announcement of such issue shall be made by or on behalf of the Issuer through the SGX-ST and such announcement will include all material information with respect to the delivery of the definitive Notes, including details of the paying agent in Singapore.

APPENDIX I

INDEPENDENT AUDITOR'S REPORT AND AUDITED FINANCIAL STATEMENTS OF THE GROUP FOR THE YEAR ENDED 31 DECEMBER 2006

TO THE SHAREHOLDERS OF WING HANG BANK, LIMITED

(Incorporated in Hong Kong with limited liability)

We have audited the consolidated accounts of Wing Hang Bank, Limited ("the Bank") set out on pages 101 to 168, which comprise the consolidated and the Bank balance sheets as at 31 December 2006, and the consolidated profit and loss account, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the accounts

The Directors of the Bank are responsible for the preparation and the true and fair presentation of these accounts in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of accounts that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these accounts based on our audit. This report is made solely to you, as a body, in accordance with section 141 of the Hong Kong Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the accounts are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the accounts. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the accounts, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the accounts in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Directors, as well as evaluating the overall presentation of the accounts.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated accounts give a true and fair view of the state of affairs of the Bank and of the Group as at 31 December 2006 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

KPMG

Certified Public Accountants

8th Floor, Prince's Building

10 Chater Road

Central, Hong Kong

15 March 2007

Consolidated Profit and Loss Account
For the year ended 31st December, 2006

(Expressed in thousands of Hong Kong dollars unless otherwise stated)

	Note	2006	2005
Interest income.....	5(a)	5,818,646	4,041,779
Interest expense.....	5(b)	(3,899,913)	(2,312,655)
Net interest income		1,918,733	1,729,124
Net interest income on financial instruments held for trading and measured at fair value through profit or loss	5(c)	207,165	135,876
Other operating income.....	5(d)	811,549	755,770
Operating income		2,937,447	2,620,770
Operating expenses.....	5(e)	(1,074,369)	(975,789)
Operating profit before impairment losses and allowances charge on loans and advances		1,863,078	1,644,981
Impairment losses and allowances charge on loans and advances.....	19	(773)	(54,056)
Operating profit.....		1,862,305	1,590,925
Gains on revaluation of investment properties and disposal of tangible fixed assets	6(a)	54,222	22,680
Gains/(losses) on disposal of available-for-sale financial assets.....	6(b)	13,773	(9,048)
Share of net profits of associated companies.....	22	50,951	11,249
Profit before taxation		1,981,251	1,615,806
Taxation.....	7(a)	(319,138)	(264,861)
Profit after taxation		<u>1,662,113</u>	<u>1,350,945</u>
Profit attributable to:			
Shareholders of the Bank	8 & 33	1,660,716	1,348,718
Minority interests.....		1,397	2,227
Profit after taxation		<u>1,662,113</u>	<u>1,350,945</u>
Dividends attributable to the year:			
Interim dividend paid during the year.....		241,260	205,800
Underprovision of final dividend in respect of the previous year.....		96	57
Final dividend proposed after the balance sheet date.....		588,441	470,433
	9	<u>829,797</u>	<u>676,290</u>
		HK\$	HK\$
Earnings per share	12		
Basic		5.65	4.59
Diluted		5.60	4.57
Dividends per share			
Interim		0.82	0.70
Proposed final.....		2.00	1.60
		<u>2.82</u>	<u>2.30</u>

The notes on pages 106 to 168 form part of these accounts

Consolidated Balance Sheet**As at 31st December, 2006***(Expressed in thousands of Hong Kong dollars unless otherwise stated)*

	Notes	2006	2005
ASSETS			
Cash and short-term funds	13 & 37	28,785,949	20,053,798
Placements with banks and other financial institutions maturing			
between one and twelve months	14	3,677,234	2,657,380
Trade bills less impairment allowances	15	370,549	652,375
Trading assets	16	738,392	911,264
Financial assets measured at fair value through profit or loss	17	5,382,956	5,924,424
Advances to customers and other accounts less impairment allowances	18(a)	60,704,258	55,472,883
Held-to-maturity and available-for-sale financial assets	20	19,534,360	15,909,430
Investments in associated companies	22	197,906	146,955
Tangible fixed assets	23		
- Investment properties		258,390	231,447
- Other properties, plants and equipment		1,635,398	1,506,041
Goodwill	24	847,422	847,422
Current tax recoverable	7(c)	1,074	1,211
Deferred tax assets	7(d)	16,679	7,986
Total assets		<u>122,150,567</u>	<u>104,322,616</u>
EQUITY AND LIABILITIES			
Deposits and balances of banks and other financial institutions	25	1,692,887	1,703,026
Deposits from customers	26	102,066,947	85,673,452
Certificates of deposit issued	27	3,715,303	3,824,339
Trading liabilities	28	590,899	865,962
Current tax payable	7(c)	152,706	102,798
Deferred tax liabilities	7(d)	105,274	91,570
Other accounts and provisions	29	1,981,978	1,203,530
Loan capital	30	2,527,850	2,519,888
Total liabilities		<u>112,833,844</u>	<u>95,984,565</u>
Share capital	32	294,221	294,021
Reserves	33	9,002,494	8,021,919
Shareholders' funds		9,296,715	8,315,940
Minority interests		20,008	22,111
Total equity		<u>9,316,723</u>	<u>8,338,051</u>
Total equity and liabilities		<u>122,150,567</u>	<u>104,322,616</u>

Patrick Y B Fung	<i>Chairman and Chief Executive</i>
Frank J Wang	<i>Director and Deputy Chief Executive</i>
Michael Y S Fung	<i>Director and Senior General Manager</i>
Louis C W Ho	<i>Director and Secretary</i>

The notes on pages 106 to 168 form part of these accounts

Balance Sheet**As at 31st December, 2006***(Expressed in thousands of Hong Kong dollars unless otherwise stated)*

	Notes	2006	2005
ASSETS			
Cash and short-term funds	13	26,124,387	18,744,775
Placements with banks and other financial institutions maturing between one and twelve months	14	3,608,960	2,629,507
Trade bills less impairment allowances	15	323,718	412,544
Trading assets	16	749,578	929,710
Financial assets measured at fair value through profit or loss	17	5,382,956	5,924,424
Advances to customers and other accounts less impairment allowances	18(a)	46,524,605	43,220,921
Amounts due from subsidiaries		7,285,939	6,074,285
Held-to-maturity and available-for-sale financial assets	20	18,930,025	15,249,952
Investments in subsidiaries	21	682,707	682,707
Investments in associated companies	22	174,000	174,000
Tangible fixed assets	23		
- Investment properties		10,380	18,300
- Other properties, plants and equipment		1,116,282	1,150,192
Goodwill	24	847,422	847,422
Deferred tax assets	7(d)	9,452	3,479
Total assets		<u>111,770,411</u>	<u>96,062,218</u>
EQUITY AND LIABILITIES			
Deposits and balances of banks and other financial institutions	25	1,673,424	1,694,613
Deposits from customers	26	81,184,068	67,902,897
Certificates of deposit issued	27	3,720,276	3,829,252
Trading liabilities	28	592,379	869,748
Current tax payable	7(c)	106,086	57,750
Deferred tax liabilities	7(d)	79,012	69,251
Other accounts and provisions	29	1,133,815	809,857
Amounts due to subsidiaries		16,100,651	14,201,751
Total liabilities		<u>104,589,711</u>	<u>89,435,119</u>
Share capital	32	294,221	294,021
Reserves	33	6,886,479	6,333,078
Total equity		<u>7,180,700</u>	<u>6,627,099</u>
Total equity and liabilities		<u>111,770,411</u>	<u>96,062,218</u>

Patrick Y B Fung	<i>Chairman and Chief Executive</i>
Frank J Wang	<i>Director and Deputy Chief Executive</i>
Michael Y S Fung	<i>Director and Senior General Manager</i>
Louis C W Ho	<i>Director and Secretary</i>

The notes on pages 106 to 168 form part of these accounts

Consolidated Statement of Changes in Equity

For the year ended 31st December, 2006

(Expressed in thousands of Hong Kong dollars unless otherwise stated)

	Notes	2006	2005
Total equity as at 1st January		8,338,051	7,602,038
Unrealised gains/(losses) on revaluation of available-for-sale financial assets			
after deferred tax charge/credit.....	33	14,378	(20,650)
(Gains)/losses transferred from investment revaluation reserve to current year			
profit or loss account on disposal of available-for-sale financial assets	33	(11,890)	7,424
Unrealised gains on revaluation of bank premises.....	33	11,010	9,297
Deferred tax (charged)/credited to bank premises revaluation reserve	33	(1,440)	2,900
Effects of foreign exchange rate changes.....	33	1,098	(759)
Net gains/(losses) recognised directly in equity.....		13,156	(1,788)
Net profit for the year.....		1,662,113	1,350,945
Total recognised income and expenses for the year.....		1,675,269	1,349,157
Dividends paid	33	(711,789)	(626,149)
Proceeds on shares issued under share option scheme	32 & 33	6,327	4,010
Share premium under Employee Incentive Plan and share option scheme.....	33	12,365	8,995
Ordinary dividends paid to minority interest holder		(3,500)	—
Total equity as at 31st December.....		<u>9,316,723</u>	<u>8,338,051</u>
Total recognised income and expenses for the year attributable to:			
Shareholders of the Bank		1,673,872	1,346,930
Minority interests.....		1,397	2,227
		<u>1,675,269</u>	<u>1,349,157</u>

The notes on pages 106 to 168 form part of these accounts

Consolidated Cash Flow Statement**For the year ended 31st December, 2006***(Expressed in thousands of Hong Kong dollars unless otherwise stated)*

	Note	2006	2005
Net cash inflow from operating activities.....	35(a)	<u>10,343,333</u>	<u>2,158,383</u>
Investing activities			
Purchase of held-to-maturity and available-for-sale financial assets.....		(5,535,348)	(7,397,211)
Sale and redemption of held-to-maturity and available-for-sale financial assets.....		1,927,217	6,603,467
Net cash outflow from acquisition of a subsidiary.....		—	(879)
Purchase of tangible fixed assets.....		(255,228)	(55,899)
Sale of tangible fixed assets.....		<u>82,918</u>	<u>47,551</u>
Net cash outflow from investing activities.....		<u>(3,780,441)</u>	<u>(802,971)</u>
Financing			
Issue of new shares under share option scheme.....		6,327	4,010
Dividends paid.....		(711,789)	(626,149)
Dividends paid to minority interests.....		(3,500)	—
Interest paid on loan capital.....		<u>(134,029)</u>	<u>(134,148)</u>
Net cash outflow from financing activities.....		<u>(842,991)</u>	<u>(756,287)</u>
Increase in cash and cash equivalents.....		5,719,901	599,125
Cash and cash equivalents at 1st January.....		20,968,190	20,375,662
Effects of foreign exchange rate changes.....		<u>9,060</u>	<u>(6,597)</u>
Cash and cash equivalents at 31st December.....	35(b)	<u><u>26,697,151</u></u>	<u><u>20,968,190</u></u>
Cash flows from operating activities included:			
Interest received.....		5,729,738	4,122,265
Interest paid.....		3,927,229	2,020,871
Dividend received.....		8,420	8,038
Analysis of the balances of cash and cash equivalents			
Cash and balances with banks and other financial institutions.....		2,182,173	1,724,925
Money at call and short notice.....		22,829,146	16,638,711
Treasury bills.....		1,226,701	760,393
Placements with banks and other financial institutions with an original maturity between one and three months.....		<u>459,131</u>	<u>1,844,161</u>
		<u><u>26,697,151</u></u>	<u><u>20,968,190</u></u>

The notes on pages 106 to 168 form part of these accounts

Notes to the Accounts:

For the year ended 31st December, 2006

(Expressed in thousands of Hong Kong dollars unless otherwise stated)

1. PRINCIPAL ACTIVITIES

The Bank and its subsidiaries (together referred to as “the Group”) are engaged in commercial banking and related financial services.

2. PRINCIPAL ACCOUNTING POLICIES

(a) Statement of compliance

The accounts have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (“HKFRSs”), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (“HKASs”), and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance. These accounts also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (“the Listing Rules”) and the module on “Financial Disclosure by Locally Incorporated Authorised Institutions” under the Supervisory Policy Manual issued by the Hong Kong Monetary Authority (“HKMA”). A summary of the significant accounting policies adopted by the Group is set out below.

The HKICPA has issued certain new and revised HKFRSs that are first effective or available for early adoption for the current accounting period of the Group and the Bank. The adoption of these new and revised HKFRSs do not result in significant changes to the Group’s and the Bank’s accounting policies applied in these accounts for the years presented. Note 4 provides information on the changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Group for the current and prior accounting periods reflected in these accounts.

(b) Basis of preparation of the accounts

The consolidated accounts for the year ended 31st December, 2006 comprise the Bank and its subsidiaries and the Group’s interest in associated companies. The measurement basis used in the preparation of the accounts is historical cost except that the following assets and liabilities are stated at their fair value as explained in the accounting policies set out below:

- financial instruments classified as trading, measured at fair value through profit or loss and available-for-sale (note 2(f)(ii));
- investment property (note 2(l));
- other freehold land and buildings (note 2(l)); and
- other leasehold land and buildings, for which the fair values cannot be measured separately at the inception of the lease and the entire lease is classified as finance lease (notes 2(l) and 2(m)).

The preparation of accounts in conformity with HKFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of HKFRSs that have significant effect on the accounts and estimates with a significant risk of material adjustment in the next year are discussed in note 3.

(c) Subsidiaries and minority interests

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from their activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

An investment in a subsidiary is consolidated into the consolidated accounts from the date that control commences until the date that control ceases.

Intra-group balances and transactions and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the consolidated accounts. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

Minority interests represent the portion of the net assets of subsidiaries attributable to interests that are not owned by the Bank, whether directly or indirectly through subsidiaries, and in respect of which the Group has not agreed any additional terms with the holders of these interests which would result in the Group as a whole having a contractual obligation in respect of those interests that meet the definition of a financial liability. Minority interests are presented in the consolidated balance sheet within equity, separately from equity attributable to the equity shareholders of the Bank. Minority interests in the results of the Group are presented on the face of the consolidated profit and loss account as an allocation of the total profit or loss for the year between minority interests and the equity shareholders of the Bank.

Where losses applicable to the minority exceed the minority's interest in the equity of a subsidiary, the excess, and any further losses applicable to the minority, are charged against the Group's interest except to the extent that the minority has a binding obligation to, and is able to, make additional investment to cover the losses. If the subsidiary subsequently reports profits, the Group's interest is allocated all such profits until the minority's share of losses previously absorbed by the Group has been recovered.

In the Bank's balance sheet, its investments in subsidiaries are stated at cost less impairment losses, if any (note 2(p)).

(d) Associated companies

An associated company is an entity over which the Group or Bank has significant influence, but not control, or joint control, over its management, including participation in the financial and operating policy decisions.

An investment in an associated company is accounted for in the consolidated accounts under the equity method and is initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of the associated company's net assets. The consolidated profit and loss account includes the Group's share of the post-acquisition, post-tax results of the associated companies for the year, including any impairment loss on goodwill relating to the investment in associated companies recognised for the year (notes 2(e) and 2(p)).

When the Group's share of losses exceeds its interest in the associated company, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associated company. For these purposes, the Group's interest in the associated company is the carrying amount of the investment under equity method together with the Group's long-term interests that in substance form part of the Group's net investment in the associated company.

Unrealised profits and losses resulting from transactions between the Group and its associated companies are eliminated to the extent of the Group's interest in the associated company, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in profit or loss.

In the Bank's balance sheet, its investments in associated companies are stated at cost less impairment losses, if any (note 2(p)).

(e) Goodwill

Goodwill represents the excess of the cost of a business combination or an investment in an associated company over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is tested annually for impairment (note 2(p)). In respect of associated companies, the carrying amount of goodwill is included in the carrying amount of the interest in the associated companies.

Any excess of the Group's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over the cost of a business combination or an investment in an associated company is recognised immediately in the profit and loss account.

On disposal of a cash generating unit, or an associated company during the year, any attributable amount of purchased goodwill is included in the calculation of the profit or loss on disposal.

Expenditure on internally generated goodwill and brand name is recognised as an expense in the period in which it is incurred.

(f) Financial instruments

(i) Initial recognition

The Group classifies its financial instruments into different categories at inception, depending on the purpose for which the assets were acquired or the liabilities were incurred. The categories are: fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets and other financial liabilities.

Financial instruments are measured initially at fair value, which normally will be equal to the transaction price plus, in case of a financial asset or financial liability not held at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset or issue of the financial liability. Transaction costs on financial assets and financial liabilities at fair value through profit or loss are expensed immediately.

The Group recognises financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instrument. A regular way purchase or sale of financial assets is recognised using trade date accounting. From this date, any gains and losses arising from changes in fair value of the financial assets or financial liabilities are recorded.

(ii) Classification

Fair value through profit or loss

This category comprises financial assets and financial liabilities held for trading, and those measured at fair value through profit or loss upon initial recognition, but excludes those investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured.

Trading financial instruments are financial assets or financial liabilities which are acquired or incurred principally for the purpose of trading, or are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivatives that do not qualify for hedge accounting (note 2(h)) are accounted for as trading instruments.

The Group has the option to designate financial instruments at fair value through profit or loss upon initial recognition when:

- the assets or liabilities are managed, evaluated and reported internally on a fair value basis;
- the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise;
- the asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract; or
- the separation of the embedded derivative(s) from the financial instrument is not prohibited.

Financial assets and financial liabilities under this category are carried at fair value. Changes in the fair value are included in the profit and loss account in the period in which they arise. Upon disposal or repurchase, the difference between the net sale proceeds or net payment and the carrying value is included in the profit and loss account.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than (1) those that the Group intends to sell immediately or in the near term, which will be classified as held for trading; (2) those that the Group, upon initial recognition, designates as at fair value through profit or loss or as available-for-sale; or (3) those where the Group may not recover substantially all of its initial investment, other than because of credit deterioration, which will be classified as available-for-sale. Loans and receivables mainly comprise loans and advances to customer and placements with banks and financial institutions.

Securities classified as loans and receivables typically comprise of securities issued by the same customers with whom the Group has a lending relationship that are not quoted in an active market. Investment decisions for credit substitute securities are subject to the same credit approval processes as loans, and the Group bears the same customer risk as it does for loans extended to those customers. Additionally the yield and maturity terms are generally directly negotiated by the Group with the issuer. These securities include commercial paper, short term debentures and preference shares issued by the borrower.

Loans and receivables and securities classified as loans and receivables are carried at amortised cost using the effective interest method, less impairment losses, if any (note 2(p)).

Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity which the Group has the positive intention and ability to hold to maturity, other than (1) those that the Group, upon initial recognition, designates as at fair value through profit or loss or as available for sale; and (2) those that meet the definition of loans and receivables.

Held-to-maturity investments are carried at amortised cost using the effective interest method less impairment losses, if any (note 2(p)).

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated at available-for-sale or are not classified in any of the other three categories above. They include financial assets intended to be held for an indefinite period of time, but which may be sold in response to needs for liquidity or changes in the market environment.

Available-for-sale financial assets are carried at fair value. Unrealised gains and losses arising from changes in the fair value are recognised directly in the investment revaluation reserve, except for impairment losses and foreign exchange gains and losses on monetary items such as debt securities which are recognised in the profit and loss account.

Investments in equity securities that do not have a quoted market price in an active market and whose fair value cannot be measured reliably, and derivatives that are linked to and must be settled by delivery of such unquoted equity securities are carried at cost less impairment losses, if any (note 2(p)).

When the available-for-sale financial assets are sold, gains or losses on disposal include the difference between the net sale proceeds and the carrying value, and the accumulated fair value adjustments which are released from the investment revaluation reserve.

Other financial liabilities

Financial liabilities, other than trading liabilities and those designated at fair value through profit or loss, are measured at amortised cost using the effective interest method.

(iii) Fair value measurement principles

The fair value of financial instruments is based on their quoted market prices at the balance sheet date without any deduction for estimated future selling costs. Financial assets are priced at current bid prices, while financial liabilities are priced at current asking prices.

If there is no publicly available latest traded price nor a quoted market price on a recognised stock exchange or a price from a broker/dealer for non-exchange-traded financial instruments, or if the market for it is not active, the fair value of the instrument is estimated using valuation techniques that provide a reliable estimate of prices which could be obtained in actual market transactions.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market rate at the balance sheet date applicable for an instrument with similar terms and conditions. Where other pricing models are used, inputs are based on market data at the balance sheet date.

(iv) Derecognition

A financial asset is derecognised when the contractual rights to receive the cash flows from the financial asset expire, or where the financial asset together with substantially all the risks and rewards of ownership, have been transferred.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expires.

The Group uses the weighted average method to determine realised gains and losses to be recognised in profit or loss on derecognition.

(v) Offsetting

Financial assets and financial liabilities are offset and the net amount is reported in the balance sheet where there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(vi) Embedded derivatives

An embedded derivative is a component of a hybrid (combined) instrument that includes both the derivative and a host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. The embedded derivatives are separated from the host contract and accounted for as a derivative when (1) the economic characteristics and risks of the embedded derivative are not closely related to the host contract; and (2) the hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in the profit and loss account.

When the embedded derivative is separated, the host contract is accounted for in accordance with note (ii) above.

(g) Repurchase and reverse repurchase transactions

Securities sold subject to a simultaneous agreement to repurchase these securities at a certain later date at a fixed price (repurchase agreements) are retained in the accounts and measured in accordance with their original measurement principles. The proceeds from the sale are reported as liabilities and are carried at amortised cost.

Securities purchased under agreements to resell (reverse repurchase agreements) are reported not as purchases of the securities, but as receivables and are carried in the balance sheet at amortised cost.

Interest earned on reverse repurchase agreements and interest incurred on repurchase agreements are recognised as interest income and interest expense respectively, over the life of each agreement using the effective interest method.

(h) Hedging

Hedge accounting recognises the offsetting effects on profit or loss of changes in the fair values of the hedging instrument and the hedged item. The Group assesses and documents whether the financial instruments that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items attributable to the hedged risks both at hedge inception and on an ongoing basis. The Group discontinues prospectively hedge accounting when (1) the hedging instrument expires or is sold, terminated or exercised; (2) the hedge no longer meets the criteria for hedge accounting; or (3) the Group revokes the designation.

(i) Fair value hedge

A fair value hedge seeks to offset risks of changes in the fair value of recognised asset or liability that will give rise to a gain or loss being recognised in the profit and loss account.

The hedging instrument is measured at fair value, with fair value changes recognised in the profit and loss account. The carrying amount of the hedged item is adjusted by the amount of the changes in fair value of the hedging instrument attributable to the risk being hedged. This adjustment is recognised in the profit and loss account to offset the effect of the gain or loss on the hedging instrument.

When a hedging instrument expires or is sold, terminated or exercised, or the Group revokes designation of the hedge relationship, any adjustment up to that point, to a hedged item for which the effective interest method is used, is amortised to the profit and loss account as part of the recalculated effective interest rate of the item over its remaining life.

(ii) Cash flow hedge

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, or the foreign currency risk of a committed future transaction, the effective part of any gain or loss on remeasurement of the derivative financial instrument to fair value is recognised directly in equity. The ineffective portion of any gain or loss is recognised immediately in the profit and loss account.

If the hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, the associated gain or loss is removed from equity and included in the initial cost or other carrying amount of the non-financial asset or liability.

If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, the associated gain or loss is removed from equity and recognised in the profit and loss account in the same period or periods during which the asset acquired or liability assumed affects the profit and loss account (such as when interest income or expense is recognised).

For all other cash flow hedges, the associated gain or loss is removed from equity and recognised in the profit and loss account in the same period or periods in which the hedged cash flows affect the profit and loss account.

When a hedging instrument expires or is sold, terminated or exercised, or the Group revokes designation of the hedge relationship but the hedged forecast transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, the cumulative unrealised gain or loss recognised in equity is recognised immediately in the profit and loss account.

(iii) Net investment hedge

Hedges of net investment in foreign operations are accounted for similarly to cash flow hedges. The portion of the gain or loss on remeasurement of the hedging instrument that is determined to be an effective hedge is directly recognised in equity until the disposal of the foreign operation, at which time the cumulative gain or loss recognised directly in equity is recognised in the profit and loss account. The ineffective portion is recognised immediately in the profit and loss account.

(iv) Hedge effectiveness testing

The Group expects the hedge to be highly effective (prospective effectiveness) at the inception of the hedge to qualify for hedge accounting. Actual effectiveness (retrospective effectiveness) is also demonstrated on an ongoing basis.

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed. The method which the Group adopts for assessing hedge effectiveness will depend on its risk management strategy.

For fair value hedge relationships, the Group utilises the cumulative dollar offset method or regression analysis as effectiveness testing methodologies. For cash flow hedge relationships, the Group utilises the change in variable cash flow method or the cumulative dollar offset method using the hypothetical derivative approach.

For prospective effectiveness, the hedging instrument must be expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. For actual effectiveness, the changes in fair value or cash flows must offset each other in the range of 80 per cent to 125 per cent for the hedge to be deemed effective.

(i) Revenue recognition

Provided it is probable that economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in the profit and loss account as follows:

(i) Interest income

Interest income for all interest-bearing financial instruments is recognised in the profit and loss account on an accruals basis using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating the interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment, call and similar options) but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

For impaired financial assets, the accrual of interest income based on the original terms of the financial assets is discontinued, but any increase in the present value of impaired financial assets due to the passage of time is reported as interest income.

(ii) Fee and commission income

Fee and commission income is recognised in the profit and loss account when the corresponding service is provided, except where the fee is charged to cover the costs of a continuing service to, or risk borne for, the customer, or is interest in nature. In these cases, the fee is recognised as income in the accounting period in which the costs or risk is incurred and is accounted for as interest income.

Origination or commitment fees received/paid by the Group which result in the creation or acquisition of a financial asset are deferred and recognised as an adjustment to the effective interest rate. When a loan commitment is not expected to result in the draw-down of a loan, loan commitment fees are recognised in a straight line basis over the commitment period.

(iii) Finance income from finance lease and hire purchase contract

Finance income implicit in finance lease and hire purchase payments is recognised as interest income over the period of the leases so as to produce an approximately constant periodic rate of return on the outstanding net investment in the leases for each accounting period. Contingent rentals receivable are recognised as income in the accounting period in which they are earned.

(iv) Rental income from operating lease

Rental income received under operating leases is recognised as other operating income in equal instalments over the periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives granted are recognised in the profit and loss account as an integral part of the aggregate net lease payments receivable. Contingent rentals receivable are recognised as income in the accounting period in which they are earned.

(v) Dividend income

Dividend income from unlisted investments is recognised when the shareholder's right to receive payment is established. Dividend income from listed investments is recognised when the share price of the investment goes ex-dividend.

(j) Income tax

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in the profit and loss account except to the extent that they relate to items recognised directly in equity, in which case they are recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of prior years.

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that taxable profits will be available, against which deductible temporary differences can be utilised.

Deferred tax is calculated at the tax rates that are expected to apply in the year when the liability is settled or the asset is realised. Deferred tax assets and liabilities are not discounted. The carrying amount of deferred tax assets is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the related tax benefit to be utilised. Any such deduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available. Additional income taxes that arise from the distribution of dividends are recognised when the liability to pay the related dividends is recognised.

Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities if the Bank or the Group has the legally enforceable right to set off current tax assets against current tax liabilities. The principle of offsetting usually applies to income tax levied by the same tax authority on the same taxable entity.

(k) Translation of foreign currencies

Foreign currency transactions during the year are translated into Hong Kong dollars at the foreign exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the foreign exchange rates ruling at the balance sheet date. Exchange gains and losses are recognised in the profit and loss account.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated into Hong Kong dollars using the foreign exchange rates ruling at the transaction dates. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated using the foreign exchange rates ruling at the dates the fair value was determined.

Exchange differences relating to investments at fair value through profit or loss and derivative financial instruments are included in net realised and unrealised gains / losses on trading financial instruments or financial instruments measured at fair value through profit or loss. All other exchange differences relating to monetary items are presented as gains/losses arising from dealing in foreign currencies in the profit and loss account.

The results of overseas operation are translated into Hong Kong dollars at the exchange rates approximating the foreign exchange rates ruling at the dates of the transactions. Balance sheet items are translated into Hong Kong dollars at the foreign exchange rates ruling at the balance sheet date. The resulting exchange differences are recognised directly in a separate component of equity.

On disposal of an overseas operation, the cumulative amount of the exchange differences recognised in equity which relate to that overseas operation is included in the calculation of the profit or loss on disposal.

(l) Tangible fixed assets and depreciation

- (i) Bank premises are stated in the balance sheet at cost or at directors' valuation, by reference to an independent professional valuation, less accumulated depreciation and impairment losses. In preparing these accounts, advantage has been taken of the transitional provisions set out in paragraph 80A of HKAS 16 "Property, Plant and Equipment" issued by the HKICPA, with the effect that bank premises have not been revalued to fair value at the balance sheet date.
- (ii) Equipment, comprising furniture, plant and other equipment, is stated at cost less depreciation calculated on a straight-line basis to write off the assets over their estimated useful lives, which are generally between three to ten years.
- (iii) No amortisation is provided on freehold land. Leasehold land (note 2(m)) is amortised in equal annual instalments over the remaining term of the lease. Buildings are amortised by equal instalments over the estimated useful lives which in no case exceed fifty years.
- (iv) Investment properties are land and/or buildings which are owned and/or held under a leasehold interest (note 2(m)) to earn rental income and/or for capital appreciation. These include land held for a currently undetermined future use, which are stated in the balance sheet at their open market values which are assessed annually by professional qualified valuers. Any gain or loss arising from a change in fair value or from the retirement or disposal of an investments properties is recognised in the profit and loss account.

(m) Finance and operating leases

An arrangement, comprising a transaction or a series of transactions, is or contains a lease if the Group determines that the arrangement conveys a right to use a specific asset or assets for an agreed period of time in return for a payment or a series of payments. Such a determination is made based on an evaluation of the substance of the arrangement and is regardless of whether the arrangement takes the legal form of a lease.

(i) Classification of assets leased to the Group

Assets that are held by Group under leases which transfer to the Group substantially all the risks and rewards of ownership are classified as being held under finance leases. Leases which do not transfer substantially all the risks and rewards of ownership to the Group are classified as operating leases.

(ii) Finance leases

Where the Group is a lessor under finance leases, an amount representing the net investment in the lease is included in the balance sheet as “Advances to customers”. Hire purchase contracts having the characteristics of finance leases are accounted for in the same manner as finance leases. Impairment losses are accounted for in accordance with the accounting policy as set out in note 2(p).

(iii) Operating leases

Where the Group leases out assets under operating leases, the assets are included in the balance sheet according to their nature and, where applicable, are depreciated in accordance with the Group’s depreciation policies, as set out in note 2(l)(ii) except where the asset is classified as an investment property. Impairment losses are accounted for in accordance with the accounting policy as set out in note 2(p). Revenue arising from operating leases is recognised in accordance with the Group’s revenue recognition policies, as set out in note 2(i)(iv).

Where the Group has the use of assets held under operating leases, payments made under the leases are charged to profit and loss account in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives received are recognised in profit and loss account as an integral part of the aggregate net lease payments made. Contingent rentals are charged to the profit and loss account in the accounting period in which they are incurred.

The cost of acquiring land held under an operating lease is amortised on a straight-line basis over the period of the lease term except where the property is classified as an investment property (note 2(l)(iv)).

(n) Repossessed assets

In the recovery of impaired loans and advances, the Group may take possession of the collateral assets through court proceedings or voluntary delivery of possession by the borrowers. In accordance with the Group’s accounting policy set out in note 2(p), impairment allowances for impaired loans and advances are maintained after taking into account the net realisable value of the repossessed assets. Repossessed assets continue to be treated as securities for loans and advances.

Repossessed assets are recorded at the lower of their carrying amount of the related loans and advances and fair value less costs to sell at the date. They are not depreciated or amortised.

(o) Financial guarantees issued, provisions and contingent liabilities

(i) Financial guarantees issued

Financial guarantees are contracts that require the issuer (i.e. the guarantor) to make specified payments to reimburse the beneficiary of the guarantee (“the holder”) for a loss the holder incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Where the Group issues a financial guarantee to customers, the fair value of the guarantee (being the guarantee fees received) is initially recognised as deferred income within other liabilities. Where the Bank issues a financial guarantee to its subsidiaries, the fair value of the guarantee is estimated and capitalised as the cost of investment in subsidiaries and deferred income within “Other accounts and provisions”.

The deferred income is amortised in the profit and loss account over the term of the guarantee as income from financial guarantees issued. In addition, provisions are recognised in accordance with note 2(o)(ii) if and when (1) it becomes probable that the holder of the guarantee will call upon the Group under the guarantee, and (2) the amount of that claim on the Group is expected to exceed the amount currently carried in other liabilities in respect of that guarantee i.e. the amount initially recognised, less accumulated amortisation.

(ii) Other provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group or Bank has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(p) Impairment of assets

The carrying amount of the Group's assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, the carrying amount is reduced to the estimated recoverable amount by means of a charge to the profit and loss account.

(i) Loans and receivables

Impairment losses on loans and receivables are measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets). Receivables with a short duration are not discounted if the effect of discounting is immaterial.

The total allowance for credit losses consists of two components: individual impairment allowances, and collective impairment allowances.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

The individual impairment allowance is based upon management's best estimate of the present value of the cash flows which are expected to be received discounted at the original effective interest rate. In estimating these cash flows, management makes judgments about the borrower's financial situation and the net realisable value of any underlying collateral or guarantees in favour of the Group. Each impaired asset is assessed on its own merits.

In assessing the need for collective loan loss allowances, management considers factors such as credit quality, portfolio size, concentrations, and economic factors. In order to estimate the required allowance, the Group makes assumptions both to define the way the Group models inherent losses and to determine the required input parameters, based on historical experience and current economic conditions.

The accuracy of the impairment allowances the Group makes depends on how well the Group can estimate future cash flows for individually assessed impairment allowances and the model assumptions and parameters used in determining collective impairment allowances. While this necessarily involves judgment, the Group believes that the impairment allowances on advances to customers are reasonable and supportable.

Any subsequent changes to the amounts and timing of the expected future cash flows compared to the prior estimates that can be linked objectively to an event occurring after the write-down, will result in a change in the impairment allowances on loans and receivables and be charged or credited to the profit and loss account. A reversal of impairment losses is limited to the loans and receivables' carrying amount that would have been determined had no impairment loss been recognised in prior years.

When there is no reasonable prospect of recovery, the advances and the related interest receivables are written off.

(ii) Held-to-maturity investments

Impairment on held-to-maturity investments is considered at both individual and collective level. The individual impairment allowance is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the asset's original effective interest rate, where the effect of discounting is material.

All significant assets found not to be individually impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Assets that are not individually significant are then collectively assessed for impairment by grouping together financial assets with similar risk characteristics.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the profit and loss account. A reversal of impairment losses shall not result in the asset's carrying amount exceeding that which would have been determined had no impairment loss been recognised in prior years.

(iii) Available-for-sale financial assets

When there is objective evidence that an available-for-sale financial asset is impaired, the cumulative loss that had been recognised directly in equity is removed from equity and is recognised in profit and loss account. The amount of the cumulative loss that is recognised in the profit and loss account is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised in the profit and loss account.

For unquoted available-for-sale equity securities that are carried at cost, the impairment loss is measured as the difference between the carrying amount of the equity securities and the estimated future cash flows, discounted at the current market rate of return for a similar financial asset where the effect of discounting is material.

Impairment losses recognised in the profit and loss account in respect of available-for-sale equity securities are not reversed through the profit and loss account. Any subsequent increase in the fair value of such assets is recognised directly in equity.

Impairment losses in respect of available-for-sale debt securities are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in the profit and loss account.

(iv) Other assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or, except in the case of goodwill, an impairment loss previously recognised no longer exists or may have decreased:

- tangible fixed assets (other than properties carried at revalued amounts);
- investments in subsidiaries and associated companies; and
- goodwill.

If any such indication exists, the asset's recoverable amount is estimated. In addition, for goodwill, the recoverable amount is estimated annually whether or not there is any indication of impairment.

— *Calculation of recoverable amount*

The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

— *Recognition of impairment losses*

An impairment loss is recognised in the profit and loss account whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

— *Reversals of impairment losses*

In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is not reversed.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to the profit and loss account in the year in which the reversals are recognised.

(v) Interim financial reporting and impairment

Under the Listing Rules, the Group is required to prepare an interim financial report in compliance with HKAS 34, *Interim financial reporting*, in respect of the first six months of the year. At the end of the interim period, the Group applies the same impairment testing, recognition, and reversal criteria as it would at the end of the year (notes 2(p)(i) to 2(p)(iv)).

Impairment losses recognised in an interim period in respect of goodwill and available-for-sale equity securities carried at cost are not reversed in a subsequent period. This is the case even if no loss, or a smaller loss, would have been recognised had the impairment been assessed only at the end of the year to which the interim period relates.

(q) Related parties

For the purposes of these accounts, a party is considered to be related to the Group if:

- (i) the party has the ability, directly or indirectly through one or more intermediaries, to control the Group or exercise significant influence over the Group in making financial and operating policy decisions, or has joint control over the Group;
- (ii) the Group and the party are subject to common control;
- (iii) the party is an associated company of the Group;
- (iv) the party is a member of key management personnel of the Group or the Group's parent, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals;
- (v) the party is a close family member of a party referred to in (i) or is an entity under the control, joint control or significant influence of such individuals; or
- (vi) the party is a post-employment benefit plan which is for the benefit of employees of the Group or of any entity that is a related party of the Group.

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity.

(r) Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

In accordance with the Group's internal reporting system, the Group has chosen business segment information as the primary reporting format and geographical segment information as the secondary reporting format for the purposes of these accounts.

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment. Segment revenue, expenses, assets and liabilities are determined before intra-group balances and intra-group transactions are eliminated as part of the consolidation process, except to the extent that such intra-group balances and transactions are between entities of the Group within a single segment. Inter-segment pricing is based on similar terms as those available to other external parties.

Segment capital expenditure is the total cost incurred during the year to acquire segment assets (both tangible and intangible) that are expected to be used for more than one year.

(s) Cash and cash equivalents

Cash and cash equivalents comprise cash and balances with banks and other financial institutions, and short-term, highly liquid inter-bank placements and investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition. Balances of banks and other financial institutions that are repayable on demand and form an integral part of the Group's cash management are also included as a component of cash and cash equivalents for the purposes of the cash flow statement.

(t) Employee benefits

- (i) Salaries, annual bonuses, paid annual leave and the cost to the Group of non-monetary benefits are accrued in the year in which the associated services are rendered by employees of the Group.
- (ii) Contributions to Mandatory Provident Funds as required under the Hong Kong Mandatory Provident Funds Scheme Ordinance are recognised as an expense in the profit and loss account when incurred.

- (iii) When the Group grants employees options to acquire shares of the Bank, the considerations received are recognised in the balance sheet as “Other accounts and provisions” at the date of grant. The fair value of the options is measured at the grant date and is charged to the profit and loss account and credited to shareholders’ funds between the grant date and the vesting date. When the options are exercised, shareholders’ funds are increased by the amount of the proceeds and consideration received.
- (iv) When the Group grants employees awards to acquire shares of the Bank under the Employee Incentive Plan (“EIP”). The fair value of the awards is measured at the grant date and is charged to the profit and loss account and credited to shareholders’ funds between the grant date and the vesting date. The cash amount equal to the dividend that would have been paid during the period up to vesting will be charged to the profit and loss account as bonus expenses on an accruals basis.

3. ACCOUNTING ESTIMATES AND JUDGEMENTS

Notes 23, 24, 40 and 41 contain information about the assumptions and their risk factors relating to valuation of investment property, goodwill impairment, fair value of share options granted and fair value of financial instruments. Other key sources of estimation uncertainty are as follows:

(a) Key sources of estimation uncertainty

Impairment losses

(i) *Loans and advances*

Loan portfolios are reviewed periodically to assess whether impairment losses exist. The Group makes judgements as to whether there is any objective evidence that a loan portfolio is impaired, i.e. whether there is a decrease in estimated future cash flows. Objective evidence for impairment includes observable data that the payment status of borrowers in a group has adversely changed. It may also include observable data about local or economic conditions that correlate with defaults on the assets in the group. If management has determined, based on their judgement, that objective evidence of impairment exists, expected future cash flows are estimated based on historical loss experience for assets with credit risk characteristics similar to those of the group. Historical loss experience is adjusted on the basis of the current observable data. Management reviews the methodology and assumptions used in estimating future cash flows regularly to reduce any difference between loss estimates and actual loss experience.

(ii) *Available-for-sale equity securities*

The Group determines that available-for-sale equity securities are impaired when there has been a significant or prolonged decline in the fair value below cost. The determination of when a decline in fair value below cost is not recoverable within a reasonable time period is judgmental by nature, so profit and loss could be affected by differences in this judgement.

(b) Critical accounting judgements in applying the Group’s accounting policies

Certain critical accounting judgements in applying the Group’s accounting policies are described below.

(i) *Held-to-maturity investments*

The Group classifies non-derivative financial assets with fixed or determinable payments and fixed maturity and where the Group has a positive intention and ability to hold to maturity as held-to-maturity investments. In making this judgement, the Group evaluates its intention and ability to hold such investments till maturity.

If the Group fails to hold these investments to maturity other than for certain specific circumstances, the Group will have to reclassify the entire portfolio of held-to-maturity investments as available-for-sale, as such class is deemed to have been tainted.

This would result in held-to-maturity investments being measured at fair value instead of at amortised cost.

(ii) *Investment property*

The Group has temporarily sub-let certain vacant properties but has decided not to treat the property as an investment property because it is not the Group’s intention to hold the property in the long-term for capital appreciation or rental income. Accordingly, the property has still been treated as a building held for own use.

4. CHANGES IN ACCOUNTING POLICIES

The HKICPA has issued certain new and revised HKFRSs that are effective or available for early adoption for the current accounting period of the Group.

With effect from 1st January 2006, the Group has adopted the following new and revised HKFRSs which are pertinent to its operations and relevant to these accounts:

- Amendments to HKAS 39, *Financial instruments: Recognition and measurement: Financial guarantee contracts*;
- Amendments to HKAS 39, *Financial instruments: Recognition and measurement: Fair value option*; and
- HK(IFRIC) 10, *Interim financial reporting and impairment*.

Note 2 summarises the accounting policies of the Group after the adoption of these developments to the extent that they are relevant to the Group. The Group assesses the adoption of each of the above developments and has determined that there is no material impact on the basis of preparation of these accounts and accordingly no comparatives have been restated.

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (note 42) except for HK(IFRIC) 10, *Interim financial reporting and impairment*, which is effective for accounting periods beginning on or after 1st November, 2006.

5. OPERATING PROFIT

(a) Interest income

	2006	2005
Placement with banks and other financial institutions	1,104,734	909,644
Advances to customers and trade bills	3,659,849	2,515,713
Listed investments	341,456	58,361
Unlisted investments.....	708,792	522,511
Others	3,815	35,550
	<u>5,818,646</u>	<u>4,041,779</u>

Interest income from advances to customers and trade bills includes the amount of interest income of HK\$19,124,000 (2005: HK\$22,824,000) accrued on impaired financial assets, which includes interest income on unwinding of discount on loan impairment loss of HK\$2,672,000 (2005: HK\$10,465,000) (Note 19) for the year ended 31st December, 2006.

(b) Interest expenses

	2006	2005
Deposits and balances of banks and other financial institutions	95,552	66,375
Deposits from customers	3,553,702	2,051,916
Certificates of deposit issued.....	103,539	60,216
Loan capital	134,029	134,148
Others	13,091	—
	<u>3,899,913</u>	<u>2,312,655</u>

(c) Net interest income on financial instruments held for trading and measured at fair value through profit or loss

	2006	2005
Trading assets	1,014	138
Trading liabilities.....	(106)	(562)
Financial assets measured at fair value through profit or loss	239,650	234,309
Financial liabilities measured at fair value through profit or loss	(110,319)	(84,776)
Trading financial derivative assets	99,690	55,869
Trading financial derivative liabilities.....	(22,764)	(69,102)
	<u>207,165</u>	<u>135,876</u>

(d) Other operating income

	2006	2005
Fees and commissions		
Credit commission and fees	106,413	120,456
Credit card related fees	82,231	67,947
Trade related fees	83,827	80,605
Insurance commission	53,435	56,761
Stockbroking fees	105,433	58,147
Other fees and commission income	198,645	173,087
Less: Fees and commission expenses	(35,993)	(36,041)
	593,991	520,962
Gains arising from dealing in foreign currencies	165,832	113,480
Gains on other dealing activities	4,077	981
Net realised and unrealised gains on trading financial instruments	77,312	33,038
Net realised and unrealised (losses)/gains on financial instruments measured at fair value through profit or loss	(59,480)	59,531
Dividend income from unlisted available-for-sale investments	7,405	6,071
Dividend income from listed available-for-sale investments	483	1,629
Dividend income from listed trading investments	314	149
Others	21,615	19,929
	<u>811,549</u>	<u>755,770</u>

(e) Operating expenses

	2006	2005
Staff costs		
Salaries and other staff costs	661,355	579,729
Retirement benefit costs (Note 40(a))	40,467	36,267
Share option scheme cost (Note 35(a))	—	6,588
EIP cost (Note 35(a))	12,365	3,372
	714,187	625,956
Premises and equipment expenses, excluding depreciation	116,211	105,179
Depreciation (Notes 23 & 36(a))	81,242	75,407
Auditor's remuneration		
Audit services	3,380	3,238
Tax services	584	532
Other services	50	868
	4,014	4,638
Impairment losses on goodwill (Notes 24 & 36(a))	—	1,170
Others	158,715	163,439
	<u>1,074,369</u>	<u>975,789</u>

6. (a) Gains on revaluation of investment properties and disposal of tangible fixed assets

	2006	2005
Unrealised revaluation gain of investment properties	15,568	12,797
Net profit on disposal of tangible fixed assets	38,654	9,883
	<u>54,222</u>	<u>22,680</u>

(b) Gains/(losses) on disposal of available-for-sale financial assets

	<u>2006</u>	<u>2005</u>
Net unrealised gains/(losses) transferred from investment revaluation reserve (Note 33)	11,890	(7,424)
Gains/(losses) on disposal of available-for-sale financial assets	<u>1,883</u>	<u>(1,624)</u>
	<u>13,773</u>	<u>(9,048)</u>

7. TAXATION**(a) Taxation in the consolidated profit and loss account represents:**

	<u>2006</u>	<u>2005</u>
Current tax — Provision for Hong Kong profits tax		
Provision for the year	284,091	239,151
Overprovision in respect of prior years	<u>(13,805)</u>	<u>(6,866)</u>
	<u>270,286</u>	<u>232,285</u>
Current tax — Provision for overseas tax		
Provision for the year	45,821	32,609
Overprovision in respect of prior years	<u>(2)</u>	<u>(6,779)</u>
	<u>45,819</u>	<u>25,830</u>
Deferred taxation		
Origination and reversal of temporary differences	3,033	7,423
Effect of decrease in overseas tax rate on deferred tax balances at 1st January	<u>—</u>	<u>(677)</u>
	<u>3,033</u>	<u>6,746</u>
	<u>319,138</u>	<u>264,861</u>

The provision for Hong Kong profits tax is calculated at 17.5% (2005: 17.5%) of the Group's estimated assessable profits for the year ended 31st December, 2006. The provision for overseas taxation is provided at the appropriate current rates of taxation ruling in the countries in which the relevant units of the Group operate.

(b) Reconciliation between tax expenses and accounting profit at applicable tax rates:

	<u>2006</u>		<u>2005</u>	
		%		%
Profit before tax	<u>1,981,251</u>	<u>100.00</u>	<u>1,615,806</u>	<u>100.00</u>
Notional tax on profit before tax, calculated at the rates applicable to profits in the countries concerned	330,010	16.66	267,845	16.57
Tax effect of non-deductible expenses	16,143	0.81	18,588	1.15
Tax effect of non-taxable revenue	(37,330)	(1.88)	(9,147)	(0.57)
Tax effect of unused tax losses not recognised	2,632	0.13	1,897	0.12
Effect on opening deferred tax balances resulting from a decrease in tax rate during the year	—	—	(677)	(0.04)
Others	21,490	1.09	—	—
Overprovision in respect of prior years	<u>(13,807)</u>	<u>(0.70)</u>	<u>(13,645)</u>	<u>(0.84)</u>
	<u>319,138</u>	<u>16.11</u>	<u>264,861</u>	<u>16.39</u>

(c) **Current tax recoverable and payable**

The components of current tax recoverable and payable in the balance sheets are as follows:

	The Group		The Bank	
	2006	2005	2006	2005
Current tax recoverable				
Provision for Hong Kong profits tax	1,074	1,211	—	—
Current tax payable				
Provision for Hong Kong profits tax	115,484	67,760	103,360	53,641
Provision for overseas tax	37,222	35,038	2,726	4,109
	152,706	102,798	106,086	57,750

All current tax recoverable and payable are expected to be settled within one year.

(d) **Deferred tax assets and liabilities recognised**

The components of deferred tax (assets)/liabilities recognised in the balance sheets and the movements during the year are as follows:

	The Group						
	2006						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Revaluation of available-for-sale financial assets	Collective impairment allowances for loans and advances	Tax losses	Others	Total
At 1st January, 2006	30,755	84,818	2,446	(31,758)	(2,540)	(137)	83,584
Charged/(credited) to consolidated profit and loss account	(1,893)	(4,924)	—	11,641	(470)	(1,321)	3,033
Charged to reserves	—	1,440	538	—	—	—	1,978
At 31st December, 2006	28,862	81,334	2,984	(20,117)	(3,010)	(1,458)	88,595

	The Group						
	2005						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Revaluation of available-for-sale financial assets	Collective impairment allowances for loans and advances	Tax losses	Others	Total
At 1st January, 2005	28,944	85,479	4,835	(34,491)	(2,640)	—	82,127
Charged/(credited) to consolidated profit and loss account	1,811	2,239	—	2,733	100	(137)	6,746
Credited to reserves	—	(2,900)	(2,389)	—	—	—	(5,289)
At 31st December, 2005	30,755	84,818	2,446	(31,758)	(2,540)	(137)	83,584

The Bank						
2006						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Revaluation of available-for-sale financial assets	Collective impairment allowances for loans and advances	Others	Total
At 1st January, 2006.....	25,536	69,404	2,443	(31,474)	(137)	65,772
Charged/(credited) to profit and loss account.....	(2,215)	347	—	7,754	(1,321)	4,565
(Credited)/charged to reserves.....	—	(1,205)	428	—	—	(777)
At 31st December, 2006.....	<u>23,321</u>	<u>68,546</u>	<u>2,871</u>	<u>(23,720)</u>	<u>(1,458)</u>	<u>69,560</u>

The Bank						
2005						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Revaluation of available-for-sale financial assets	Collective impairment allowances for loans and advances	Others	Total
At 1st January, 2005.....	24,032	73,021	4,522	(34,692)	—	66,883
Charged/(credited) to profit and loss account.....	1,504	910	—	3,218	(137)	5,495
Credited to reserves.....	—	(4,527)	(2,079)	—	—	(6,606)
At 31st December, 2005.....	<u>25,536</u>	<u>69,404</u>	<u>2,443</u>	<u>(31,474)</u>	<u>(137)</u>	<u>65,772</u>

	The Group		The Bank	
	2006	2005	2006	2005
Net deferred tax assets recognised on the balance sheets.....	(16,679)	(7,986)	(9,452)	(3,479)
Net deferred tax liabilities recognised on the balance sheets.....	<u>105,274</u>	<u>91,570</u>	<u>79,012</u>	<u>69,251</u>
	<u>88,595</u>	<u>83,584</u>	<u>69,560</u>	<u>65,772</u>

8. PROFIT ATTRIBUTABLE TO THE SHAREHOLDERS OF THE BANK

The profit attributable to the shareholders of the Bank includes an amount of HK\$1,242,954,000 (2005: HK\$1,124,275,000) which has been dealt with in the accounts of the Bank.

9. DIVIDENDS

(a) Dividends attributable to the year

	2006	2005
Interim dividend declared and paid of HK\$0.82 (2005: HK\$0.70) per ordinary share on 294,220,500 shares (2005: 294,000,500 shares).....	241,260	205,800
Underprovision of final dividend in respect of the prior year.....	96	57
Final dividend proposed after the balance sheet date of HK\$2.00 (2005: HK\$1.60) per ordinary share on 294,220,500 shares (2005: 294,020,500 shares).....	<u>588,441</u>	<u>470,433</u>
	<u>829,797</u>	<u>676,290</u>

The final dividend proposed after the balance sheet date has not been recognised as a liability at the balance sheet date.

(b) Dividends attributable to the previous year, approved and paid during the year

	2006	2005
Final dividend in respect of the prior year, approved and paid during the year, of HK\$1.60 (2005: HK\$1.43) per ordinary share on 294,080,500 shares (2005: 293,950,500 shares).....	470,529	420,349

10. DIRECTORS' EMOLUMENTS

Directors' emoluments disclosed pursuant to section 161 of the Hong Kong Companies Ordinance are as follows:

2006							
	Directors' fee	Salaries and other emoluments	Pension contributions	Performance bonuses	Sub-total	Share-based payment	Total
Chairman							
Patrick Y B Fung.....	229	5,720	660	7,573	14,182	3,845	18,027
Executive directors							
Frank J Wang.....	115	2,700	—	4,956	7,771	2,331	10,102
Michael Y S Fung	115	2,874	331	3,786	7,106	1,923	9,029
Louis C W Ho	115	1,609	186	824	2,734	48	2,782
Non-executive directors							
Aloysius H Y Tse	100	89	—	—	189	—	189
Ambrose H C Lau	100	—	—	—	100	—	100
Andrew M Gordon	100	50	—	—	150	—	150
Cheng Hon Kwan	100	50	—	—	150	—	150
David Drabkin	100	—	—	—	100	—	100
Kenneth A Lopian.....	100	—	—	—	100	—	100
Simon K Y Lee.....	100	50	—	—	150	—	150
Tung Chee Chen.....	100	—	—	—	100	—	100
Total.....	1,374	13,142	1,177	17,139	32,832	8,147	40,979

2005							
	Directors' fee	Salaries and other emoluments	Pension contributions	Performance bonuses	Sub-total	Share-based payment	Total
Chairman							
Patrick Y B Fung.....	229	5,200	600	4,026	10,055	1,908	11,963
Executive directors							
Frank J Wang.....	115	2,460	—	2,666	5,241	1,356	6,597
Michael Y S Fung	115	2,704	312	2,013	5,144	1,234	6,378
Louis C W Ho	115	1,609	186	571	2,481	798	3,279
Non-executive directors							
Alan R Griffith.....	100	—	—	—	100	—	100
Aloysius H Y Tse	100	89	—	—	189	—	189
Ambrose H C Lau	100	—	—	—	100	—	100
Andrew M Gordon	100	50	—	—	150	—	150
Cheng Hon Kwan	100	50	—	—	150	—	150
Kenneth A Lopian.....	100	—	—	—	100	—	100
Simon K Y Lee.....	100	50	—	—	150	—	150
Tung Chee Chen.....	100	—	—	—	100	—	100
Total.....	1,374	12,212	1,098	9,276	23,960	5,296	29,256

The above share-based payments are fair value of share options and awards granted under the Group's Share Option Scheme and EIP. The details of these benefits in kind are disclosed under "Share Option Scheme" and "Employee Incentive Plan" in Note 40(b).

11. EXECUTIVES' EMOLUMENTS

The five highest paid individuals include three (2005: four) directors, details of whose emoluments are set out in Note 10. The emoluments of the remaining two (2005: one) individuals are as follows:

	2006	2005
Salaries and other emoluments	4,107	1,922
Pension contributions	472	220
Performance bonuses	3,351	1,200
Share-based payment	880	554
	<u>8,810</u>	<u>3,896</u>

The emoluments of the executives are within the following band:

	2006	2005
	Number of executives	Number of executives
HK\$3,500,001 - HK\$4,000,000	—	1
HK\$4,000,001 - HK\$4,500,000	2	—
	<u>2</u>	<u>1</u>

12. EARNINGS PER SHARE

The calculation of basic earnings per share is based on profit attributable to the Bank's shareholders of HK\$1,660,716,000 (2005: HK\$1,348,718,000) and on the weighted average number of ordinary shares of 294,126,856 shares (2005: 293,970,062 shares) in issue during the year.

	2006	2005
	Number of shares of HK\$1.00 each	Number of shares of HK\$1.00 each
Issued ordinary shares at 1st January	294,020,500	293,910,500
Effect of share option exercised	106,356	59,562
Weighted average number of ordinary shares used in calculating basic earnings per share	<u>294,126,856</u>	<u>293,970,062</u>

The calculation of diluted earnings per share is based on profit attributable to the Bank's shareholders of HK\$1,660,716,000 (2005: HK\$1,348,718,000) and on the weighted average number of ordinary shares of 296,657,181 shares (2005: 294,844,825 shares) in issue during the year after adjustment for the effects of all dilutive potential ordinary shares of 2,530,325 shares (2005: 874,763 shares).

	2006	2005
	Number of shares of HK\$1.00 each	Number of shares of HK\$1.00 each
Weighted average number of ordinary shares used in calculating basic earnings per share	294,126,856	293,970,062
Deemed exercise of share option scheme	504,647	733,918
Deemed exercise of EIP	2,025,678	140,845
Weighted average number of ordinary shares used in calculating diluted earnings per share	<u>296,657,181</u>	<u>294,844,825</u>

13. CASH AND SHORT-TERM FUNDS

	The Group		The Bank	
	2006	2005	2006	2005
Cash and balances with banks and other financial institutions	2,253,725	1,781,679	1,691,086	1,387,648
Money at call and short notice	23,847,991	16,998,025	23,835,729	16,958,098
Treasury bills	2,684,233	1,274,094	597,572	399,029
	<u>28,785,949</u>	<u>20,053,798</u>	<u>26,124,387</u>	<u>18,744,775</u>

Cash and balances with banks and other financial institutions are analysed as follows:

	The Group		The Bank	
	2006	2005	2006	2005
Cash balances	446,035	381,624	241,618	271,043
Balances and placement with central banks	387,073	413,531	143,744	228,574
Balances and placement with banks and other financial institutions	1,420,617	986,524	1,305,724	888,031
	<u>2,253,725</u>	<u>1,781,679</u>	<u>1,691,086</u>	<u>1,387,648</u>

Money at call and short notice are analysed as follows:

	The Group		The Bank	
	2006	2005	2006	2005
Placement with banks	<u>23,847,991</u>	<u>16,998,025</u>	<u>23,835,729</u>	<u>16,958,098</u>

All treasury bills are held-to-maturity, issued by central governments and central banks, and are unlisted.

14. PLACEMENTS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS MATURING BETWEEN ONE AND TWELVE MONTHS

	The Group		The Bank	
	2006	2005	2006	2005
Placement with banks	<u>3,677,234</u>	<u>2,657,380</u>	<u>3,608,960</u>	<u>2,629,507</u>

15. TRADE BILLS LESS IMPAIRMENT ALLOWANCES

	The Group		The Bank	
	2006	2005	2006	2005
Trade bills	375,189	653,992	328,352	414,160
Individual impairment allowances for impaired loans and advances (Note 19)	(4,355)	(961)	(4,355)	(961)
Collective impairment allowances for loans and advances (Note 19)	(285)	(656)	(279)	(655)
	<u>370,549</u>	<u>652,375</u>	<u>323,718</u>	<u>412,544</u>

16. TRADING ASSETS

	The Group		The Bank	
	2006	2005	2006	2005
Debt securities:				
Listed in Hong Kong	115,220	299	115,220	299
Unlisted.....	—	1,413	—	1,413
	115,220	1,712	115,220	1,712
Equity securities listed in Hong Kong	18,482	74,380	13,525	66,380
Total trading securities	133,702	76,092	128,745	68,092
Positive fair values of derivative financial instruments held for trading (Note 34(b)(ii)(2)).....	604,690	835,172	620,833	861,618
	<u>738,392</u>	<u>911,264</u>	<u>749,578</u>	<u>929,710</u>

Trading assets of the Bank include positive fair values of derivative financial instruments transacted with a subsidiary amounting to HK\$16,990,000 (2005: HK\$26,445,000).

Trading securities analysed by counterparty are as follows:

	The Group		The Bank	
	2006	2005	2006	2005
Issued by:				
Central governments and central banks	—	201	—	201
Banks and other financial institutions	15,901	42,036	13,525	37,014
Corporate entities.....	117,497	33,757	114,922	30,779
Public sector entities.....	304	98	298	98
	<u>133,702</u>	<u>76,092</u>	<u>128,745</u>	<u>68,092</u>

17. FINANCIAL ASSETS MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS

	The Group		The Bank	
	2006	2005	2006	2005
Debt securities:				
Listed in Hong Kong	54,684	93,506	54,684	93,506
Listed outside Hong Kong	697,448	1,230,053	697,448	1,230,053
Unlisted.....	4,630,824	4,600,865	4,630,824	4,600,865
	<u>5,382,956</u>	<u>5,924,424</u>	<u>5,382,956</u>	<u>5,924,424</u>

Financial assets measured at fair value through profit or loss analysed by counterparty are as follows:

	The Group		The Bank	
	2006	2005	2006	2005
Issued by:				
Banks and other financial institutions	2,379,167	2,886,507	2,379,167	2,886,507
Corporate entities.....	2,501,097	2,527,422	2,501,097	2,527,422
Public sector entities.....	502,692	510,495	502,692	510,495
	<u>5,382,956</u>	<u>5,924,424</u>	<u>5,382,956</u>	<u>5,924,424</u>

18. ADVANCES TO CUSTOMERS AND OTHER ACCOUNTS LESS IMPAIRMENT ALLOWANCES

(a) Advances to customers and other accounts less impairment allowances

	The Group		The Bank	
	2006	2005	2006	2005
Gross advances to customers	58,638,237	54,401,834	45,204,201	42,518,513
Individual impairment allowances for impaired loans and advances (Note 19)	(92,317)	(119,720)	(70,016)	(104,194)
Collective impairment allowances for loans and advances (Note 19)	(168,717)	(207,842)	(146,411)	(178,795)
Net advances to customers	58,377,203	54,074,272	44,987,774	42,235,524
Advances to banks and other financial institutions	47,539	79,191	47,539	79,191
Accrued interest and other accounts	2,272,096	1,310,822	1,481,872	897,608
Positive fair values of derivative financial instruments held for hedging (Note 34(b)(ii)(1))	7,420	8,598	7,420	8,598
	<u>60,704,258</u>	<u>55,472,883</u>	<u>46,524,605</u>	<u>43,220,921</u>

(b) Advances to customers analysed by industry sectors

The information concerning advances to customers by industry sectors is prepared by classifying the advances according to the usage of the advances and is stated gross of any impairment allowances.

	The Group		The Bank	
	2006	2005	2006	2005
Advances for use in Hong Kong				
Industrial, commercial and financial				
- Property development	405,490	652,264	405,490	652,264
- Property investment	10,901,148	9,628,817	10,815,074	9,536,468
- Financial concerns	1,101,513	508,747	1,101,513	508,747
- Stockbrokers	346,457	307,150	346,457	307,150
- Wholesale and retail trade	807,723	835,833	805,722	829,045
- Manufacturing	1,241,327	1,460,996	1,139,576	1,366,358
- Transport and transport equipment	2,416,631	2,827,696	326,691	593,886
- Share financing	277,747	256,776	277,747	256,776
- Others	2,762,740	2,899,347	2,548,377	2,682,803
Individuals				
- Advances for the purchase of flats under the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	1,591,838	1,500,857	1,591,838	1,500,857
- Advances for the purchase of other residential properties	14,692,277	13,917,497	13,122,821	12,536,471
- Credit card advances	323,145	385,932	323,145	385,932
- Others	<u>3,238,841</u>	<u>3,523,120</u>	<u>1,508,815</u>	<u>1,870,588</u>
	40,106,877	38,705,032	34,313,266	33,027,345
Trade finance	3,049,104	3,057,178	2,773,451	2,713,906
Advances for use outside Hong Kong				
- Mainland China	9,257,219	7,801,900	8,023,139	6,667,519
- Macau	6,211,056	4,817,591	80,364	94,610
- Others	13,981	20,133	13,981	15,133
	<u>15,482,256</u>	<u>12,639,624</u>	<u>8,117,484</u>	<u>6,777,262</u>
	<u>58,638,237</u>	<u>54,401,834</u>	<u>45,204,201</u>	<u>42,518,513</u>

(c) **Impaired advances to customers**

The gross impaired advances to customers and individual impairment allowances made after taking into account the discounted value of future recoverable amounts in respect of such advances are as follows:

	The Group		The Bank	
	2006	2005	2006	2005
Gross impaired advances to customers.....	364,092	560,065	293,170	463,689
Gross impaired advances to customers as a percentage of total advances to customers.....	0.62%	1.03%	0.65%	1.09%
Individual impairment allowances	92,317	119,720	70,016	104,194

There are no individual impairment allowances made on advances to banks and other financial institutions as at 31st December, 2006 and 31st December, 2005.

(d) **Included in advances to customers are net investments in finance leases**

The total minimum lease payments receivable under finance leases and their present values are as follows:

	The Group			
	2006		2005	
	Present value of the minimum lease payments	Total minimum lease payments	Present value of the minimum lease payments	Total minimum lease payments
Amount receivable:				
Within 1 year	1,856,521	2,087,318	1,766,192	1,979,874
After 1 year but within 5 years	2,039,947	2,220,070	2,086,306	2,282,263
After 5 years	94,378	120,057	181,878	263,114
	<u>3,990,846</u>	<u>4,427,445</u>	<u>4,034,376</u>	<u>4,525,251</u>
Individual impairment allowances for impaired loans and advances	(1,658)	—	(2,434)	—
Collective impairment allowances for loans and advances	(11,914)	—	(15,209)	—
Unearned future income on finance lease	—	(436,599)	—	(490,875)
Net investment in finance leases	<u>3,977,274</u>	<u>3,990,846</u>	<u>4,016,733</u>	<u>4,034,376</u>

The Bank has no finance lease receivable as at 31st December, 2006 and 31st December, 2005.

19. IMPAIRMENT ALLOWANCES FOR LOANS AND ADVANCES

	The Group		
	2006		
	Individual	Collective	Total
At 1st January	120,681	208,498	329,179
Additions	53,779	—	53,779
Releases	(13,510)	(39,496)	(53,006)
Net charged/(credited) to consolidated profit and loss account	40,269	(39,496)	773
Unwind of discount of loan impairment loss (Note 5(a))	(2,672)	—	(2,672)
Recoveries of advances written off in prior years	42,237	—	42,237
Amounts written off	(103,843)	—	(103,843)
At 31st December	<u>96,672</u>	<u>169,002</u>	<u>265,674</u>
Representing impairment allowances for:			
Trade bills (Note 15)	4,355	285	4,640
Advances to customers (Note 18(a))	<u>92,317</u>	<u>168,717</u>	<u>261,034</u>
	<u>96,672</u>	<u>169,002</u>	<u>265,674</u>

	The Group		
	2005		
	Individual	Collective	Total
At 1st January	123,979	222,330	346,309
Additions	105,066	16,106	121,172
Releases	(37,178)	(29,938)	(67,116)
Net charged/(credited) to consolidated profit and loss account	67,888	(13,832)	54,056
Unwind of discount of loan impairment loss (Note 5(a))	(10,465)	—	(10,465)
Recoveries of advances written off in prior years	86,136	—	86,136
Amounts written off	(146,857)	—	(146,857)
At 31st December	<u>120,681</u>	<u>208,498</u>	<u>329,179</u>
Representing impairment allowances for:			
Trade bills (Note 15)	961	656	1,617
Advances to customers (Note 18(a))	<u>119,720</u>	<u>207,842</u>	<u>327,562</u>
	<u>120,681</u>	<u>208,498</u>	<u>329,179</u>

The Bank			
2006			
	Individual	Collective	Total
At 1st January	105,155	179,450	284,605
Additions	33,295	—	33,295
Releases	(9,500)	(32,760)	(42,260)
Net (credited)/charged to profit and loss account	23,795	(32,760)	(8,965)
Unwind of discount of loan impairment loss	(2,672)	—	(2,672)
Recoveries of advances written off in prior years	30,269	—	30,269
Amounts written off	(82,176)	—	(82,176)
At 31st December	<u>74,371</u>	<u>146,690</u>	<u>221,061</u>
Representing impairment allowances for:			
Trade bills (Note 15)	4,355	279	4,634
Advances to customers (Note 18(a))	<u>70,016</u>	<u>146,411</u>	<u>216,427</u>
	<u>74,371</u>	<u>146,690</u>	<u>221,061</u>

The Bank			
2005			
	Individual	Collective	Total
At 1st January	83,205	196,246	279,451
Additions	85,289	9,687	94,976
Releases	(21,852)	(26,483)	(48,335)
Net charged/(credited) to profit and loss account	63,437	(16,796)	46,641
Unwind of discount of loan impairment loss	(10,465)	—	(10,465)
Recoveries of advances written off in prior years	74,108	—	74,108
Amounts written off	(105,130)	—	(105,130)
At 31st December	<u>105,155</u>	<u>179,450</u>	<u>284,605</u>
Representing impairment allowances for:			
Trade bills (Note 15)	961	655	1,616
Advances to customers (Note 18(a))	<u>104,194</u>	<u>178,795</u>	<u>282,989</u>
	<u>105,155</u>	<u>179,450</u>	<u>284,605</u>

20. HELD-TO-MATURITY AND AVAILABLE-FOR-SALE FINANCIAL ASSETS

	The Group		The Bank	
	2006	2005	2006	2005
Held-to-maturity debt securities:				
Listed in Hong Kong	83,424	85,348	83,424	85,348
Listed outside Hong Kong	248,737	202,232	248,737	202,232
	332,161	287,580	332,161	287,580
Unlisted.....	9,328,427	9,838,934	8,838,746	9,295,630
	9,660,588	10,126,514	9,170,907	9,583,210
Available-for-sale debt securities:				
Listed in Hong Kong	—	12,467	—	—
Listed outside Hong Kong	6,566,073	2,782,418	6,514,242	2,730,229
	6,566,073	2,794,885	6,514,242	2,730,229
Unlisted.....	3,192,960	2,879,968	3,140,872	2,839,435
	9,759,033	5,674,853	9,655,114	5,569,664
Available-for-sale equity securities:				
Listed in Hong Kong	1,600	1,856	1,600	1,470
Unlisted.....	113,139	106,207	102,404	95,608
	114,739	108,063	104,004	97,078
	9,873,772	5,782,916	9,759,118	5,666,742
	19,534,360	15,909,430	18,930,025	15,249,952
Market value of listed held-to-maturity debt securities.....	330,673	288,331	330,673	288,331
Fair value of unlisted held-to-maturity debt securities.....	9,252,236	9,757,850	8,765,493	9,220,546

Held-to-maturity and available-for-sale financial assets analysed by counterparty are as follows:

	The Group		The Bank	
	2006	2005	2006	2005
Issued by:				
Central governments and central banks	7,695	7,764	7,695	7,764
Banks and other financial institutions	17,673,362	13,564,685	17,165,638	13,069,702
Corporate entities.....	1,515,130	1,996,214	1,443,590	1,857,352
Public sector entities.....	338,173	340,767	313,102	315,134
	19,534,360	15,909,430	18,930,025	15,249,952

Held-to-maturity treasury bills are classified as “Cash and short-term funds” (Note 13).

21. INVESTMENTS IN SUBSIDIARIES

	The Bank	
	2006	2005
Unlisted shares, at cost.....	682,707	682,707

The following list contains only the particulars of principal subsidiaries:

Name of company	Place of incorporation and operation	Nominal value of issued ordinary shares	Percentage held	Principal activities
Banco Weng Hang, S.A.	Macau	MOP120,000,000	100%	Banking
Wing Hang Bank (Cayman) Limited	Cayman Islands	US\$25,000,000	100%	Banking
Wing Hang Finance Company Limited	Hong Kong	HK\$130,000,000	100%	Deposit Taking and Hire Purchase
Wing Hang Credit Limited	Hong Kong	HK\$20,000,000	100%	Consumer Lending
Wing Hang Zurich Insurance Company Limited	Hong Kong	HK\$45,000,000	65%	Insurance
Wing Hang Insurance Brokers Limited	Hong Kong	HK\$100,000	100%	Insurance Broker
Wing Hang Insurance Agency Limited	Hong Kong	HK\$50,000	100%	Insurance Agency
Wing Hang Shares Brokerage Company Limited	Hong Kong	HK\$10,000,000	100%	Securities Dealing
Wing Hang Bank (Trustee) Limited	Hong Kong	HK\$3,000,000	100%	Trustee Services
Wing Hang Bank (Nominees) Limited	Hong Kong	HK\$10,000	100%	Nominee Services
Cheuk Woo Enterprises Company Limited	Hong Kong	HK\$10,000	100%	Property Investment
Honfirst Land Limited	Hong Kong	HK\$27,000,000	100%	Property Investment
Wing Hang Financial Holdings (BVI) Limited	British Virgin Islands	US\$10	100%	Issuer of Subordinated Notes

22. INVESTMENTS IN ASSOCIATED COMPANIES

	The Group		The Bank	
	2006	2005	2006	2005
Unlisted shares, at cost	—	—	112,000	112,000
Share of net assets	135,906	84,955	—	—
Loans to associated companies	62,000	62,000	62,000	62,000
	<u>197,906</u>	<u>146,955</u>	<u>174,000</u>	<u>174,000</u>

Loans to associated companies are unsecured, interest-free and repayable in 2008.

The following list contains the particulars of associated companies:

Name of company	Place of incorporation and operation	Nominal value of issued ordinary shares	Percentage held	Voting power	Principal activities
Bank Consortium Holding Limited	Hong Kong	HK\$150,000,000	27%	2 out of 7*	Services for Retirement Schemes
Hong Kong Life Insurance Limited	Hong Kong	HK\$210,000,000	33%	1 out of 3*	Insurance
Joint Electronic Teller Services Limited ...	Hong Kong	HK\$ 10,023,800	20% ^(a)	1 out of 5*	ATM Network

* Representing the Group's number of votes on the board of directors of respective associated companies.

Notes:

- (a) The Group's share of net asset in Joint Electronic Teller Services Limited is based on the Group's share of dividend received from this associated company during this year.

Summary financial information on associated companies is set out below:

2006						
	Assets	Liabilities	Equity	Total operating income	Tax	Profit after tax
100 percent	2,601,235	1,857,334	743,901	294,198	18,772	199,962
Group's effective interest.....	736,869	600,963	135,906	61,908	4,117	50,951

2005						
	Assets	Liabilities	Equity	Total operating income	Tax	Profit after tax
100 percent	2,056,313	1,485,507	570,806	210,159	12,288	64,149
Group's effective interest.....	561,119	476,164	84,955	39,844	2,597	11,249

23. TANGIBLE FIXED ASSETS

The Group					
2006					
	Investment properties	Bank premises	Equipment	Bank premises and equipment	Total
Cost or valuation					
At 1st January, 2006	231,447	1,470,382	584,120	2,054,502	2,285,949
Additions	—	186,728	68,500	255,228	255,228
Disposals	(9,800)	(43,025)	(21,521)	(64,546)	(74,346)
Transfers from bank premises to investment properties	21,175	(21,904)	—	(21,904)	(729)
Surplus on revaluation	15,568	11,010	—	11,010	26,578
At 31st December, 2006	<u>258,390</u>	<u>1,603,191</u>	<u>631,099</u>	<u>2,234,290</u>	<u>2,492,680</u>
The analysis of cost or valuation of the above assets is as follows:					
At cost	—	1,209,589	631,099	1,840,688	1,840,688
At valuation					
2006	258,390	—	—	—	258,390
1990	—	357,888	—	357,888	357,888
1989	—	9,347	—	9,347	9,347
1984	—	26,367	—	26,367	26,367
	<u>258,390</u>	<u>1,603,191</u>	<u>631,099</u>	<u>2,234,290</u>	<u>2,492,680</u>
Accumulated depreciation					
At 1st January, 2006	—	158,987	389,474	548,461	548,461
Charge for the year (Note 5(e))	—	26,909	54,333	81,242	81,242
Written back on disposals	—	(9,817)	(20,265)	(30,082)	(30,082)
Transfers from bank premises to investment properties	—	(729)	—	(729)	(729)
At 31st December, 2006	<u>—</u>	<u>175,350</u>	<u>423,542</u>	<u>598,892</u>	<u>598,892</u>
Net book value					
At 31st December, 2006	<u>258,390</u>	<u>1,427,841</u>	<u>207,557</u>	<u>1,635,398</u>	<u>1,893,788</u>

The Group					
2005					
	Investment properties	Bank premises	Equipment	Bank premises and equipment	Total
Cost or valuation					
At 1st January, 2005	209,560	1,502,092	578,024	2,080,116	2,289,676
Additions	—	668	55,231	55,899	55,899
Disposals	(5,000)	(27,180)	(49,135)	(76,315)	(81,315)
Transfers from bank premises to investment properties	18,338	(18,743)	—	(18,743)	(405)
Transfers from investment properties to bank premises	(4,248)	4,248	—	4,248	—
Surplus on revaluation	12,797	9,297	—	9,297	22,094
At 31st December, 2005	<u>231,447</u>	<u>1,470,382</u>	<u>584,120</u>	<u>2,054,502</u>	<u>2,285,949</u>
The analysis of cost or valuation of the above assets is as follows:					
At cost	—	1,076,780	584,120	1,660,900	1,660,900
At valuation					
2005	231,447	—	—	—	231,447
1990	—	357,888	—	357,888	357,888
1989	—	9,347	—	9,347	9,347
1984	—	26,367	—	26,367	26,367
	<u>231,447</u>	<u>1,470,382</u>	<u>584,120</u>	<u>2,054,502</u>	<u>2,285,949</u>
Accumulated depreciation					
At 1st January, 2005	—	135,867	381,239	517,106	517,106
Charge for the year (Note 5(e))	—	25,700	49,707	75,407	75,407
Written back on disposals	—	(2,175)	(41,472)	(43,647)	(43,647)
Transfers from bank premises to investment properties	—	(405)	—	(405)	(405)
At 31st December, 2005	<u>—</u>	<u>158,987</u>	<u>389,474</u>	<u>548,461</u>	<u>548,461</u>
Net book value					
At 31st December, 2005	<u>231,447</u>	<u>1,311,395</u>	<u>194,646</u>	<u>1,506,041</u>	<u>1,737,488</u>

The Bank					
2006					
	Investment properties	Bank premises	Equipment	Bank premises and equipment	Total
Cost or valuation					
At 1st January, 2006	18,300	1,099,842	488,640	1,588,482	1,606,782
Additions	—	—	49,741	49,741	49,741
Disposals	(9,800)	(23,695)	(16,033)	(39,728)	(49,528)
Surplus on revaluation	1,880	—	—	—	1,880
At 31st December, 2006	<u>10,380</u>	<u>1,076,147</u>	<u>522,348</u>	<u>1,598,495</u>	<u>1,608,875</u>
The analysis of cost or valuation of the above assets is as follows:					
At cost	—	717,409	522,348	1,239,757	1,239,757
At valuation					
2006	10,380	—	—	—	10,380
1990	—	357,888	—	357,888	357,888
1989	—	850	—	850	850
	<u>10,380</u>	<u>1,076,147</u>	<u>522,348</u>	<u>1,598,495</u>	<u>1,608,875</u>
Accumulated depreciation					
At 1st January, 2006	—	117,095	321,195	438,290	438,290
Charge for the year	—	18,455	44,383	62,838	62,838
Written back on disposals	—	(3,669)	(15,246)	(18,915)	(18,915)
At 31st December, 2006	<u>—</u>	<u>131,881</u>	<u>350,332</u>	<u>482,213</u>	<u>482,213</u>
Net book value					
At 31st December, 2006	<u>10,380</u>	<u>944,266</u>	<u>172,016</u>	<u>1,116,282</u>	<u>1,126,662</u>

	The Bank				
	2005				
	Investment properties	Bank premises	Equipment	Bank premises and equipment	Total
Cost or valuation					
At 1st January, 2005	13,100	1,126,174	487,862	1,614,036	1,627,136
Additions	—	668	47,677	48,345	48,345
Disposals	—	(27,000)	(46,899)	(73,899)	(73,899)
Surplus on revaluation	5,200	—	—	—	5,200
At 31st December, 2005	<u>18,300</u>	<u>1,099,842</u>	<u>488,640</u>	<u>1,588,482</u>	<u>1,606,782</u>

The analysis of cost or valuation of the above assets is as follows:

At cost	—	741,104	488,640	1,229,744	1,229,744
At valuation					
2005	18,300	—	—	—	18,300
1990	—	357,888	—	357,888	357,888
1989	—	850	—	850	850
	<u>18,300</u>	<u>1,099,842</u>	<u>488,640</u>	<u>1,588,482</u>	<u>1,606,782</u>
Accumulated depreciation					
At 1st January, 2005	—	99,968	319,072	419,040	419,040
Charge for the year	—	19,302	41,512	60,814	60,814
Written back on disposals	—	(2,175)	(39,389)	(41,564)	(41,564)
At 31st December, 2005	<u>—</u>	<u>117,095</u>	<u>321,195</u>	<u>438,290</u>	<u>438,290</u>
Net book value					
At 31st December, 2005	<u>18,300</u>	<u>982,747</u>	<u>167,445</u>	<u>1,150,192</u>	<u>1,168,492</u>

Bank premises are stated at cost or directors' valuation. The revaluation surplus of HK\$11,010,000 (2005: HK\$9,297,000) has been transferred to the bank premises revaluation reserve of the Group, net of deferred tax of HK\$1,927,000 (2005: HK\$1,627,000).

Investment properties are revalued by an independent firm of surveyors, Savills Valuation and Professional Services Limited who have among their staff, Fellows of the Hong Kong Institute of Surveyors, on an open market value basis as at 31st December, 2006 and 31st December, 2005.

The carrying amount of the bank premises of the Group and the Bank would have been HK\$1,121,234,000 (2005: HK\$996,800,000) and HK\$652,099,000 (2005: HK\$688,763,000) respectively had they been stated at cost less accumulated depreciation.

The net book value of investment properties and bank premises comprises:

	The Group		The Bank	
	2006	2005	2006	2005
FREEHOLD				
— Held outside Hong Kong	47,519	47,870	—	—
LEASEHOLD				
— Held in Hong Kong				
Long leases (over 50 years unexpired)	861,992	871,447	492,215	519,436
Medium-term leases (10 to 50 years unexpired)....	627,114	523,900	427,318	444,620
— Held outside Hong Kong				
Long leases (over 50 years unexpired)	1,993	2,031	1,993	2,031
Medium-term leases (10 to 50 years unexpired)....	42,212	44,261	33,120	34,960
Short leases (less than 10 years unexpired)	105,401	53,333	—	—
	<u>1,686,231</u>	<u>1,542,842</u>	<u>954,646</u>	<u>1,001,047</u>

The Group leases out investment properties under operating leases. The leases typically run for an initial period of two to three years. None of the leases includes contingent rentals.

All properties held under operating leases that would otherwise meet the definition of investment property are classified as investment property.

The Group's total future minimum lease payments under non-cancellable operating leases are receivables as follows:

	The Group	
	2006	2005
1 year or less.....	10,349	8,508
5 years or less but over 1 years	8,294	4,660
	<u>18,643</u>	<u>13,168</u>

24. GOODWILL

(a) Goodwill

	The Group		The Bank	
	2006	2005	2006	2005
Cost				
At 1st January.....	848,592	847,713	847,422	847,422
Addition through acquisition of subsidiary.....	—	879	—	—
At 31st December.....	<u>848,592</u>	<u>848,592</u>	<u>847,422</u>	<u>847,422</u>
Accumulated impairment loss				
At 1st January.....	1,170	—	—	—
Impairment loss for the year (Notes 5(e) & 35(a))	—	1,170	—	—
At 31st December.....	<u>1,170</u>	<u>1,170</u>	<u>—</u>	<u>—</u>
Net book value as at 31st December.....	<u>847,422</u>	<u>847,422</u>	<u>847,422</u>	<u>847,422</u>

(b) Impairment tests for cash-generating units containing goodwill

Goodwill is allocated to the Group's cash-generating units ("CGU") identified according to country of operation and business segment as follows:

	2006	2005
Retail banking business acquired	560,128	560,128
Corporate banking business acquired	233,741	233,741
Treasury business acquired	53,553	53,553
	<u>847,422</u>	<u>847,422</u>

The recoverable amount of the CGU is determined based on value in use calculations. These calculations use cash flow projections based on financial budgets approved by management covering a five-year period. Cash flows beyond the five-year period are extrapolated using the estimate rates stated below. The growth rate does not exceed the long-term average growth rate for the business in which the CGU operates.

Key assumptions used for value in use calculations:

	2006	2005
	%	%
Growth rate.....	6.54	6.54
Discount rate.....	9.36	11.85

25. DEPOSITS AND BALANCES OF BANKS AND OTHER FINANCIAL INSTITUTIONS

Deposits and balances of banks and other financial institutions are analysed as follows:

	The Group		The Bank	
	2006	2005	2006	2005
Deposits from central banks	30,555	84,377	30,555	84,377
Deposits from banks and other financial institutions	1,662,332	1,618,649	1,642,869	1,610,236
	<u>1,692,887</u>	<u>1,703,026</u>	<u>1,673,424</u>	<u>1,694,613</u>

26. DEPOSITS FROM CUSTOMERS

	The Group		The Bank	
	2006	2005	2006	2005
Demand deposits and current accounts	10,732,083	8,309,633	9,418,873	7,624,367
Savings deposits	15,508,366	11,578,904	10,910,605	8,176,603
Time, call and notice deposits	75,826,498	65,784,915	60,854,590	52,101,927
	<u>102,066,947</u>	<u>85,673,452</u>	<u>81,184,068</u>	<u>67,902,897</u>

27. CERTIFICATES OF DEPOSIT ISSUED

	The Group		The Bank	
	2006	2005	2006	2005
Certificates of deposit issued (at amortised cost)	2,205,000	1,902,640	2,205,000	1,902,640
Structured certificates of deposit issued measured at fair value through profit or loss	1,510,303	1,921,699	1,515,276	1,926,612
	<u>3,715,303</u>	<u>3,824,339</u>	<u>3,720,276</u>	<u>3,829,252</u>

At 31st December 2006, the carrying amounts of structured certificates of deposit issued measured at fair value through profit or loss are lower than their contractual amount payables at maturity for the Group and the Bank by HK\$85,021,000 (2005: HK\$144,974,000) and HK\$85,100,000 (2005: HK\$145,102,000) respectively due to changes in benchmark interest rates.

28. TRADING LIABILITIES

Trading liabilities represent negative fair values of derivative financial instruments held for trading. Details are set out in Note 34(b)(ii)(2).

Trading liabilities of the Bank include negative fair values of derivative financial instruments transacted with a subsidiary amounting to HK\$1,495,000 (2005: HK\$3,842,000).

29. OTHER ACCOUNTS AND PROVISIONS

	The Group		The Bank	
	2006	2005	2006	2005
Negative fair value of derivative financial instruments held for hedging (Note 34(b)(ii)(1))	7,708	13,047	7,708	13,501
Amount payable for purchase of debt securities	38,890	—	38,890	—
Other payables and interest payable	1,935,380	1,190,483	1,087,217	796,356
	<u>1,981,978</u>	<u>1,203,530</u>	<u>1,133,815</u>	<u>809,857</u>

Other accounts and provisions of the Bank include negative fair values of derivative financial instruments transacted with a subsidiary amounting to HK\$454,000 as at 31st December, 2005. There was no such amount as at 31st December, 2006.

30. LOAN CAPITAL

Loan capital with face value of HK\$2,527,850,000 (Note 31) (US\$325,000,000) represents 5.25% subordinated notes qualifying as tier 2 capital which were issued during 2003 by Wing Hang Financial Holdings (BVI) Limited, a single purpose wholly-owned finance subsidiary of the Bank. The Bank unconditionally and irrevocably guarantees all amounts payable under the notes which are listed on the Singapore Exchange Trading Limited. The notes will mature on 10th October, 2013.

31. MATURITY PROFILE

The Group								
2006								
	Repayable on demand	1 month or less	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	Total
Assets								
Cash and balances with banks and other								
financial institutions (Note 13).....	2,253,725	—	—	—	—	—	—	2,253,725
Money at call and short notice (Note 13).....	—	23,847,991	—	—	—	—	—	23,847,991
Treasury bills (Note 13).....	—	1,165,186	981,449	537,598	—	—	—	2,684,233
Placements with banks and other financial								
institutions maturing between 1 and 12								
months	—	—	3,519,172	158,062	—	—	—	3,677,234
Trade bills less impairment allowances	69,633	165,609	116,468	9,906	—	—	8,933	370,549
Trading assets	—	—	—	50	248	114,922	623,172	738,392
Financial assets measured at fair value through								
profit or loss	—	77,789	—	128,088	4,032,880	1,144,199	—	5,382,956
Advances to customers less impairment								
allowances (Note 18(a))	2,333,861	3,674,372	4,347,226	7,588,079	17,395,060	22,731,575	307,030	58,377,203
Advances to banks and other financial								
institutions (Note 18(a))	—	—	—	31,693	15,846	—	—	47,539
Held-to-maturity and available-for-sale								
financial assets	—	38,864	274,980	1,959,450	16,151,022	995,305	114,739	19,534,360
Other assets.....	3,190	1,563,742	266,339	94,106	106,641	—	3,202,367	5,236,385
Total assets	4,660,409	30,533,553	9,505,634	10,507,032	37,701,697	24,986,001	4,256,241	122,150,567
Liabilities								
Deposits and balances of banks and other								
financial institutions	121,794	635,464	49,767	756,466	129,396	—	—	1,692,887
Deposits from customers	26,187,186	57,109,732	13,562,286	4,826,049	381,405	289	—	102,066,947
Certificates of deposit issued	—	208,338	1,037,631	501,143	1,968,191	—	—	3,715,303
Trading liabilities	—	—	—	—	—	—	590,899	590,899
Loan capital (Note 30).....	—	—	—	—	—	2,527,850	—	2,527,850
Other liabilities	—	1,365,811	256,229	478,783	70,820	—	68,315	2,239,958
Total liabilities	26,308,980	59,319,345	14,905,913	6,562,441	2,549,812	2,528,139	659,214	112,833,844
Net assets/(liabilities) gap.....	(21,648,571)	(28,785,792)	(5,400,279)	3,944,591	35,151,885	22,457,862	3,597,027	9,316,723

The Group								
2005								
	Repayable on demand	1 month or less	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	Total
Assets								
Cash and balances with banks and other financial institutions (Note 13).....	1,781,679	—	—	—	—	—	—	1,781,679
Money at call and short notice (Note 13).....	—	16,998,025	—	—	—	—	—	16,998,025
Treasury bills (Note 13).....	—	1,074,883	199,211	—	—	—	—	1,274,094
Placements with banks and other financial institutions maturing between 1 and 12 months	—	—	2,559,271	98,109	—	—	—	2,657,380
Trade bills less impairment allowances	59,356	283,050	291,217	6,813	—	—	11,939	652,375
Trading assets	—	—	—	300	1,412	—	909,552	911,264
Financial assets measured at fair value through profit or loss	—	—	155,331	1,139,979	3,991,252	637,862	—	5,924,424
Advances to customers less impairment allowances (Note 18(a))	2,412,503	3,244,921	3,951,024	6,777,178	16,612,653	20,941,046	134,947	54,074,272
Advances to banks and other financial institutions (Note 18(a))	208	—	—	31,593	47,390	—	—	79,191
Held-to-maturity and available-for-sale financial assets	—	—	13,939	682,115	14,015,122	1,090,191	108,063	15,909,430
Other assets.....	12,435	921,303	88,051	57,945	134,619	—	2,846,129	4,060,482
Total assets	4,266,181	22,522,182	7,258,044	8,794,032	34,802,448	22,669,099	4,010,630	104,322,616
Liabilities								
Deposits and balances of banks and other financial institutions	186,926	615,900	390,732	432,567	76,901	—	—	1,703,026
Deposits from customers	19,830,717	48,583,380	14,785,225	1,644,926	829,204	—	—	85,673,452
Certificates of deposit issued	—	429,215	1,448,126	684,067	1,262,931	—	—	3,824,339
Trading liabilities	—	—	—	—	—	—	865,962	865,962
Loan capital	—	—	—	—	—	2,519,888	—	2,519,888
Other liabilities	—	732,897	233,517	298,044	83,774	—	49,666	1,397,898
Total liabilities	20,017,643	50,361,392	16,857,600	3,059,604	2,252,810	2,519,888	915,628	95,984,565
Net assets/(liabilities) gap.....	(15,751,462)	(27,839,210)	(9,599,556)	5,734,428	32,549,638	20,149,211	3,095,002	8,338,051

The Bank

2006								
	Repayable on demand	1 month or less	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	Total
Assets								
Cash and balances with banks and other financial institutions (Note 13).....	1,691,086	—	—	—	—	—	—	1,691,086
Money at call and short notice (Note 13).....	—	23,835,729	—	—	—	—	—	23,835,729
Treasury bills (Note 13).....	—	199,761	397,811	—	—	—	—	597,572
Placements with banks and other financial institutions maturing between 1 and 12 months	—	—	3,450,898	158,062	—	—	—	3,608,960
Trade bills less impairment allowances	69,627	125,919	116,456	9,906	—	—	1,810	323,718
Trading assets	—	—	—	50	248	114,922	634,358	749,578
Financial assets measured at fair value through profit or loss	—	77,789	—	128,088	4,032,880	1,144,199	—	5,382,956
Advances to customers less impairment allowances (Note 18(a))	2,119,918	2,987,811	3,474,247	5,040,703	12,042,794	19,278,001	44,300	44,987,774
Advances to banks and other financial institutions (Note 18(a))	—	—	—	31,693	15,846	—	—	47,539
Amounts due from subsidiaries	456	100,787	60,000	4,009,436	1,450,260	1,665,000	—	7,285,939
Held-to-maturity and available-for-sale financial assets	—	—	274,980	1,941,953	15,753,291	855,797	104,004	18,930,025
Other assets.....	13	915,859	246,886	80,221	78,523	—	3,008,033	4,329,535
Total assets	3,881,100	28,243,655	8,021,278	11,400,112	33,373,842	23,057,919	3,792,505	111,770,411
Liabilities								
Deposits and balances of banks and other financial institutions	102,331	635,464	49,767	756,466	129,396	—	—	1,673,424
Deposits from customers	20,340,174	45,822,330	10,954,961	3,934,835	131,479	289	—	81,184,068
Certificates of deposit issued	—	208,338	1,037,631	506,116	1,968,191	—	—	3,720,276
Trading liabilities	—	—	—	—	—	—	592,379	592,379
Amounts due to subsidiaries.....	1,002,437	5,671,805	1,970,586	3,167,646	1,767,832	2,520,334	11	16,100,651
Other liabilities	—	684,330	217,300	356,794	32,977	—	27,512	1,318,913
Total liabilities	21,444,942	53,022,267	14,230,245	8,721,857	4,029,875	2,520,623	619,902	104,589,711
Net assets/(liabilities) gap.....	(17,563,842)	(24,778,612)	(6,208,967)	2,678,255	29,343,967	20,537,296	3,172,603	7,180,700

The Bank								
2005								
	Repayable on demand	1 month or less	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	Total
Assets								
Cash and balances with banks and other								
financial institutions (Note 13).....	1,387,648	—	—	—	—	—	—	1,387,648
Money at call and short notice (Note 13).....	—	16,958,098	—	—	—	—	—	16,958,098
Treasury bills (Note 13).....	—	199,818	199,211	—	—	—	—	399,029
Placements with banks and other financial								
institutions maturing between 1 and 12								
months	—	—	2,531,398	98,109	—	—	—	2,629,507
Trade bills less impairment allowances	59,322	156,114	181,550	6,809	—	—	8,749	412,544
Trading assets	—	—	—	300	1,412	—	927,998	929,710
Financial assets measured at fair value through								
profit or loss	—	—	155,331	1,139,979	3,991,252	637,862	—	5,924,424
Advances to customers less impairment								
allowances (Note 18(a))	2,164,747	2,692,787	3,032,671	4,506,517	12,141,555	17,663,043	34,204	42,235,524
Advances to banks and other financial								
institutions (Note 18(a))	208	—	—	31,593	47,390	—	—	79,191
Amounts due from subsidiaries	4,196	75,118	60,000	2,641,131	1,448,840	1,845,000	—	6,074,285
Held-to-maturity and available-for-sale								
financial assets	—	—	13,939	643,613	13,544,101	951,221	97,078	15,249,952
Other assets	9,444	642,143	85,981	50,234	86,809	—	2,907,695	3,782,306
Total assets	3,625,565	20,724,078	6,260,081	9,118,285	31,261,359	21,097,126	3,975,724	96,062,218
Liabilities								
Deposits and balances of banks and other								
financial institutions	178,513	615,900	390,732	432,567	76,901	—	—	1,694,613
Deposits from customers	15,807,745	39,609,656	11,129,575	1,180,104	175,817	—	—	67,902,897
Certificates of deposit issued	—	429,215	1,448,127	688,980	1,262,930	—	—	3,829,252
Trading liabilities	—	—	—	—	—	—	869,748	869,748
Amounts due to subsidiaries	836,150	4,364,485	2,034,712	3,360,063	1,093,945	2,512,396	—	14,201,751
Other liabilities	—	450,236	224,258	197,182	48,074	—	17,108	936,858
Total liabilities	16,822,408	45,469,492	15,227,404	5,858,896	2,657,667	2,512,396	886,856	89,435,119
Net assets/(liabilities) gap	(13,196,843)	(24,745,414)	(8,967,323)	3,259,389	28,603,692	18,584,730	3,088,868	6,627,099

32. SHARE CAPITAL

	2006	2005
Authorised:		
450,000,000 (2005: 450,000,000) ordinary shares of HK\$1.00 each	450,000	450,000
Issued and fully paid:		
At 1st January	294,021	293,911
Shares issued under share option scheme	200	110
294,220,500 (2005: 294,020,500) ordinary shares of HK\$1.00 each	294,221	294,021

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Bank. All ordinary shares rank equally with regard to the Bank's residual net assets.

During the year, options are exercised to subscribe for ordinary shares of 200,000 shares (2005: 110,000 shares) in the Bank at a consideration of HK\$6,327,000 (2005: HK\$4,010,000) of which HK\$200,000 (2005: HK\$110,000) is credited to share capital and the balance of HK\$6,127,000 (2005: HK\$3,900,000) is credited to the share premium account. At 31st December, 2006, the outstanding options are 1,085,000 shares (2005: 1,285,000 shares).

At 31st December, 2006, the outstanding awards under the EIP are 2,055,000 shares (2005: 495,000 shares).

The details of the Share Option Scheme and the EIP are disclosed in note 40 to the accounts.

33. RESERVES

The Group								
2006								
	Share premium	Capital reserve	General reserve	Bank premises revaluation reserve	Investment revaluation reserve	Capital redemption reserve	Unappro- priated profits	Total
At 1st January, 2006	359,929	215,909	2,090,415	281,236	14,146	769	5,059,515	8,021,919
Exchange adjustments	—	—	1,098	—	—	—	—	1,098
Shares issued under share option scheme	6,127	—	—	—	—	—	—	6,127
Shares premium under EIP	12,365	—	—	—	—	—	—	12,365
Unrealised gains on revaluation of available- for-sale financial assets net of deferred tax charge	—	—	—	—	14,378	—	—	14,378
Gains on revaluation of available-for-sale financial assets transferred to consolidated profit and loss account on disposal (Note 6(b))	—	—	—	—	(11,890)	—	—	(11,890)
Unrealised gain on revaluation of bank premises	—	—	—	11,010	—	—	—	11,010
Deferred tax charged to revaluation reserve	—	—	—	(1,440)	—	—	—	(1,440)
Dividends paid	—	—	—	—	—	—	(711,789)	(711,789)
Profit attributable to shareholders of the Bank for the year	—	—	—	—	—	—	1,660,716	1,660,716
At 31st December, 2006	378,421	215,909	2,091,513	290,806	16,634	769	6,008,442	9,002,494

The Group								
2005								
	Share premium	Capital reserve	General reserve	Bank premises revaluation reserve	Investment revaluation reserve	Capital redemption reserve	Unappro- priated profits	Total
At 1st January, 2005	347,034	215,909	2,091,174	269,039	27,372	769	4,336,946	7,288,243
Exchange adjustments	—	—	(759)	—	—	—	—	(759)
Shares issued under share option scheme	3,900	—	—	—	—	—	—	3,900
Shares premium under share option scheme	6,588	—	—	—	—	—	—	6,588
Shares premium under EIP	2,407	—	—	—	—	—	—	2,407
Unrealised losses on revaluation of available- for-sale financial assets net of deferred tax credit	—	—	—	—	(20,650)	—	—	(20,650)
Losses on revaluation of available-for-sale financial assets transferred to consolidated profit and loss account on disposal (Note 6(b))	—	—	—	—	7,424	—	—	7,424
Unrealised gain on revaluation of bank premises	—	—	—	9,297	—	—	—	9,297
Deferred tax credited to revaluation reserve	—	—	—	2,900	—	—	—	2,900
Dividends paid	—	—	—	—	—	—	(626,149)	(626,149)
Profit attributable to shareholders of the Bank for the year	—	—	—	—	—	—	1,348,718	1,348,718
At 31st December, 2005	359,929	215,909	2,090,415	281,236	14,146	769	5,059,515	8,021,919

The Bank							
2006							
	Share premium	General reserve	Bank premises revaluation reserve	Investment revaluation reserve	Capital redemption reserve	Unappropriated profits	Total
At 1st January, 2006.....	359,929	1,802,259	272,847	14,007	769	3,883,267	6,333,078
Exchange adjustments	—	518	—	—	—	—	518
Shares issued under share option scheme	6,127	—	—	—	—	—	6,127
Shares premium under EIP.....	12,365	—	—	—	—	—	12,365
Unrealised gains on revaluation of available-for-sale financial assets net of deferred tax charge.....	—	—	—	13,911	—	—	13,911
Losses on revaluation of available-for-sale financial assets transferred to profit and loss account on disposal	—	—	—	(11,890)	—	—	(11,890)
Deferred tax credited to revaluation reserve	—	—	1,205	—	—	—	1,205
Dividends paid.....	—	—	—	—	—	(711,789)	(711,789)
Profit attributable to shareholders of the Bank for the year ...	—	—	—	—	—	1,242,954	1,242,954
At 31st December, 2006.....	378,421	1,802,777	274,052	16,028	769	4,414,432	6,886,479

The Bank							
2005							
	Share premium	General reserve	Bank premises revaluation reserve	Investment revaluation reserve	Capital redemption reserve	Unappropriated profits	Total
At 1st January, 2005.....	347,034	1,802,376	268,320	23,812	769	3,385,141	5,827,452
Exchange adjustments	—	(117)	—	—	—	—	(117)
Shares issued under share option scheme	3,900	—	—	—	—	—	3,900
Shares premium under share option scheme	6,588	—	—	—	—	—	6,588
Shares premium under EIP.....	2,407	—	—	—	—	—	2,407
Unrealised losses on revaluation of available-for-sale financial assets net of deferred tax charge.....	—	—	—	(17,229)	—	—	(17,229)
Losses on revaluation of available-for-sale financial assets transferred to profit and loss account on disposal	—	—	—	7,424	—	—	7,424
Deferred tax credited to revaluation reserve	—	—	4,527	—	—	—	4,527
Dividends paid.....	—	—	—	—	—	(626,149)	(626,149)
Profit attributable to shareholders of the Bank for the year ...	—	—	—	—	—	1,124,275	1,124,275
At 31st December, 2005.....	359,929	1,802,259	272,847	14,007	769	3,883,267	6,333,078

The Group's unappropriated profits as at 31st December, 2006 included the accumulated profits of HK\$24,985,000 (accumulated losses in 2005: HK\$25,966,000) of the associated companies and a regulatory reserve of HK\$417,665,000 (2005: HK\$336,176,000). The regulatory reserve is maintained to satisfy the provisions of the Hong Kong Banking Ordinance for prudential supervision purposes by earmarking amounts in respect of losses which the Group will or may incur on advances to customers in addition to impairment losses recognised. Movements in the reserve are earmarked directly through unappropriated profits and in consultation with the Hong Kong Monetary Authority.

The application of the share premium account and the capital redemption reserve is governed by Sections 48B and 49H of the Hong Kong Companies Ordinance.

The general reserve was set up from the transfer of retained earnings and exchange differences arising from translation of the accounts of overseas branches and subsidiaries (note 2(k)). The capital reserve comprises retained earnings capitalised on the issue of bonus shares by subsidiaries in prior years and a legal reserve established by Banco Weng Hang, S.A. in accordance with the banking regulations in Macau. Revaluation reserves have been set up and are dealt with in accordance with the accounting policies adopted for the revaluation of bank premises and available-for-sale financial assets (notes 2(l) and (f)).

Capital reserve, bank premises revaluation reserve, investment revaluation reserve and capital redemption reserve do not represent realised profits and are not available for distribution.

The Bank and its financial subsidiaries operate under regulatory jurisdictions which require the maintenance of minimum capital adequacy ratios which could therefore potentially restrict the amount of retained profits which can be distributed to shareholders.

34. OFF-BALANCE SHEET EXPOSURES

(a) Contingent liabilities and commitments

Contingent liabilities and commitments are credit-related instruments which include letters of credit, guarantees and commitments to extend credit. The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client default. Since a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of the contractual amounts is not representative of future liquidity requirements. The following is a summary of the contractual amounts of each significant class of contingent liabilities and commitments:

	The Group		The Bank	
	2006	2005	2006	2005
Direct credit substitutes	1,795,317	848,908	1,734,157	944,422
Transaction-related contingencies	133,868	105,582	333,868	305,582
Trade-related contingencies	1,191,434	1,482,947	1,033,201	1,320,491
Other commitments:				
With an original maturity of under 1 year or which are unconditionally cancellable	9,716,773	9,211,179	9,862,419	9,066,228
With an original maturity of 1 year and over	2,491,796	1,329,636	1,602,006	1,072,475
Forward forward deposits placed	—	2,000,600	—	2,000,600
Total (Note 36(b))	<u>15,329,188</u>	<u>14,978,852</u>	<u>14,565,651</u>	<u>14,709,798</u>

(b) Derivative financial instruments

(i) *Derivatives refer to financial contracts whose value depends on the value of one or more underlying assets or indices.*

Derivative financial instruments arise from forward, swap and option transactions undertaken by the Group and the Bank in the foreign exchange, interest rate and equity markets.

The notional amounts of these instruments indicate the volume of transactions outstanding at the balance sheet date and do not represent amounts at risk.

The following table is a summary of the notional amounts of each significant type of derivatives.

	The Group		The Bank	
	2006	2005	2006	2005
Exchange rate contracts				
Forwards — trading	61,189,905	6,866,513	61,724,847	7,441,234
Option purchased — trading	4,334,573	242,524	4,334,573	242,524
Option written — trading	4,495,155	242,524	4,495,155	242,524
Total exchange rate contracts	<u>70,019,633</u>	<u>7,351,561</u>	<u>70,554,575</u>	<u>7,926,282</u>
Interest rate contracts				
Swaps — trading — receiving fixed rate	33,427,156	79,759,074	33,731,046	80,022,841
Swaps — trading — paying fixed rate	35,860,439	83,558,435	36,479,889	84,347,273
Swaps — hedging — receiving fixed rate	—	—	—	16,000
Swaps — hedging — paying fixed rate	482,236	535,485	482,236	535,485
Total interest rate contracts	<u>69,769,831</u>	<u>163,852,994</u>	<u>70,693,171</u>	<u>164,921,599</u>
Equity contracts				
Option purchased — trading	944,593	—	944,593	—
Option written — trading	1,137,137	76,210	1,137,137	76,210
Total equity contracts	<u>2,081,730</u>	<u>76,210</u>	<u>2,081,730</u>	<u>76,210</u>
	<u>141,871,194</u>	<u>171,280,765</u>	<u>143,329,476</u>	<u>172,924,091</u>

The trading transactions include the Group's and the Bank's positions arising from the execution of trade orders from customers or transactions undertaken to hedge these positions.

(ii) *Use of derivative financial instruments*

(1) *as hedging instruments*

The following is a summary of the fair values of derivative financial instruments held for hedging purposes by type of derivatives entered into by the Group and the Bank:

	The Group			
	2006		2005	
	Assets	Liabilities	Assets	Liabilities
Interest rate contracts (Notes 18(a) & 29)	<u>7,420</u>	<u>7,708</u>	<u>8,598</u>	<u>13,047</u>

	The Bank			
	2006		2005	
	Assets	Liabilities	Assets	Liabilities
Interest rate contracts (Notes 18(a) & 29)	<u>7,420</u>	<u>7,708</u>	<u>8,598</u>	<u>13,501</u>

Interest rate swaps are used principally as fair value hedges to protect against changes in the fair value of assets due to movements in market interest rates.

(2) *as trading instruments*

The following is a summary of the fair values of derivative financial instruments held for trading purposes by type of derivatives entered into by the Group and the Bank:

	The Group			
	2006		2005	
	Assets	Liabilities	Assets	Liabilities
Exchange rate contracts.....	169,917	112,748	59,496	24,157
Interest rate contracts	416,823	458,867	774,582	841,740
Equity contracts.....	15,096	17,229	1,094	65
Credit default swap	<u>2,854</u>	<u>2,055</u>	<u>—</u>	<u>—</u>
Total (Note 16).....	<u>604,690</u>	<u>590,899</u>	<u>835,172</u>	<u>865,962</u>

	The Bank			
	2006		2005	
	Assets	Liabilities	Assets	Liabilities
Exchange rate contracts.....	169,070	112,733	59,496	24,101
Interest rate contracts	433,813	460,362	801,028	845,582
Equity contracts.....	15,096	17,229	1,094	65
Credit default swap	<u>2,854</u>	<u>2,055</u>	<u>—</u>	<u>—</u>
Total (Note 16).....	<u>620,833</u>	<u>592,379</u>	<u>861,618</u>	<u>869,748</u>

(iii) *Remaining life of derivative financial instruments*

The following tables provide an analysis of the notional amounts of derivatives of the Group by relevant maturity groupings based on the remaining periods to settlement at the balance sheet date.

The Group				
2006				
	Up to 1 year	5 years or less but over 1 year	More than 5 years	Total
Exchange rate contracts.....	67,736,026	2,283,607	—	70,019,633
Interest rate contracts	27,692,840	40,299,171	1,777,820	69,769,831
Equity contracts.....	2,081,730	—	—	2,081,730
	<u>97,510,596</u>	<u>42,582,778</u>	<u>1,777,820</u>	<u>141,871,194</u>

The Group				
2005				
	Up to 1 year	5 years or less but over 1 year	More than 5 years	Total
Exchange rate contracts.....	7,351,561	—	—	7,351,561
Interest rate contracts	103,946,999	57,938,993	1,967,002	163,852,994
Equity contracts.....	76,210	—	—	76,210
	<u>111,374,770</u>	<u>57,938,993</u>	<u>1,967,002</u>	<u>171,280,765</u>

The Bank				
2006				
	Up to 1 year	5 years or less but over 1 year	More than 5 years	Total
Exchange rate contracts.....	68,270,968	2,283,607	—	70,554,575
Interest rate contracts	28,080,620	40,759,731	1,852,820	70,693,171
Equity contracts.....	2,081,730	—	—	2,081,730
	<u>98,433,318</u>	<u>43,043,338</u>	<u>1,852,820</u>	<u>143,329,476</u>

The Bank				
2005				
	Up to 1 year	5 years or less but over 1 year	More than 5 years	Total
Exchange rate contracts.....	7,926,282	—	—	7,926,282
Interest rate contracts	104,112,999	58,766,598	2,042,002	164,921,599
Equity contracts.....	76,210	—	—	76,210
	<u>112,115,491</u>	<u>58,766,598</u>	<u>2,042,002</u>	<u>172,924,091</u>

(c) The replacement costs and credit risk weighted amounts of the above off-balance sheet exposures are as follows:

	The Group			
	2006		2005	
	Replacement cost	Credit risk weighted amount	Replacement cost	Credit risk weighted amount
Contingent liabilities and commitments	N/A	2,659,818	N/A	1,954,688
Exchange rate contracts	169,917	219,406	59,494	41,391
Interest rate contracts	424,243	152,106	783,180	259,614
Equity contracts	15,096	34,342	1,094	—
	<u>609,256</u>	<u>3,065,672</u>	<u>843,768</u>	<u>2,255,693</u>

	The Bank			
	2006		2005	
	Replacement cost	Credit risk weighted amount	Replacement cost	Credit risk weighted amount
Contingent liabilities and commitments	N/A	2,712,568	N/A	2,120,970
Exchange rate contracts	169,070	219,879	59,496	42,518
Interest rate contracts	441,233	156,190	809,626	265,955
Equity contracts	15,096	34,342	1,094	—
	<u>625,399</u>	<u>3,122,979</u>	<u>870,216</u>	<u>2,429,443</u>

Replacement cost represents the cost of replacing all contracts which have a positive value when marked to market. The credit risk weighted amounts of off-balance sheet exposures are computed in accordance with the Third Schedule of the Hong Kong Banking Ordinance on capital adequacy and depend on the status of the counterparty and the maturity characteristics. The risk weights used range from 0% to 100% for contingent liabilities and commitments, and from 0% to 50% for exchange rate, interest rate and equity contracts.

These amounts do not take into account the effects of bilateral netting arrangements.

(d) Capital commitments

Capital commitments for acquisition of tangible fixed assets outstanding at 31st December, 2006 not provided for in the accounts are as follows:

	The Group		The Bank	
	2006	2005	2006	2005
Expenditure authorised and contracted for	44,934	121,438	36,920	115,380
Expenditure authorised but not contracted for	—	—	—	—
	<u>44,934</u>	<u>121,438</u>	<u>36,920</u>	<u>115,380</u>

(e) Lease commitments

At 31st December, 2006, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

	The Group		The Bank	
	2006	2005	2006	2005
Properties				
1 year or less	28,785	23,350	25,621	20,553
5 years or less but over 1 year	25,366	33,771	23,460	31,732
Over 5 years	5,459	6,329	5,459	6,329
	<u>59,610</u>	<u>63,450</u>	<u>54,540</u>	<u>58,614</u>
Others				
1 year or less	247	344	50	136
5 years or less but over 1 year	16	161	15	—
Over 5 years	—	—	—	—
	<u>263</u>	<u>505</u>	<u>65</u>	<u>136</u>

The Group leases a number of properties and items of equipment under operating leases. The leases run for an initial period of one to ten years, with an option to renew the lease when all terms are renegotiated. Lease payments are periodically adjusted to reflect market rentals. None of the leases includes contingent rentals.

35. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

(a) Reconciliation of operating profit to net cash inflow from operating activities

	The Group	
	2006	2005
Operating profit	1,862,305	1,590,925
Depreciation.....	81,242	75,407
Impairment losses on goodwill (Note 24)	—	1,170
Share option scheme cost (Note 5(e))	—	6,588
EIP cost (Note 5(e))	12,365	3,372
Interest expense on loan capital	134,029	134,148
Profits tax paid	(266,060)	(203,423)
Increase in treasury bills with original maturity of three months or above	(943,831)	(111,285)
Increase in placements with banks and other financial institutions with original maturity of three months or above.....	(3,064,415)	(76,617)
Decrease/(increase) in trade bills less impairment allowances.....	281,826	(101,250)
Decrease in certificates of deposit held.....	—	30,000
Decrease/(increase) in trading assets	172,872	(440,966)
Decrease/(increase) in financial assets measured at fair value through profit or loss	541,468	(646,762)
Increase in advances to customers and other accounts less impairment allowances.....	(5,231,375)	(5,447,396)
(Decrease)/increase in deposits and balances of banks and other financial institutions.....	(24,937)	527,541
Increase in deposits from customers.....	16,393,495	7,104,291
Decrease in certificates of deposit issued.....	(109,036)	(758,233)
(Decrease)/increase in trading liabilities	(275,063)	279,164
Increase in other accounts and provision	778,448	191,709
Net cash inflow from operating activities	<u>10,343,333</u>	<u>2,158,383</u>

(b) Reconciliation of cash and cash equivalents with the consolidated balance sheet

	The Group	
	2006	2005
Cash and short-term funds.....	28,785,949	20,053,798
Placements with banks and other financial institutions maturing between one and twelve months	<u>3,677,234</u>	<u>2,657,380</u>
Amounts shown in the consolidated balance sheet	32,463,183	22,711,178
Less: Amounts with an original maturity of three months or above	(5,694,480)	(1,686,234)
Deposits and balances of banks and other financial institutions that are repayable on demand	<u>(71,552)</u>	<u>(56,754)</u>
Cash and cash equivalents in the consolidated cash flow statement	<u><u>26,697,151</u></u>	<u><u>20,968,190</u></u>

36. SEGMENT REPORTING

(a) Business segments

Retail banking activities include acceptance of deposits, residential mortgages, hire purchase and consumer loans.

Corporate banking activities include advance of commercial and industrial loans, trade financing and institutional banking.

Treasury activities include foreign exchange services, management of investment securities and trading activities.

Other business activities include insurance businesses, stockbroking activities and services for retirement schemes.

Unallocated items mainly comprise the shareholders' funds, investments in premises and investment property, and results of other activities which cannot be reasonably allocated to specific business segments.

The Group							
2006							
	Retail banking	Corporate banking	Treasury	Others	Unallocated	Inter- segment elimination	Total
Net interest income/(expense).....	1,455,093	473,035	(325,670)	2,389	313,886	—	1,918,733
Net interest income/(expense) on financial instruments held for trading and measured at fair value through profit or loss.....	—	—	317,484	—	(110,319)	—	207,165
Other operating income	427,272	78,781	156,439	99,944	49,113	—	811,549
Inter-segment income/(expense).....	—	—	—	—	62,171	(62,171)	—
Operating income.....	1,882,365	551,816	148,253	102,333	314,851	(62,171)	2,937,447
Operating expenses	(690,193)	(150,562)	(27,708)	(50,545)	(155,361)	—	(1,074,369)
Inter-segment (expense)/income.....	(55,745)	(3,062)	(894)	(2,470)	—	62,171	—
Operating profit before impairment losses and allowances charge on loans and advances.....	1,136,427	398,192	119,651	49,318	159,490	—	1,863,078
Impairment losses and allowances (charge)/release for loans and advances	(26,787)	26,134	—	(120)	—	—	(773)
Operating profit	1,109,640	424,326	119,651	49,198	159,490	—	1,862,305
Gains/(losses) on revaluation of investment properties and disposal of tangible fixed assets	(698)	(73)	(2)	(88)	55,083	—	54,222
Gains on disposal of available-for-sale financial assets	1,132	—	12,221	420	—	—	13,773
Share of net profits/(losses) of associated companies	—	—	—	51,252	(301)	—	50,951
Profit before taxation	1,110,074	424,253	131,870	100,782	214,272	—	1,981,251
Depreciation (Note 5(e)).....	29,856	5,283	2,740	801	42,562	—	81,242
Segment assets	45,126,008	24,849,597	25,658,545	108,148	26,210,363	—	121,952,661
Investments in associated companies.....	—	—	—	190,227	7,679	—	197,906
Total assets.....	45,126,008	24,849,597	25,658,545	298,375	26,218,042	—	122,150,567
Total liabilities	97,070,598	2,415,551	617,992	23,875	12,705,828	—	112,833,844
Capital expenditure	88,261	7,708	571	689	157,999	—	255,228

The Group							
2005							
	Retail banking	Corporate banking	Treasury	Others	Unallocated	Inter- segment elimination	Total
Net interest income/(expense).....	1,230,339	378,742	(90,958)	2,855	208,146	—	1,729,124
Net interest income/(expense) on financial instruments held for trading and measured at fair value through profit or loss.....	—	—	220,652	—	(84,776)	—	135,876
Other operating income	398,322	85,892	131,503	82,326	57,727	—	755,770
Inter-segment income/(expense).....	—	—	—	—	56,344	(56,344)	—
Operating income.....	1,628,661	464,634	261,197	85,181	237,441	(56,344)	2,620,770
Operating expenses	(648,406)	(123,753)	(35,108)	(41,919)	(126,603)	—	(975,789)
Inter-segment (expense)/income.....	(51,468)	(2,377)	(652)	(1,847)	—	56,344	—
Operating profit before impairment losses and allowances charges on loans and advances.....	928,787	338,504	225,437	41,415	110,838	—	1,644,981
Impairment losses and allowances charge on loans and advances.....	(15,604)	(38,452)	—	—	—	—	(54,056)
Operating profit	913,183	300,052	225,437	41,415	110,838	—	1,590,925
Gains/(losses) on revaluation of investment properties and disposal of tangible fixed assets	(3,146)	(28)	—	(1)	25,855	—	22,680
(Losses)/gains on disposal of available- for-sale financial assets	—	—	(8,174)	59	(933)	—	(9,048)
Share of net profits of associated companies.....	—	—	—	11,005	244	—	11,249
Profit before taxation	910,037	300,024	217,263	52,478	136,004	—	1,615,806
Depreciation (Note 5(e)).....	27,926	3,807	2,029	1,005	40,640	—	75,407
Impairment losses on goodwill (Note 5(e)).....	—	—	—	291	879	—	1,170
Segment assets.....	40,112,196	21,714,801	21,943,990	122,253	20,282,421	—	104,175,661
Investments in associated companies.....	—	—	—	138,978	7,977	—	146,955
Total assets.....	40,112,196	21,714,801	21,943,990	261,231	20,290,398	—	104,322,616
Total liabilities	84,031,512	1,897,049	662,086	20,550	9,373,368	—	95,984,565
Capital expenditure	24,729	10,557	1,114	238	19,261	—	55,899

(b) Geographical segments

The information concerning geographical segments has been classified by the geographical location of the principal operations of the subsidiaries, or in the case of the Bank itself, of the geographical location of the branch responsible for reporting the results or booking the assets and liabilities.

The Group					
2006					
	Hong Kong	Macau	Others	Less: inter- segment elimination	Total
Total operating income	2,648,730	416,198	190,956	(318,437)	2,937,447
Profit before taxation.....	1,764,280	276,338	82,042	(141,409)	1,981,251
Total assets	118,039,586	18,274,017	16,514,225	(30,677,261)	122,150,567
Total liabilities.....	109,663,538	17,188,389	16,050,385	(30,068,468)	112,833,844
Contingent liabilities and commitments (Note 34(a))....	13,636,801	2,298,288	971,802	(1,577,703)	15,329,188
Capital expenditure	174,999	72,344	7,885	—	255,228

	The Group				
	2005				
	Hong Kong	Macau	Others	Less: inter-segment elimination	Total
Total operating income	2,439,037	328,961	138,562	(285,790)	2,620,770
Profit before taxation	1,476,178	233,180	61,249	(154,801)	1,615,806
Total assets	102,123,436	12,823,757	15,733,485	(26,358,062)	104,322,616
Total liabilities	94,384,492	11,981,792	15,320,048	(25,701,767)	95,984,565
Contingent liabilities and commitments (Note 34(a))...	14,190,916	1,236,398	665,151	(1,113,613)	14,978,852
Capital expenditure	40,759	7,554	7,586	—	55,899

37. PLEDGE OF ASSETS

At 31st December, 2005, a demand deposit of HK\$7,754,000 included in “Cash and short-term funds” is pledged as collateral with the State of California in compliance with the statutory requirements of the State of California. There was no such demand deposit as at 31st December, 2006.

38. MATERIAL RELATED PARTY TRANSACTIONS

(a) Substantial shareholder

During the year, transactions with The Bank of New York Company Inc. (“BNY”), a substantial shareholder of the Bank, or its subsidiaries are entered into by the Group in the ordinary course of business and on normal commercial terms. The income and expenses for the year, average on-balance sheet outstanding for the year and on-balance sheet outstanding at the balance sheet date are:

(i) <i>Income and expense for the year</i>	The Group		The Bank	
	2006	2005	2006	2005
Interest income	8,333	2,927	8,333	2,927
Interest expense	1,454	612	1,454	612

(ii) *Average on-balance sheet outstanding for the year*

	2006	2005	2006	2005
Cash and short-term funds	214,309	110,776	210,390	105,845
Deposits and balances of banks and other financial institutions	43,853	22,254	42,614	20,857

(iii) *On-balance sheet outstanding at the balance sheet date*

	2006	2005	2006	2005
Cash and short-term funds	48,609	62,379	45,948	55,969
Deposits and balances of banks and other financial institutions	106,807	46,539	104,899	46,539

- (iv) On 19th September, 2002, the Bank entered into a Delegation Agreement with BNY pursuant to which the Bank agreed to provide various back-up support services to BNY in connection with a securitisation transaction undertaken by BNY. The Delegation Agreement was terminated on 6th November, 2006. In 2006, the Bank received from BNY a total service fee of HK\$86,000 (2005: HK\$216,000) for the year.

(b) Minority interest holder

On 30th June, 1995, Wing Hang Zurich Insurance Company Limited (“WHZ Insurance”), a 65 percent owned subsidiary of the Bank, entered into a Management Agreement with Swiss Insurance Management (Hong Kong) Limited (“Swiss Insurance”), a wholly own subsidiary of Zurich Insurance Limited (“Zurich Insurance”) pursuant to which Swiss Insurance has been appointed as manager of WHZ Insurance in connection with the conduct by WHZ Insurance of its insurance business. Zurich Insurance is a substantial shareholder of WHZ Insurance holding 35 percent of WHZ Insurance’s issued share capital. On 7th February, 2007, the Management Agreement was extended for two years from 1st January, 2007 to 31st December, 2008. The revised management fee is based on a certain percentage of gross written premiums received. Under the Management Agreement, WHZ Insurance pays to Swiss Insurance an amount of HK\$5,312,000 (2005: HK\$5,299,000), being the contractual management fees payable during the year.

The auditors of the Bank have confirmed to the Board of Directors in writing that:

- (i) The transactions have been approved by the Board of Directors;
- (ii) The transactions have been entered into for considerations consistent with the pricing policies as stated in the Management Agreement;
- (iii) The transactions have been entered into in accordance with the terms of the Management Agreement; and
- (iv) No cap was disclosed in the previous announcement.

The independent non-executive directors of the Bank considered the above transactions were in line with the normal course of business for the Bank on normal commercial terms in accordance with the Management Agreement that was considered fair and reasonable and in the interests of the shareholders.

(c) Subsidiaries

During the year, the Bank entered into the transactions with subsidiaries owned by the Bank in the ordinary course of business and on normal commercial terms. The income and expenses for the year, average on-balance sheet outstanding for the year, on-balance sheet and off-balance sheet outstandings at the balance sheet date are:

	The Bank	
	2006	2005
(i) Income and expense for the year		
Interest income	307,933	191,407
Interest expense	652,629	489,175
(ii) Average on-balance sheet outstanding for the year		
Amounts due from subsidiaries	6,412,937	5,708,720
Amounts due to subsidiaries	14,094,649	13,818,556
(iv) On-balance sheet outstanding at the balance sheet date		
Amounts due from subsidiaries	7,285,939	6,074,285
Amounts due to subsidiaries	16,100,651	14,201,751

(vi) *Off-balance sheet outstanding (contract amounts) at the balance sheet date*

	2006	2005
Direct credit substitutes	12,666	14,052
Transaction-related contingencies	200,000	200,000
Trade-related contingencies	49,326	67,486
Other commitments	684,140	417,484

(d) **Associated company**

The Group provides an unsecured and interest-free loan of HK\$62,000,000 (2005: HK\$62,000,000) to an associated company which is repayable in 2008.

(e) **Key management personnel**

During the year, the Group enters into a number of transactions with the Group's key management personnel and their close family members and companies controlled or significantly influenced by them. All the transactions are in the ordinary course of business and under terms and conditions normally applicable to customers of comparable standing. The interest income, interest expenses and emoluments for the year, average on-balance sheet outstanding for the year and on-balance sheet outstanding at the balance sheet date are as follows:

	The Group		The Bank	
	2006	2005	2006	2005
Interest income	30,159	25,243	30,078	25,201
Interest expense	36,814	20,909	35,866	17,447

(ii) *Average on-balance sheet outstanding for the year*

	2006	2005	2006	2005
Advances to customers	550,981	654,791	549,450	653,133
Deposits from customers	892,011	782,131	867,278	660,831

(iii) *On-balance sheet outstanding at the balance sheet date*

	2006	2005	2006	2005
Advances to customers	528,757	659,624	527,277	658,031
Deposits from customers	974,236	776,434	963,722	657,882

(iv) *Emoluments for the year*

Remuneration for key management personnel, including amounts paid to the Bank's directors as disclosed in note 10 and certain of the highest paid employees as disclosed in note 11, is as follows:

	2006	2005
Short-term employee benefits	39,113	28,240
Post-employment benefits	1,648	1,522
Equity compensation benefits	9,028	6,464
	<u>49,789</u>	<u>36,226</u>

(f) Loans to officers

Particulars of loans to officers disclosed pursuant to section 161B(9) of the Hong Kong Companies Ordinance are as follows:

	The Group and the Bank	
	2006	2005
Aggregate amount of relevant loans outstanding at 31st December	398,019	424,044
The maximum aggregate amount of relevant loans outstanding during the year	479,419	499,399

(g) During the year, no allowance for impairment losses has been made in respect of the above advances to related parties (2005: Nil).

39. MANAGEMENT OF RISKS

The Group has established policies, procedures and limits to manage various types of risk that the Group is exposed to. Risk management processes and management information systems are in place to identify, measure, monitor and control credit risk, liquidity risk, market risk, operational risk etc. The risk management policies, procedures and limits are approved by the Board of Directors or its designated committee, and are monitored and reviewed regularly by relevant risk management committees, such as the Credit Committee and the Asset and Liability Management Committee (“ALMCO”). Internal auditors perform regular audits and independent checking to ensure compliance with the policies and procedures.

(a) Credit risk management

Credit risk arises from the possibility that the counterparty in a transaction may default. It arises from the lending, trade finance, treasury, derivatives and other activities undertaken by the Group. The Board of Directors has delegated the Group’s credit risk management to the Credit Committee, which is chaired by the Bank’s Chairman and Chief Executive.

The credit risk management function is independent of the business units. It oversees the implementation of credit policies and ensures the quality of credit evaluation and approval. Credit approval is conducted in accordance with the Group’s credit policy, which defines the credit extension criteria, the credit approval and monitoring processes, the loan classification system and impairment policy. The credit policy also takes into account the requirements of the Hong Kong Banking Ordinance, guidelines issued by the HKMA and accounting standards issued by the HKICPA with respect to large exposures and impairment requirements.

Guidelines to manage credit risk have been laid down in the Group’s Loaning Manual, which is regularly reviewed and approved by the Credit Committee. The Loaning Manual covers the delegated lending authorities, credit extension criteria, credit monitoring process, loan classification system, credit recovery and impairment policy.

(i) Corporate credit risk

The corporate credit exposures are diversified among corporates, middle market borrowers and SMEs. The large corporate exposures are generally concentrated among highly rated customers. The principal means of managing credit risk is the credit approval process. The Group has policies and procedures to evaluate the potential credit risk of a particular counterparty or transaction and to approve the transaction. For corporate clients, the Group has a detailed credit review system that is applied to each counterparty on a regular basis. The Group also has limits for exposure to individual industries and for borrowers and groups of borrowers, regardless of whether the exposure is in the form of loans or non-funded exposures. The Group also has a review process that ensures the proper level of review and approval depending on the size of the facility and risk grading of the credit.

The Group undertakes ongoing credit review and monitoring at various levels. The credit policies promote early detection of counterparty, industry or product exposures that require special attentions. The Credit Committee oversees the overall portfolio risk as well as individual problem loans and potential problem loans on a regular basis.

(ii) Retail credit risk

The Group’s retail credit policy and approval process are designed based on the characteristics of the retail banking products: small value but high volume, and relatively homogeneous transactions. Monitoring the credit risk of retail exposures is based primarily on statistical analyses and portfolio review with respect to different products and types of customers. The Group reviews and revises the product terms and customer profiles on a continual basis according to the performance of respective portfolios and the market practices.

(iii) Credit-related commitments

The risks involved in credit-related commitments and contingencies are essentially the same as the credit risk involved in extending loan facilities to customers. These transactions are, therefore, subject to the same credit application, portfolio maintenance and collateral requirements as for customers applying for loans.

(iv) Concentrations of credit risk

Concentration of credit risk exists when changes in geographic, economic or industry factors similarly affect groups of counterparties whose aggregate credit exposure is material in relation to the Group's total exposures. The Group's portfolio is diversified along geographic, industry and product sectors in accordance with the established limits approved by the relevant risk committees.

Analysis of credit risk concentration by economic sector of respective financial assets is disclosed in notes 15 to 20 and geographical concentration of the Group's asset is disclosed in note 36(b).

(b) Liquidity risk management

Liquidity risk is the risk of inability to fund an increase in assets or meet obligations as they fall due. The Group has established liquidity management policies for ensuring adequate liquidity is maintained at all times. The Group maintained an average liquidity ratio of 51.6% in 2006, which is well above the statutory requirement of 25%.

Liquidity is managed day-to-day by the treasury under the direction of ALMCO. ALMCO, which comprises personnel from senior management, treasury function, risk management, financial management and other business areas that could affect liquidity risk, is responsible for overseeing the liquidity risk management, in particular implementation of appropriate liquidity policies and procedures, identifying, measuring and monitoring liquidity risk, and control over the liquidity risk management process. The Board of Directors approves the liquidity risk strategy and policies, maintaining continued awareness of the overall liquidity risk profile, and ensuring liquidity risk is adequately managed and controlled by senior management within the established risk management framework.

To cater for funding requirements during ordinary course of business, sufficient liquid assets are held and also access to the interbank market is maintained. In addition, adequate standby facilities are maintained in order to meet any unexpected and material cash outflow. The Group also performs regular stress tests on its liquidity position to ensure adequate liquidity is maintained at all times. The detail of the analysis on the Group's and Bank's material assets and liabilities into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date are set out in note 31.

(c) Market risk management

Market risk is the risk arising from the movements in market prices of on- and off- balance sheet positions in interest rates, foreign exchange rates as well as equity and commodity prices and the resulting change in the profit/loss or reserve of the Group.

The Group is exposed to market risk on position taken or financial instrument held or taken such as foreign exchange contracts, interest rate contracts, fixed income and equity securities and derivatives instruments.

The Board of Directors reviews and approves the policies for the management of market risks and trading authorities. ALMCO has been delegated the responsibility of controlling and monitoring market risk including regular review of the risk exposures and the risk management framework such as the established limits and stop-losses. The limits are set by ALMCO and reviewed on a periodic basis with reference to market conditions, with any material changes requiring a review by the Board of Directors. It is the Bank's policy that no limit should be exceeded. Middle Office has been delegated the duties of intra-day monitoring and ensuring compliance with the policy and limits.

The Group adopts a prudent approach in managing the portfolio of trading instruments. It reduces excessive market risk by offsetting trading transactions or hedging the open positions by executing derivative contracts with other market counterparties. Trading of interest rate and foreign exchange derivative contracts forms an integral part of the Group's trading activities, which are primarily for squaring the trading positions or covering the customer driven positions.

The Group uses Price Value Basis Point ("PVB") to monitor and limit its interest rate risk exposure. PVB is a technique involving the calculation of the change in present value of a financial instrument or a portfolio of instruments due to a change in one basis point of interest rates. It also provides a quick tool to evaluate the impact on profit and loss due to a basis point movement in interest rates.

(i) Interest rate risk

The Group's interest rate exposures arise from lending, deposit taking as well as treasury activities. Interest rate risk primarily results from the timing differences in the repricing of interest-bearing assets, liabilities and commitments, which may apply to both banking book and trading book. It also relates to positions from non-interest bearing liabilities including shareholders' funds and current accounts, as well as from certain fixed rate loans and liabilities. The Group's interest rate risk is monitored by the ALMCO within limits approved by the Board, including interest rate gap limit, product limit and PVB limit. The Group also uses interest rate swaps and other derivatives to manage interest rate risk.

Structural interest rate risk arises primarily from the deployment of non-interest bearing liabilities, including shareholders' funds and current accounts, as well as from certain fixed rate loans and liabilities. Structural interest rate risk is monitored by ALMCO.

The following tables indicate the expected next repricing dates (or maturity dates whichever are earlier) for the assets and liabilities at the balance sheet date.

The Group						
2006						
	Total	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Non-interest bearing
Assets						
Cash and short-term funds.....	28,785,949	27,500,077	537,598	—	—	748,274
Placements with banks and other financial institutions maturing between one and twelve months	3,677,234	3,519,172	158,062	—	—	—
Trade bills less impairment allowances	370,549	360,636	9,913	—	—	—
Trading assets	738,392	—	50	248	114,922	623,172
Financial assets measured at fair value through profit or loss	5,382,956	1,320,416	165,939	3,412,250	484,351	—
Advances to customers and other account less impairment allowances	60,656,719	51,822,520	3,370,438	2,553,473	627,544	2,282,744
Advances to banks	47,539	—	47,539	—	—	—
Held-to-maturity and available-for- sale financial assets	19,534,360	9,561,003	658,282	8,205,030	995,306	114,739
Other assets.....	2,956,869	—	—	—	—	2,956,869
Total assets	122,150,567	94,083,824	4,947,821	14,171,001	2,222,123	6,725,798
Liabilities						
Deposits and balances of banks and other financial institutions.....	1,692,887	795,123	756,466	129,395	—	11,903
Deposits from customers	102,066,947	92,055,356	4,702,941	204,148	836	5,103,666
Certificates of deposit issued.....	3,715,303	3,475,160	86,952	153,191	—	—
Trading liabilities.....	590,899	—	—	—	—	590,899
Other liabilities	2,239,958	72,208	—	—	—	2,167,750
Loan capital	2,527,850	—	—	2,527,850	—	—
Total liabilities.....	112,833,844	96,397,847	5,546,359	3,014,584	836	7,874,218
Interest rate sensitivity gap.....	9,316,723	(2,314,023)	(598,538)	11,156,417	2,221,287	(1,148,420)

The Group						
2005						
	Total	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Non-interest bearing
Assets						
Cash and short-term funds.....	20,053,798	19,435,975	95,335	—	—	522,488
Placements with banks and other financial institutions maturing between one and twelve months	2,657,380	2,559,271	98,109	—	—	—
Trade bills less impairment allowances.....	652,375	645,555	6,820	—	—	—
Trading assets	911,264	—	300	1,412	—	909,552
Financial assets measured at fair value through profit or loss	5,924,424	981,327	1,223,951	3,274,944	444,202	—
Advances to customers and other account less impairment allowances.....	55,393,692	47,715,104	3,264,783	2,762,867	389,864	1,261,074
Advances to banks	79,191	78,982	—	—	—	209
Held-to-maturity and available-for- sale financial assets	15,909,430	5,789,899	219,240	8,702,037	1,090,191	108,063
Other assets.....	2,741,062	—	—	—	—	2,741,062
Total assets	104,322,616	77,206,113	4,908,538	14,741,260	1,924,257	5,542,448
Liabilities						
Deposits and balances of banks and other financial institutions.....	1,703,026	1,160,138	432,567	76,901	—	33,420
Deposits from customers	85,673,452	79,337,292	1,688,551	328,575	1,150	4,317,884
Certificates of deposit issued.....	3,824,339	3,432,341	384,067	7,931	—	—
Trading liabilities.....	865,962	—	—	—	—	865,962
Other liabilities	1,397,898	44,236	—	—	—	1,353,662
Loan capital	2,519,888	—	—	2,519,888	—	—
Total liabilities.....	95,984,565	83,974,007	2,505,185	2,933,295	1,150	6,570,928
Interest rate sensitivity gap.....	8,338,051	(6,767,894)	2,403,353	11,807,965	1,923,107	(1,028,480)

The Bank						
2006						
	Total	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Non-interest bearing
Assets						
Cash and short-term funds.....	26,124,387	25,623,019	—	—	—	501,368
Placements with banks and other financial institutions maturing between one and twelve months	3,608,960	3,450,897	158,063	—	—	—
Trade bills less impairment allowances.....	323,718	313,805	9,913	—	—	—
Trading assets	749,578	—	50	248	114,922	634,358
Financial assets measured at fair value through profit or loss	5,382,956	1,320,416	165,939	3,412,250	484,351	—
Advances to customers and other accounts less impairment allowances.....	46,477,066	42,569,045	1,444,243	397,486	573,470	1,492,822
Advances to banks	47,539	—	47,539	—	—	—
Held-to-maturity and available-for- sale financial assets	18,930,025	9,491,049	640,785	7,838,390	855,797	104,004
Amounts due from subsidiaries	7,285,939	3,733,768	400,000	1,445,000	1,665,000	42,171
Other assets.....	2,840,243	—	—	—	—	2,840,243
Total assets	111,770,411	86,501,999	2,866,532	13,093,374	3,693,540	5,614,966
Liabilities						
Deposits and balances of banks and other financial institutions.....	1,673,424	778,755	756,466	129,396	—	8,807
Deposits from customers	81,184,068	73,158,440	3,961,148	132,268	—	3,932,212
Certificates of deposit issued.....	3,720,276	3,475,160	91,925	153,191	—	—
Trading liabilities.....	592,379	—	—	—	—	592,379
Amounts due to subsidiaries.....	16,100,651	8,192,718	3,130,884	4,287,035	—	490,014
Other liabilities.....	1,318,913	72,208	—	—	—	1,246,705
Total liabilities.....	104,589,711	85,677,281	7,940,423	4,701,890	—	6,270,117
Interest rate sensitivity gap.....	7,180,700	824,718	(5,073,891)	8,391,484	3,693,540	(655,151)

The Bank						
2005						
	Total	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Non-interest bearing
Assets						
Cash and short-term funds.....	18,744,775	18,379,921	—	—	—	364,854
Placements with banks and other financial institutions maturing between one and twelve months	2,629,507	2,531,398	98,109	—	—	—
Trade bills less impairment allowances.....	412,544	405,724	6,820	—	—	—
Trading assets	929,710	—	300	1,412	—	927,998
Financial assets measured at fair value through profit or loss	5,924,424	981,327	1,223,951	3,274,944	444,202	—
Advances to customers and other accounts less impairment allowances.....	43,141,730	39,911,818	1,573,446	491,679	335,544	829,243
Advances to banks	79,191	78,982	—	—	—	209
Held-to-maturity and available-for-sale financial assets	15,249,952	5,758,880	180,738	8,262,035	951,221	97,078
Amounts due from subsidiaries	6,074,285	2,483,291	270,000	1,445,000	1,845,000	30,994
Other assets.....	2,876,100	—	—	—	—	2,876,100
Total assets	96,062,218	70,531,341	3,353,364	13,475,070	3,575,967	5,126,476
Liabilities						
Deposits and balances of banks and other financial institutions.....	1,694,613	1,152,206	432,567	76,901	—	32,939
Deposits from customers	67,902,897	62,804,506	1,218,022	177,890	—	3,702,479
Certificates of deposit issued.....	3,829,252	3,432,341	388,980	7,931	—	—
Trading liabilities.....	869,748	—	—	—	—	869,748
Amounts due to subsidiaries.....	14,201,751	7,032,897	3,328,411	3,605,499	—	234,944
Other liabilities.....	936,858	44,236	—	—	—	892,622
Total liabilities.....	89,435,119	74,466,186	5,367,980	3,868,221	—	5,732,732
Interest rate sensitivity gap.....	6,627,099	(3,934,845)	(2,014,616)	9,606,849	3,575,967	(606,256)

The following table indicates the effective interest rates for the last month of the year:

	The Group		The Bank	
	2006	2005	2006	2005
	%	%	%	%
Placement with banks and other financial institutions	4.75	4.51	4.75	4.51
Advances to customers and trade bills	6.08	6.08	5.88	5.92
Debt securities	5.18	4.40	5.28	4.45
	5.57	5.37	5.44	5.21
Deposits and balances of banks and other financial institutions	4.08	3.71	4.12	3.74
Deposits from customers	4.01	3.69	4.10	3.77
Certificates of deposit issued	3.19	3.73	3.19	3.73
Loan capital	5.32	5.32	5.32	5.32
	4.01	3.74	4.10	3.82

(ii) **Currency risk**

The Group foreign exchange positions, which arise from foreign exchange dealing, commercial banking operations and structural foreign currency exposures arising from capital investment in subsidiaries and branches outside Hong Kong, mainly in US dollar, Macau Patacas and Renminbi, are managed by ALMCO. All foreign exchange positions are managed by the ALMCO within limits approved by the Board of Directors.

The net positions or net structural positions in foreign currencies are disclosed below where each currency constitutes 10% or more of the respective total net position or total net structural position in all foreign currencies.

(In millions of HK\$ equivalent)	The Group			
	2006		2005	
	US\$	Total	US\$	Total
Spot assets	33,352	54,786	31,689	51,672
Spot liabilities	(33,486)	(54,549)	(32,431)	(52,130)
Forward purchases	32,214	35,141	5,396	7,871
Forward sales	(28,651)	(32,299)	(3,257)	(5,783)
Net option position	(171)	(166)	—	—
Net long positions	<u>3,258</u>	<u>2,913</u>	<u>1,397</u>	<u>1,630</u>

(In millions of HK\$ equivalent)	The Group			
	2006			
	Macau Patacas	Chinese Renminbi	US\$	Total
Net structural positions	<u>441</u>	<u>199</u>	<u>324</u>	<u>964</u>

(In millions of HK\$ equivalent)	The Group			
	2005			
	Macau Patacas	Chinese Renminbi	US\$	Total
Net structural positions	<u>204</u>	<u>192</u>	<u>317</u>	<u>713</u>

(In millions of HK\$ equivalent)	The Bank			
	2006		2005	
	US\$	Total	US\$	Total
Spot assets	32,657	53,936	30,706	50,587
Spot liabilities	(33,033)	(53,905)	(31,683)	(51,291)
Forward purchases	32,214	35,095	5,396	7,871
Forward sales	(28,651)	(32,297)	(3,257)	(5,775)
Net option position	(171)	(166)	—	—
Net long positions	<u>3,016</u>	<u>2,663</u>	<u>1,162</u>	<u>1,392</u>

(In millions of HK\$ equivalent)	The Bank			
	2006			
	Macau Patacas	Chinese Renminbi	US\$	Total
Net structural positions	<u>(583)</u>	<u>199</u>	<u>324</u>	<u>(60)</u>

(In millions of HK\$ equivalent)	The Bank			
	2005			
	Macau Patacas	Chinese Renminbi	US\$	Total
Net structural positions.....	(583)	192	317	(74)

(d) 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.

The Group's risk management framework is established to control risks at both corporate and departmental levels. The underlying management principle is built upon a long-standing culture of high integrity and risk awareness fostered by senior executives of the Group.

The framework consists of governing policies with control measures to ascertain absolute compliance by all operating units. These measures are directed, controlled and held to account by operation management committees chaired by senior executives. Regular reviews are performed by the committees to ensure proper functioning of internal controls and to identify improvement opportunities.

Furthermore, independent reviews are conducted by the Group's Internal Audit Division to measure the effectiveness of the Group's system of internal controls. This division reports to the Audit Committee to ensure the framework is managed with high standards of probity.

40. STAFF BENEFITS

(a) Retirement schemes

	The Group	
	2006	2005
Retirement benefit costs (Note 5(e))	40,467	36,267

The Group operates both a Mandatory Provident Fund Exempt ORSO Scheme ("the ORSO Scheme") which is registered under the Hong Kong Occupational Retirement Schemes Ordinance and two Mandatory Provident Fund Schemes ("the MPF Schemes") established under the Hong Kong Mandatory Provident Fund Ordinance to cover all qualifying employees in Hong Kong. As from 1st August, 2004, the ORSO Scheme has been frozen as employees and the employer have made the contributions to MPF Schemes instead. In addition, a defined contribution scheme was established on 3rd January, 2001 to cover all qualifying employees in Macau at various funding rates, in accordance with the local practice and requirements. The costs of these schemes are charged to the profit and loss account as incurred and the assets of these schemes are held separately from the Group. Any forfeiture amount under the MPF Schemes is refunded to the Group when the member leaves employment prior to the employer's voluntary contributions being vested fully.

(b) Equity compensation benefits

(i) Share Option Scheme

Pursuant to the approved Share Option Scheme, the directors are authorised, at their discretion, to invite certain executives, to take up options to purchase ordinary shares in the Bank as an incentive to them. Prior to 1st September, 2001, the exercise price was 80% of the average closing price on The Stock Exchange of Hong Kong Limited ("SEHK") on the five business days immediately preceding the date of offer of such options. After 1st September, 2001, the exercise price should be at least the higher of the closing price of the shares on SEHK on the date of the grant, which must be a trading day, and the average closing price of the shares on SEHK for the five business days immediately preceding the date of grant.

(1) Movements in share options

	2006		2005	
	Weighted average exercise price	Number of shares	Weighted average exercise price	Number of shares
	HK\$		HK\$	
Outstanding at 1st January	37.43	1,285,000	33.56	1,105,000
Granted	—	—	50.88	350,000
Lapsed	—	—	36.45	(60,000)
Exercised	31.64	(200,000)	46.49	(110,000)
Outstanding at 31st December.....	<u>38.50</u>	<u>1,085,000</u>	<u>37.43</u>	<u>1,285,000</u>
Exercisable at 31st December	<u>38.50</u>	<u>1,085,000</u>	<u>32.86</u>	<u>960,000</u>

(2) Terms and conditions of unexpired and unexercised share options at balance sheet date

		2006	2005
Date of options granted	Exercise price	Number of shares	Number of shares
	HK\$		
10/03/2001	23.60	150,000	190,000
15/03/2002	26.30	120,000	170,000
14/01/2003	25.80	60,000	80,000
14/03/2003	26.50	100,000	130,000
21/05/2004	43.80	350,000	390,000
14/01/2005	51.25	220,000	220,000
28/01/2005	50.25	85,000	105,000
		<u>1,085,000</u>	<u>1,285,000</u>

The options granted under the Share Option Scheme will be exercisable between the first and the tenth anniversaries of the date of grant, and settled by physical delivery of shares.

The options outstanding at 31st December, 2006 have a weighted average remaining contractual life of 6.71 years (2005: 7.59 years).

(3) Details of share options granted during the year, all of which were granted with HK\$1.00 consideration.

		2006	2005
Exercise period	Exercise price	Number of shares	Number of shares
	HK\$		
14/01/2006 — 14/01/2015	51.25	—	220,000
28/01/2006 — 28/01/2015	50.25	—	130,000
		<u>—</u>	<u>350,000</u>

(4) Details of share options exercised during the year

Exercise date	Exercise price	Weighted average closing price per share at preceding day before exercise date	Proceeds received	2006	2005
		HK\$		Number of shares	Number of shares
15/04/2005	23.60	48.20	944,000	—	40,000
21/05/2005	43.80	51.00	657,000	—	15,000
31/05/2005	43.80	54.50	657,000	—	15,000
16/08/2005	43.80	58.90	876,000	—	20,000
27/09/2005	43.80	56.40	876,000	—	20,000
01/02/2006	50.25	56.10	1,005,000	20,000	—
01/04/2006	25.80	65.15	516,000	20,000	—
01/04/2006	26.30	65.15	526,000	20,000	—
16/06/2006	43.80	63.95	1,752,000	40,000	—
18/08/2006	23.60	77.70	944,000	40,000	—
25/08/2006	26.30	75.00	789,000	30,000	—
25/08/2006	26.50	75.00	795,000	30,000	—
				<u>200,000</u>	<u>110,000</u>

The weighted average share price at the exercise date for share options exercised during the year is HK\$69.32 (2005: HK\$52.90).

(5) Fair value of share options and assumptions

The fair value per option at the dates of grant using the Bi-nominal pricing model with the following assumptions are as follows:

	Option granted on 28/01/2005	Option granted on 14/01/2005
Risk-free interest rate (%)	3.63	3.79
Expected life (in years)	10.0	10.0
Expected Volatility (%)	23.48	24.65
Expected dividend yield (%)	3.57	3.57
Estimated fair value per option (HK\$)	11.45	11.85

The Bi-nominal pricing model was used in estimating the fair value of share options after taking into account the exercise price and the life of the option. Such option pricing model requires the input of highly subjective assumptions including the risk-free interest rate, expected volatility and dividend yield of the shares. The changes in subjective input assumptions can materially affect the fair value estimate.

The expected volatility is based on the historic volatility (calculated based on the weighted average remaining life of the share options), adjusted for any expected changes to future volatility due to publicly available information. Expected dividends are based on historical dividends.

Share options were granted under a service condition. This condition has not been taken into account in the grant date fair value measurement of the services received. The fair value of the options were measured at the grant date and are charged to the profit and loss account and credited to shareholders' funds between the grant date and vesting date. There were no market conditions associated with the share option grants.

(ii) EIP

Pursuant to the approved EIP, the directors are authorised, at their discretion, to invite certain executives, to take up awards to vesting ordinary shares in the Bank as incentive for them to remain in employment with the Bank. The maximum number of awards that may be granted under the EIP may not exceed 1% of the issued share capital of the Bank for the time being in issue within five years of the date of approval of the plan on 22nd April, 2004.

The Group grants awards at no consideration for certain employees to acquire ordinary shares in the Bank under the EIP. The shares will be acquired at a nominal value of HK\$1 per share under the award. If the Board of Directors determines to select the cash option when shares vest, which is available under the plan, no new shares will be issued on the date of vesting. The percentage of awards vested between the sixth to the tenth anniversaries after the date of grant is as follows:

Date	Percentage of Award vesting
Sixth anniversary of the date of grant	5%
Seventh anniversary of the date of grant	10%
Eighth anniversary of the date of grant	15%
Ninth anniversary of the date of grant	20%
Tenth anniversary of the date of grant	50%

At 31st December, 2006, the Directors and employees of the Bank have the following interest in awards to purchase the ordinary shares in the Bank.

Date of awards granted	Exercise price	2006		2005	
		Fair value of awards at date of grant	Number of shares	Fair value of awards at date of grant	Number of shares
	HK\$				
21/05/2004	1.00	21,186,000	495,000	21,186,000	495,000
23/01/2006	1.00	87,672,000	1,560,000	—	—
		<u>108,858,000</u>	<u>2,055,000</u>	<u>21,186,000</u>	<u>495,000</u>

The fair value per award at the date of grant is determined based on the closing price of the shares of the Bank less the exercise price of the award. The fair value per award at the date of grant is as follows:

	Award granted on 23/01/2006
	HK\$
Closing price of the shares of the Bank at the date of grant	57.20
Less: Exercise price	(1.00)
Estimated fair value per award	<u>56.20</u>

41. FAIR VALUES OF FINANCIAL INSTRUMENTS

Fair value estimates are generally subjective in nature, and are made as of a specific point in time based on the characteristics of the financial instruments and relevant market information. Where available, the most suitable measure for fair value is the quoted market price. In the absence of organised secondary markets for most financial instruments, and in particular for loans, deposits and unlisted derivatives, direct market prices are not available. The fair value of such instruments was therefore calculated on the basis of well-established valuation techniques using current market parameters. In particular, the fair value is a theoretical value applicable at a given reporting date, and hence can only be used as an indicator of the value realisable in a future sale.

All valuation models are validated before they are used as a basis for financial reporting. Wherever possible, the Group compares valuations derived from models with quoted prices of similar financial instruments, and with actual values when realised, in order to further validate and calibrate the models. These techniques involve uncertainties and are significantly affected by the assumptions used and judgments made regarding risk characteristics of various financial instruments, discount rates, estimates of future cash flows, future expected loss experiences and other factors. Changes in assumptions could significantly affect these estimates and the resulting fair values. Derived fair value estimates cannot necessarily be substantiated by comparison to independent markets and, in many cases, could not be realised in an immediate sale of the instruments.

All financial instruments are stated at fair value or carried at amounts not materially different from their fair values as at 31st December, 2006 and 31st December, 2005 except as follows:

	The Group			
	2006	2005	2006	2005
	Carrying value	Carrying value	Fair value	Fair value
Financial assets				
Held-to-maturity and available-for-sale financial assets..	19,534,360	15,909,430	19,456,681	15,829,097
Financial liabilities				
Certificates of deposit issued at amortised cost	2,205,000	1,902,640	2,208,888	1,905,045
Loan capital	2,527,850	2,519,888	2,486,484	2,479,972

	The Bank			
	2006	2005	2006	2005
	Carrying value	Carrying value	Fair value	Fair value
Financial assets				
Held-to-maturity and available-for-sale financial assets..	18,930,025	15,249,952	18,855,284	15,175,619
Financial liabilities				
Certificates of deposit issued at amortised cost	2,205,000	1,902,640	2,208,888	1,905,045

The following methods and significant assumptions have been applied in determining the fair values of financial instruments presented in above.

- (a) the fair value of demand deposits and savings accounts with no specific maturity is assumed to be the amount payable on demand at the balance sheet date.
- (b) the fair value of variable rate financial instruments is assumed to approximate their carrying amounts and, in the case of loans and unquoted debt securities, does not, therefore, reflect changes in their credit quality, as the impact of credit risk is recognised separately by deducting the amount of the impairment loss and allowances from both the carrying amount and fair value.
- (c) the fair value of fixed rate loans and mortgages carried at amortized cost is estimated by comparing market interest rates when the loans were granted with current market rates offered on similar loans. Changes in the credit quality of loans within the portfolio are not taken into account in determining gross fair values, as the impact of credit risk is recognised separately by deducting the amount of the impairment loss and allowances from both the carrying amount and fair value.
- (d) the fair value of unquoted equity investments is estimated, if possible, using applicable price/earnings ratios for similar listed companies adjusted to reflect the specific circumstances of the issuers.
- (e) the fair value of forward exchange contracts and interest rate swaps is estimated either using broker quotes or by discounting future cash flows. Broker quotes are back tested using pricing models or discounted cash flow techniques. Future cash flows are estimated based on management's best estimates of the amount it would receive or pay to terminate the contract at the balance sheet date taking into account current market conditions and the current creditworthiness of the counterparties. The discount rate used is a market rate for a similar instrument at the balance sheet date. The fair value of an option contract is determined by applying the Black-Scholes option valuation model. Inputs are based on market related data at the balance sheet date.

42. POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE YEAR ENDED 31ST DECEMBER, 2006

Up to the date of issue of the accounts, the HKICPA has issued a number of amendments, new standards and interpretations and the HKMA has recommended additional disclosures, which are not yet effective for the accounting year ended 31st December, 2006 and which have not been adopted in these accounts.

The Group is in the process of making an assessment of what the impact of these amendments, new standards, new interpretations and additional disclosures is expected to be in the period of initial application. So far it has concluded that the adoption of them is only expected to affect the level of detail of the disclosures, and is not expected to have any impact on the Bank's balance sheet or the Group's consolidated profit and loss account, consolidated balance sheet, consolidated statement of changes in equity and consolidated cash flow statement.

In addition, the following developments may result in new or amended disclosures in the financial statements:

	Effective for accounting periods beginning on or after
HKFRS 7, <i>Financial instruments: disclosures</i>	1st January, 2007
Amendment to HKAS 1, <i>Presentation of financial statements: capital disclosures</i>	1st January, 2007
Banking (Disclosure) Rules	1st January, 2007

43. NON-ADJUSTING POST BALANCE SHEET EVENTS

On 21st December, 2006, the Bank entered into a Share Purchase Agreement with BankAmerica International Financial Corporation (“BankAmerica”), Inchcape Hong Kong Limited (“Inchcape”) and Inchcape International Holdings Limited whereby the Bank agreed to acquire the entire issued share capital of Inchroy Credit Corporation Limited (“Inchroy”) from BankAmerica and Inchcape for a consideration of HK\$1,400 millions. The purchase price represents approximately 1.49 times the net asset value of Inchroy as at 31st December, 2006. Inchroy is a registered deposit-taking company in Hong Kong. The completion date of the acquisition was 31st January 2007.

44. APPROVAL OF ACCOUNTS

The accounts were approved and authorised for issue by the Board of Directors on 15th March, 2007.

APPENDIX II

REPORT OF THE AUDITORS AND AUDITED FINANCIAL STATEMENTS OF THE GROUP FOR THE YEAR ENDED 31 DECEMBER 2005

TO THE SHAREHOLDERS OF WING HANG BANK, LIMITED

(Incorporated in Hong Kong with limited liability)

We have audited the accounts on pages 170 to 253 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Hong Kong Companies Ordinance requires the directors to prepare accounts which give a true and fair view. In preparing accounts which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on those accounts and to report our opinion solely to you, as a body, in accordance with section 141 of the Hong Kong Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

BASIS OF OPINION

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the Bank's and Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the accounts are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts. We believe that our audit provides a reasonable basis for our opinion.

OPINION

In our opinion, the accounts give a true and fair view of the state of affairs of the Bank and of the Group as at 31st December, 2005 and of the Group's profit and cash flows for the year then ended and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

KPMG

Certified Public Accountants

Hong Kong, 16th March, 2006

Consolidated Profit and Loss Account
For the year ended 31st December, 2005
(Expressed in thousands of Hong Kong dollars)

		2005	2004
	Notes		(restated)
Interest income.....	5(a)	4,041,779	2,877,006
Interest expenses.....	5(b)	<u>(2,312,655)</u>	<u>(1,082,689)</u>
Net interest income		1,729,124	1,794,317
Net interest income on financial instruments held for trading and measured at fair value through profit or loss.....	5(c)	<u>135,876</u>	<u>—</u>
Total net interest income.....		1,865,000	1,794,317
Other operating income.....	5(d)	<u>755,770</u>	<u>640,017</u>
Operating income		2,620,770	2,434,334
Operating expenses	5(e)	<u>(975,789)</u>	<u>(1,033,039)</u>
Operating profit before impairment allowances on impaired loans and advances.....		1,644,981	1,401,295
Impairment losses and allowances on impaired loans and advances	20	(54,056)	—
Charge for bad and doubtful debts	20	<u>—</u>	<u>(54,434)</u>
Operating profit.....		1,590,925	1,346,861
Gains on revaluation of investment properties, disposal of tangible fixed assets and associated company	6(a)	22,680	55,552
(Losses)/profits on disposal of held-to-maturity and available-for-sale financial assets	6(b)	(9,048)	201
Profits on disposal of non-trading securities		—	6,307
Impairment allowances release for held-to-maturity financial assets		<u>—</u>	<u>4,848</u>
Profit on ordinary activities		1,604,557	1,413,769
Share of net profits in associated companies.....		<u>11,249</u>	<u>4,545</u>
Profit before taxation		1,615,806	1,418,314
Taxation.....	7	<u>(264,861)</u>	<u>(250,033)</u>
Profit after taxation.....		<u>1,350,945</u>	<u>1,168,281</u>
Profits attributable to:			
Shareholders of the Bank	8 & 35	1,348,718	1,166,689
Minority interests		<u>2,227</u>	<u>1,592</u>
Profit after taxation.....		<u>1,350,945</u>	<u>1,168,281</u>
Dividends attributable to the year:			
Interim dividend paid during the year.....		205,800	155,773
Underprovision of final dividend in respect of previous year		57	140
Final dividend proposed after the balance sheet date		<u>470,433</u>	<u>420,292</u>
	9	<u>676,290</u>	<u>576,205</u>
		HK\$	HK\$
Earnings per share	12		
Basic.....		4.59	3.97
Diluted.....		4.57	3.96
Dividends per share			
Interim.....		0.70	0.53
Proposed final.....		<u>1.60</u>	<u>1.43</u>
		<u>2.30</u>	<u>1.96</u>

The notes on pages 175 to 253 form part of these accounts.

Consolidated Balance Sheet**As at 31st December, 2005***(Expressed in thousands of Hong Kong dollars)*

		2005	2004
	Notes		(restated)
ASSETS			
Cash and short-term funds	13 & 39	20,053,798	20,529,318
Placements with banks and other financial institutions maturing between one and twelve months.....	14 & 33	2,657,380	1,435,527
Trade bills less impairment allowances	15 & 33	652,375	551,124
Certificates of deposit held	16 & 33	—	30,000
Trading assets	17	911,264	30,808
Financial assets measured at fair value through profit or loss	18	5,924,424	—
Advances to customers and other accounts less impairment allowances.....	19(a)	55,472,883	49,693,267
Held-to-maturity and available-for-sale financial assets	21	15,909,430	18,867,918
Non-trading securities	22	—	1,520,822
Investments in associated companies	24	146,955	135,706
Tangible fixed assets	25		
— Investment properties		231,447	209,560
— Other properties, plants and equipment.....		1,506,041	1,563,010
Goodwill	26	847,422	847,713
Current tax recoverable.....	7(c)	1,211	5,381
Deferred tax assets.....	7(d)	7,986	27,950
Total assets.....		<u>104,322,616</u>	<u>95,448,104</u>
EQUITY AND LIABILITIES			
Deposits and balances of banks and other financial institutions	27 & 33	1,703,026	1,209,582
Deposits from customers.....	28 & 33	85,673,452	78,569,161
Certificates of deposit issued.....	29 & 33	3,824,339	4,616,090
Trading liabilities	30	865,962	8,628
Current tax payable.....	7(c)	102,798	63,381
Deferred tax liabilities	7(d)	91,570	64,953
Other accounts and provisions	31	1,203,530	975,122
Loan capital	32 & 33	2,519,888	2,526,485
Total liabilities		<u>95,984,565</u>	<u>88,033,402</u>
Share capital.....	34	294,021	293,911
Reserves	35	8,021,919	7,100,907
Shareholders' funds		8,315,940	7,394,818
Minority interests		22,111	19,884
Total equity		<u>8,338,051</u>	<u>7,414,702</u>
Total equity and liabilities		<u>104,322,616</u>	<u>95,448,104</u>

Patrick Y B Fung	<i>Chairman and Chief Executive</i>
Frank J Wang	<i>Director and Deputy Chief Executive</i>
Michael Y S Fung	<i>Director and Senior General Manager</i>
Louis C W Ho	<i>Director and Secretary</i>

The notes on pages 175 to 253 form part of these accounts

Balance Sheet**As at 31st December, 2005***(Expressed in thousands of Hong Kong dollars)*

		2005	2004
	Notes		(restated)
ASSETS			
Cash and short-term funds	13	18,744,775	19,990,535
Placements with banks and other financial institutions maturing between one and twelve months.....	14 & 33	2,629,507	1,408,389
Trade bills less impairment allowances	15 & 33	412,544	387,243
Certificates of deposit held	16 & 33	—	30,000
Trading assets	17	929,710	18,894
Financial assets measured at fair value through profit or loss	18	5,924,424	—
Advances to customers and other accounts less impairment allowances.....	19(a)	43,220,921	39,768,427
Amounts due from subsidiaries.....		6,074,285	4,985,038
Held-to-maturity and available-for-sale financial assets	21	15,249,952	18,382,534
Non-trading securities	22	—	1,407,308
Investments in subsidiaries	23	682,707	633,416
Investments in associated companies	24	174,000	174,000
Tangible fixed assets	25		
— Investment properties		18,300	13,100
— Other properties, plants and equipment.....		1,150,192	1,194,996
Goodwill	26	847,422	847,422
Deferred tax assets.....	7(d)	3,479	9,324
Total assets.....		<u>96,062,218</u>	<u>89,250,626</u>
EQUITY AND LIABILITIES			
Deposits and balances of banks and other financial institutions	27 & 33	1,694,613	1,205,409
Deposits from customers.....	28 & 33	67,902,897	63,098,291
Certificates of deposit issued.....	29 & 33	3,829,252	4,621,145
Trading liabilities	30	869,748	8,628
Current tax payable.....	7(c)	57,750	20,206
Deferred tax liabilities	7(d)	69,251	49,508
Other accounts and provisions	31	809,857	566,239
Amounts due to subsidiaries		14,201,751	13,641,108
Total liabilities		<u>89,435,119</u>	<u>83,210,534</u>
Share capital.....	34	294,021	293,911
Reserves	35	6,333,078	5,746,181
Total equity		<u>6,627,099</u>	<u>6,040,092</u>
Total equity and liabilities		<u>96,062,218</u>	<u>89,250,626</u>

Patrick Y B Fung	<i>Chairman and Chief Executive</i>
Frank J Wang	<i>Director and Deputy Chief Executive</i>
Michael Y S Fung	<i>Director and Senior General Manager</i>
Louis C W Ho	<i>Director and Secretary</i>

The notes on pages 175 to 253 form part of these accounts

Consolidated Statement of Changes in Equity
For the year ended 31st December, 2005
(Expressed in thousands of Hong Kong dollars)

		<u>2005</u>	<u>2004</u>
	Notes		(restated)
Shareholders' funds (as previously reported as at 31st December)		7,403,887	6,686,881
Minority interests (as previously presented separately from equity and liabilities as at 31st December)		19,884	18,292
Total equity as at 1st January as previously reported		7,423,771	6,705,173
— prior year adjustments arising from change in accounting policies	4(a)(i)	(9,069)	—
As restated, before opening balance adjustments		7,414,702	6,705,173
— opening balance adjustments arising from change in accounting policies	35	187,336	—
Total equity as at 1st January, after prior year and opening balance adjustments		7,602,038	6,705,173
Unrealised gains on revaluation of non-trading securities after deferred tax charge	35	—	4,393
Unrealised losses on revaluation of available-for-sale financial assets after deferred tax credit	35	(20,650)	—
Realisation on disposal of available-for-sale financial assets	35	7,424	—
Unrealised gains on revaluation of investment properties	35	—	11,809
Deferred tax credited to investment properties revaluation reserve	35	—	10,933
Disposal of investment properties	35	—	(10,020)
Unrealised gains on revaluation of bank premises	35	9,297	—
Deferred tax credited to bank premises revaluation reserve	35	2,900	122
Exchange adjustments	35	(759)	42
Net (expenses)/income recognised directly in equity as previously reported		(1,788)	17,279
— prior year adjustment in respect of change in accounting policies	35	—	(12,669)
Net (expenses)/income recognised directly in equity as restated		(1,788)	4,610
Profit attributable to the shareholders as previously reported		—	1,168,021
Profit attributable to minority interests as previously reported		—	1,592
Net profit for the year as previously reported		—	1,169,613
— prior year adjustment in respect of change in accounting policies	4(a)(i)	—	(1,332)
Net profit for the year (2004: as restated)		1,350,945	1,168,281
Total recognised income and expenses for the year		1,349,157	1,172,891
Dividends paid	35	(626,149)	(473,196)
Proceeds on shares issued under share option scheme		4,010	3,298
Change in accounting policy in share option scheme	4(a)(i)	—	4,932
Share premium under Employee Incentive Plan and share option scheme	35	8,995	1,604
Total equity as at 31st December		<u>8,338,051</u>	<u>7,414,702</u>
Total recognised income and expenses for the year attributable to:			
Shareholders of the Bank		1,346,930	1,171,299
Minority interests		2,227	1,592
		<u>1,349,157</u>	<u>1,172,891</u>

The notes on pages 175 to 253 form part of these accounts.

Consolidated Cash Flow Statement
For the year ended 31st December, 2005
(Expressed in thousands of Hong Kong dollars)

		2005	2004
	Notes		(restated)
Net cash inflow from operating activities.....	37(a)	<u>2,158,383</u>	<u>4,924,832</u>
Investing activities			
Purchase of held-to-maturity and available-for-sale financial assets		(7,397,211)	—
Sale and redemption of held-to-maturity and available-for-sale financial assets		6,603,467	—
Purchase of held-to-maturity and non-trading securities		—	(18,670,472)
Sale and redemption of held-to-maturity and non-trading securities		—	15,880,750
Ordinary dividends received from an associated company		—	2,080
Amount recovered of goodwill		—	66,864
Amount paid for goodwill		—	(4,441)
Net cash outflow from acquisition of subsidiary	37(c)	(879)	—
Sale of an associated company		—	3,990
Loan repaid from associated companies		—	630
Purchase of properties, plants and equipment		(55,899)	(151,290)
Sale of properties, plants and equipment		<u>47,551</u>	<u>61,485</u>
Net cash outflow from investing activities		<u>(802,971)</u>	<u>(2,810,404)</u>
Financing			
Issue of new shares under share option scheme		4,010	3,298
Ordinary dividends paid		(626,149)	(473,196)
Interest paid on loan capital		<u>(134,148)</u>	<u>(134,514)</u>
Net cash outflow from financing activities		<u>(756,287)</u>	<u>(604,412)</u>
Increase in cash and cash equivalents		599,125	1,510,016
Cash and cash equivalents at 1st January		20,375,662	18,862,071
Effects of exchange rate changes on the balance of subordinated debts		<u>(6,597)</u>	<u>3,575</u>
Cash and cash equivalents at 31st December		<u><u>20,968,190</u></u>	<u><u>20,375,662</u></u>
Cash flows from operating activities included:			
Interest received		4,122,265	2,819,640
Interest paid		2,020,871	844,608
Dividend income		8,038	10,090
Analysis of the balances of cash and cash equivalents	37(b)		
Cash and balances with banks and other financial institutions		1,724,925	1,303,218
Money at call and short notice		16,638,711	17,764,627
Treasury bills		760,393	183,942
Placements with banks and other financial institutions with an original maturity between one and three months		<u>1,844,161</u>	<u>1,123,875</u>
		<u><u>20,968,190</u></u>	<u><u>20,375,662</u></u>

The notes on pages 175 to 253 form part of these accounts.

Notes to the Accounts
For the year ended 31st December, 2005
(Expressed in thousands of Hong Kong dollars)

1. PRINCIPAL ACTIVITIES

The Bank and its subsidiaries are engaged in commercial banking and related financial services.

2. PRINCIPAL ACCOUNTING POLICIES

(a) Statement of compliance

The accounts have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (“HKFRSs”), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (“HKASs”), and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance. These accounts also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and the module on “Financial Disclosure by Locally Incorporated Authorised Institutions” under the Supervisory Policy Manual issued by the Hong Kong Monetary Authority. A summary of the significant accounting policies adopted by the Group is set out below.

The HKICPA has issued a number of new and revised HKFRSs that are effective or available for early adoption for accounting periods beginning on or after 1st January, 2005. The Board of Directors has determined the accounting policies to be adopted in the preparation of these accounts, on the basis of HKFRSs currently in issue. Information on the changes in accounting policies resulting from initial application of these new and revised HKFRSs for the current and prior accounting years reflected in these accounts is provided in note 4.

(b) Basis of preparation of the accounts

With effect from 9th August, 2004, Chekiang First Bank Limited (“CFB”) has been merged with the Bank through The Wing Hang Bank Limited (Merger) Ordinance, under which all the assets and liabilities situated in Hong Kong and the rights and obligations of CFB as expressly governed by Hong Kong law have been transferred to the Bank. By virtue of this Ordinance, the accounts of the Bank for the year ended 31st December, 2004 were prepared as if the undertaking of CFB had vested in the Bank on 1st January, 2004.

The measurement basis used in the preparation of the accounts is historical cost except that the following assets and liabilities are stated at their fair value as explained in the accounting policies set out below:

- financial instruments classified as trading, designated at fair value through profit or loss and available-for-sale (note 2(f)(ii));
- investment property (note 2(l));
- other freehold land and buildings (note 2(l)); and
- other leasehold land and buildings, for which the fair values cannot be allocated reliably between the two elements at the inception of the lease and the entire lease is classified as finance lease (note 2(l) and 2(m)).

The preparation of financial statements in conformity with HKFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of HKFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 3.

(c) Investments in subsidiaries and controlled enterprises

A subsidiary, in accordance with the Hong Kong Companies Ordinance, is a company in which the Group, directly or indirectly, holds more than half of the issued share capital, or controls more than half of the voting power, or controls the composition of the Board of Directors. Subsidiaries are considered to be controlled if the Bank has the power, directly or indirectly, to govern the financial and operating policies, so as to obtain benefits from their activities.

An investment in a controlled subsidiary is consolidated into the consolidated accounts, unless it is acquired and held exclusively with a view to subsequent disposal in the near future or operates under severe long-term restrictions which significantly impair its ability to transfer funds to the Group, in which case, it is stated in the consolidated balance sheet at fair value with changes in fair value recognised in the investment revaluation reserve as they arise. The results of subsidiaries acquired during the year are included in the consolidated profit and loss account from the date of their acquisition.

Intra-group balances and transactions, and any unrealised profits arising from intra-group transactions, are eliminated in full in preparing the consolidated accounts. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

Minority interests at the balance sheet date, being the portion of the net assets of subsidiaries attributable to equity interests that are not owned by the Bank, whether directly or indirectly through subsidiaries, are presented in the consolidated balance sheet and statement of changes in equity within total equity, separately from equity attributable to the shareholders of the Bank. Minority interests in the results of the Group are presented on the face of the consolidated profit and loss account as an allocation of the total profit or loss for the year between minority interests and the shareholders of the Bank.

Where losses applicable to the minority exceed the minority interests in the equity of a subsidiary, the excess, and any further losses applicable to the minority, are charged against the Group's interest except to the extent that the minority has a binding obligation to, and is able to, make additional investment to cover the losses. If the subsidiary subsequently reports profits, the Group's interest is allocated all such profits until the minority's share of losses previously absorbed to the Group has been recovered.

In the Bank's balance sheet, an investment in a subsidiary is stated at cost less any impairment losses (note 2(p)), unless it is acquired and held exclusively with a view to subsequent disposal in the near future or operates under severe long-term restrictions which significantly impair its ability to transfer funds to the Bank, in which case, it is stated at fair value with changes in fair value recognised in the investment revaluation reserve as they arise.

(d) Associated companies

An associated company is an entity in which the Group or Bank has significant influence, but not control or joint control, over its management, including participation in the financial and operating policy decisions.

An investment in an associated company is accounted for in the consolidated accounts under the equity method and is initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of the associated company's net assets, unless it is acquired and held exclusively with a view to subsequent disposal in the near future or operates under severe long-term restrictions that significantly impair its ability to transfer funds to the Bank, in which case it is stated at fair value with changes in fair value recognised in the investment revaluation reserve as they arise. The consolidated profit and loss account reflects the Group's share of the post-acquisition results of the associated companies for the year, including any impairment loss on goodwill relating to the investment in associates recognised for the year (note 2(p)).

When the Group's share of losses exceeds its interest in the associated company accounted for under equity method, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associated company. For these purposes, the Group's interest in the associated company accounted for under equity method is the carrying amount of the investment under equity method together with the Group's other long-term interests that in substance form part of the Group's net investment in the associated company.

Unrealised profits and losses resulting from transactions between the Group and its associated companies are eliminated to the extent of the Group's interest in the associated company, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in the profit and loss account.

In the Bank's balance sheet, its investments in associated companies are stated at cost less impairment losses (note 2(p)), unless it is acquired and held exclusively with a view to subsequent disposal in the near future or operates under severe long-term restrictions that significantly impair its ability to transfer funds to the Bank, in which case, it is stated at fair value with changes in fair value recognised in the investment revaluation reserve as they arise.

(e) Goodwill

Positive goodwill arising on consolidation represents the excess of the cost of the acquisition over the Group's share of the fair value of the identifiable assets, liabilities and contingent liabilities acquired. In respect of controlled subsidiaries, positive goodwill is stated in the consolidated balance sheet at cost less any impairment losses (note 2(p)). In respect of acquisition of associated companies, the cost of positive goodwill less any impairment losses (note 2(p)) is included in the carrying amount of the investments in associated companies.

On disposal of a controlled subsidiary or an associated company during the year, any attributable amount of purchased goodwill is included in the calculation of the profit or loss on disposal.

(f) Financial instruments

(i) Initial recognition

The Group classifies its financial instruments into different categories at inception, depending on the purpose for which the assets were acquired or the liabilities were incurred. The categories are: fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets and other financial liabilities.

Financial instruments are measured initially at fair value, which normally will be equal to the transaction price, plus, in case of a financial asset or financial liability not held at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs on financial assets and financial liabilities at fair value through profit or loss are expensed immediately.

The Group recognises financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instrument. A regular way purchase of financial assets is recognised using trade date accounting. From this date, any gains and losses arising from changes in fair value of the financial assets or financial liabilities are recorded.

(ii) Classification

Fair value through profit or loss

This category comprises financial assets and financial liabilities held for trading, and those designated at fair value through profit or loss upon initial recognition, but excludes those investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured.

Trading financial instruments are financial assets or financial liabilities which are acquired or incurred principally for the purpose of trading, or are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivatives that do not qualify for hedge accounting (note 2(h)) are accounted for as trading instruments.

Financial instruments designated at fair value through profit or loss primarily consist of securities with embedded derivatives that the characteristics and risks of the embedded derivatives are not closely related to the host contracts.

Financial assets and liabilities under this category are carried at fair value. Realised gains and losses, and unrealised gains and losses arising from changes in the fair value are included in the profit and loss account in the period in which they arise. Upon disposal or repurchase, the difference between the net sale proceeds or net payment and the carrying value is included in the profit and loss account.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than (1) those that the Group intends to sell immediately or in the near term, which will be classified as held for trading; (2) those that the Group, upon initial recognition, designates at fair value through profit or loss or as available-for-sale; or (3) those where the Group may not recover substantially all of its initial investment, other than because of credit deterioration, which will be classified as available-for-sale. Loans and receivables mainly comprise loans and advances to customer and placements with banks and financial institutions.

Securities classified as loans and receivables typically comprise of securities issued by the same customers with whom the Group has a lending relationship in its wholesale banking business. Investment decisions for credit substitute securities are subject to the same credit approval processes as loans, and the Group bears the same customer risk as it does for loans extended to those customers. Additionally the yield and maturity terms are generally directly negotiated by the Group with the issuer. These securities include commercial paper, short term debentures and preference shares issued by the borrower.

Loans and receivables and securities classified as loans and receivables are carried at amortised cost using the effective interest method, less impairment allowances (note 2(p)), if any, and are accounted for in the profit and loss account.

Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity where the Group has the positive intention and ability to hold to maturity, other than (1) those that the Group, upon initial recognition, designates as at fair value through profit or loss or as available for sale; and (2) those that meet the definition of loans and receivables.

Held-to-maturity investments are carried at amortised cost using the effective interest method less impairment losses (note 2(p)), if any.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated at available-for-sale or are not classified in any of the other three categories above. It includes financial assets intended to be held for an indefinite period of time, but which may be sold in response to needs for liquidity or changes in the market environment. Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured, and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments are carried at cost less impairment losses, if any (note 2(p)).

Available-for-sale financial assets are carried at fair value. Unrealised gains and losses arising from changes in the fair value are recognised directly in the investment revaluation reserve, except for foreign exchange gains and losses on monetary items such as debt securities which are recognised in the profit and loss account.

When the available-for-sale financial assets are sold, the difference between the net sale proceeds and the carrying value, and the accumulated fair value adjustments in the equity are treated as gains or losses on disposal.

Other financial liabilities

Financial liabilities, other than trading liabilities and those designated at fair value through profit or loss, are measured at amortised cost using the effective interest method.

(iii) Fair value measurement principles

The fair value of financial instruments is based on their quoted market prices at the balance sheet date without any deduction for estimated future selling costs. Financial assets are priced at current bid prices, while financial liabilities are priced at current asking prices.

If a quoted market price is not available on a recognised stock exchange or from a broker/dealer for non-exchange-traded financial instruments or publicly available latest traded price, or if the market for it is not active, the fair value of the instrument is estimated using valuation techniques that provide a reliable estimate of prices which could be obtained in actual market transactions.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market rate at the balance sheet date applicable for an instrument with similar terms and conditions. Where other pricing models are used, inputs are based on market data at the balance sheet date.

The fair value of derivatives that are not exchange-traded is estimated at the amount that the Group would receive or pay to terminate the contract at the balance sheet date taking into account current market conditions and the current creditworthiness of the counterparties. Specifically, the fair value of a forward contract is determined as the present value of estimated future cash flows, discounted at appropriate market rates on the valuation date.

(iv) Derecognition

A financial asset is derecognised when the contractual rights to receive the cash flows from the financial asset expire, or where the financial asset together with substantially all the risks and rewards of ownership, have been transferred.

The Group uses the weighted average method to determine realised gains and losses to be recognised in profit or loss on derecognition.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expires.

(v) Offsetting

Financial assets and financial liabilities are offset and the net amount is reported in the balance sheet where there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(vi) Embedded derivatives

An embedded derivative is a component of a hybrid (combined) instrument that includes both the derivative and a host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. The embedded derivatives are separated from the host contract and accounted for as a derivative when (1) the economic characteristics and risks of the embedded derivative are not closely related to the host contract; and (2) the hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in the profit and loss account. When the embedded derivative is separated, the host contract is accounted for in accordance with the accounting policies for financial instruments.

(g) Repurchase and reverse repurchase transactions

Securities sold subject to a simultaneous agreement to repurchase these securities at a certain later date at a fixed price (repurchase agreements) are retained in the accounts and measured in accordance with their original measurement principles. The proceeds from the sale are reported as liabilities and are carried at amortised cost.

Securities purchased under agreements to resell (reverse repurchase agreements) are reported not as purchases of the securities, but as receivables and are carried in the balance sheet at amortised cost.

Interest earned on reverse repurchase agreements and interest incurred on repurchase agreements is recognised as interest income or interest expense, over the life of each agreement using the effective interest rate method.

(h) Hedging

Hedge accounting recognises the offsetting effects on profit or loss of changes in the fair values of the hedging instrument and the hedged item. The Group assesses and documents whether the financial instruments that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items attributable to the hedged risks both at hedge inception and on an ongoing basis. The Group discontinues prospectively hedge accounting when (1) the hedging instrument expires or is sold, terminated or exercised; (2) the hedge no longer meets the criteria for hedge accounting; or (3) the Group revokes the designation.

(i) Fair value hedge

A fair value hedge seeks to offset risks of changes in the fair value of recognised asset or liability that will give rise to a gain or loss being recognised in the profit and loss account.

The hedging instrument is measured at fair value, with fair value changes recognised in the profit and loss account. The carrying amount of the hedged item is adjusted by the amount of the changes in fair value of the hedging instrument attributable to the risk being hedged. This adjustment is recognised in the profit and loss account to offset the effect of the gain or loss on the hedging instrument.

(ii) Cash flow hedges

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, or the foreign currency risk of a committed future transaction, the effective part of any gain or loss on the derivative financial instrument in relation to the hedged risk is recognised directly in equity. The ineffective part of any gain or loss is recognised immediately in the profit and loss account.

If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, the associated gains and losses that were recognised directly in equity are reclassified in the profit and loss account in the same period or periods during which the asset acquired or liability assumed affects the profit and loss account. If the hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, the associated cumulative gain or loss is removed from equity and included in the initial cost or other carrying amount of the non-financial asset or liability.

For cash flow hedges of a recognised asset or liability, the associated cumulative gain or loss is removed from equity and recognised in the profit and loss account in the same period or periods during which the hedged cash flows affect the profit.

When a hedging instrument expires or is sold, terminated or exercised, or the Group revokes designation of the hedge relationship but the hedged forecast transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, the cumulative unrealised gain or loss recognised in equity is recognised immediately in the profit and loss account.

(iii) Net investment hedge

Hedges of net investment in foreign operations are accounted for similarly to cash flow hedges. The portion of the gain or loss on remeasurement of the hedging instrument that is determined to be an effective hedge is directly recognised in equity until the disposal of the foreign operation, at which time the cumulative gain or loss recognised directly in equity is recognised in the profit and loss account. The ineffective portion is recognised immediately in the profit and loss account.

(iv) Hedge effectiveness testing

The Group expects the hedge to be highly effective (prospective effectiveness) at the inception of the hedge to qualify for hedge accounting. Actual effectiveness (retrospective effectiveness) is also demonstrated on an ongoing basis.

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed. The method the Group adopts for assessing hedge effectiveness will depend on its risk management strategy.

For fair value hedge relationships, the Group utilises the cumulative dollar offset method or regression analysis as effectiveness testing methodologies. For cash flow hedge relationship, the Group utilises the change in variable cash flow method or the cumulative dollar offset method using the hypothetical derivative approach.

For prospective effectiveness, the hedging instrument is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. For actual effectiveness, the changes in fair value or cash flows must offset each other in the range of 80% to 125% for the hedge to be deemed effective.

(i) Revenue recognition

Provided it is probable that the economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in the profit and loss account as follows:

(i) Interest income

Interest income for all interest-bearing financial instruments, except those classified as held for trading or designated at fair value through profit or loss, are recognised as “interest income” in the profit and loss account using the effective interest rate method.

The effective interest rate method is a method of calculating the amortised cost of a financial asset and of allocating the interest income over the relevant period. The effective interest rate that is the rate exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment, call and similar options) but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Interest will continue to be recognised on impaired financial assets using the interest rate for discounting future cash flows for the purpose of measuring the related impairment loss. Subsequent unwinding of discount allowance is recognised as interest income.

Net income from financial instruments designated at fair value through profit or loss and net trading income comprises all gains and losses from changes in fair value (net of accrued coupon) of such financial assets and financial liabilities, together with interest income and expense and dividend income attributable to those financial instruments.

(ii) Fee and commission income

Fee and commission income arises on financial services provided by the Group including cash management services, brokerage services, investment service and financial planning, personal banking services, project and structured finance transactions, and asset management services. Fee and commission income is recognised when the corresponding service is provided, except where the fee is charged to cover the costs of a continuing service to, or risk borne for, the customer, or is interest in nature. In these cases, the fee is recognised as income in the accounting period in which the costs or risk is incurred and is accounted for as interest income.

Origination or commitment fees received by the Group which result in the creation or acquisition of a financial asset are deferred and recognised as an adjustment to the effective interest rate. If the commitment expires without the Group making a loan, the fee is recognised as revenue on expiry.

(iii) Finance income from finance lease and hire purchase contract

Finance income implicit in finance lease and hire purchase payments is recognised as interest income over the period of the leases so as to produce an approximately constant periodic rate of return on the outstanding net investment in the leases for each accounting period. Contingent rentals receivable are recognised as income in the accounting period in which they are earned.

(iv) Rental income from operating lease

Rental income received under operating leases is recognised as other operating income in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives granted are recognised in the profit and loss accounts as an integral part of the aggregate net lease payments receivable. Contingent rentals receivable are recognised as income in the accounting period in which they are earned.

(v) Dividend income

Dividend income from unlisted investments is recognised when the shareholder’s right to receive payment is established. Dividend income from listed investments is recognised when the share price of the investment goes ex-dividend.

(j) Income tax

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in the profit and loss account except to the extent that they relate to items recognised directly in reserves, in which case they are recognised in reserves.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax assets and liabilities arise from deductible and taxable temporary differences between the carrying amounts of assets and liabilities for financial reporting purpose and their tax bases respectively. Deferred tax assets also arise from unused tax losses and unused tax credits.

Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that taxable profits will be available, against which deductible temporary differences can be utilised.

Deferred tax is calculated at the tax rates that are expected to apply in the year when the liability is settled or the asset is realised. Deferred tax assets and liabilities are not discounted. The carrying amount of deferred tax assets/liabilities is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the related tax benefit to be utilised.

Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities if, and only if, the Bank or the Group has the legally enforceable right to set off current tax assets against current tax liabilities. The principle of offsetting usually applies to income tax levied by the same tax authority on the same taxable entity.

(k) Translation of foreign currencies

Foreign currency transactions during the year are translated into Hong Kong dollars at the exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the exchange rates ruling at the balance sheet date. Exchange gains and losses are dealt with in the profit and loss account.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rates ruling at the transaction dates. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated using the foreign exchange rates ruling at the dates the fair value was determined.

Exchange differences relating to investments at fair value through profit or loss and derivative financial instruments are included in gains and losses on investments and net gain/(loss) on derivatives, respectively.

The results of overseas branches and subsidiaries are translated into Hong Kong dollars at the average exchange rates for the year; balance sheet items are translated into Hong Kong dollars at the rates of exchanges ruling at the balance sheet date. The resulting exchange differences are dealt with as movements in reserves.

(l) Tangible fixed assets and depreciation

- (i) In preparing these accounts, advantage has been taken of the transitional provisions set out in paragraph 80 of HKAS 16 “Property, Plant and Equipment” issued by the HKICPA, with the effect that bank premises have not been revalued to fair value at the balance sheet date.
- (ii) Equipment, comprising furniture, plant and other equipment, is stated at cost less depreciation calculated on a straight-line basis to write off the assets over their estimated useful lives, which are generally between 3 to 10 years.
- (iii) No amortisation is provided on freehold land. Leasehold land (note 2(m)) is amortised in equal annual instalments over the remaining term of the lease. Buildings are amortised by equal instalments over the estimated useful lives which in no case exceed 50 years.
- (iv) Investment properties are land and/or buildings which are owned or held under a leasehold interest (note 2(m)) either to earn rental income or for capital appreciation or for both. These include land held for a currently undetermined future use, which are stated in the balance sheet at their open market values which are assessed annually by professional qualified valuers. Any gain or loss arising from a change in fair value is recognised in the profit and loss account.

(m) Finance and operating leases

(i) Classification of leased assets to the Group

Assets that are held by Group under leases which transfer to the Group substantially all the risks and rewards of ownership are classified as being held under finance leases. Leases which do not transfer substantially all the risks and rewards of ownership to the Group are classified as operating leases.

(ii) Finance leases

Where the Group is a lessor under finance leases, an amount representing the net investment in the lease is included in the balance sheet as “Advances to customers”. Finance income implicit in the lease payment is recognised as “Interest income” over the period of the leases in proportion to the funds invested. Hire purchase contracts having the characteristics of finance leases are accounted for in the same manner as finance leases. Impairment losses are accounted for in accordance with the accounting policy as set out in note 2(p).

(iii) Assets held for use in operating leases

Where the Group is a lessor under operating leases, the leased assets are included in “Tangible fixed assets”. Rentals receivable under operating leases are recognised as “Other operating income” in equal instalments over the accounting period covered by the lease term. Impairment losses are accounted for in accordance with the accounting policy as set out in note 2(p).

(iv) Operating lease

Where the Group leases out assets under operating leases, the assets are included in the balance sheet according to their nature and, where applicable, are depreciated in accordance with the Group’s depreciation policies, as set out in note 2(l)(ii). Impairment losses are accounted for in accordance with the accounting policy as set out in note 2(p). Revenue arising from operating leases is recognised in accordance with the Group’s revenue recognition policies, as set out in note 2(i)(iv).

Where the Group has the use of assets held under operating leases, payments made under the leases are charged to profit and loss account in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives received are recognised in profit and loss account as an integral part of the aggregate net lease payments made. Contingent rentals are charged to the profit and loss account in the accounting period in which they are incurred.

The cost of acquiring land held under an operating lease is amortised on a straight-line basis over the period of the lease term except where the property is classified as an investment property.

(n) Repossessed assets

In the recovery of impaired loans and advances, the Group may take repossession of the collateral assets through court proceedings or voluntary delivery of possession by the borrowers. In accordance with the Group’s accounting policy set out in note 2(p), impairment allowances for impaired loans and advances are maintained after taking into account the net realisable value of the repossessed assets. Repossessed assets continue to be treated as securities for loans and advances.

Repossessed assets are recognised at the lower of their carrying amount of the related loans and advances and fair value less costs to sell. They are not depreciated or amortised.

Impairment losses on initial classification and on subsequent remeasurement are recognised in the profit and loss account.

(o) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Bank or Group has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events, are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(p) Impairment of assets

At each balance sheet date, if internal and external sources of information indicate that any of the Group’s assets are impaired, the asset’s recoverable amount is estimated, and an impairment loss is recognised in the profit and loss account whenever the carrying amount of an asset exceeds its recoverable amount.

(i) Held-to-maturity financial assets

For held-to-maturity financial assets, the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. (i.e. the effective interest rate computed at initial recognition of these assets). Receivables with a short duration are not discounted if the effect of discounting is immaterial.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the profit and loss account. A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years.

(ii) Available-for-sale financial assets

When there is objective evidence that an available-for-sale financial asset is impaired, the cumulative loss that had been recognised directly in equity is removed from equity and is recognised in profit and loss account. The amount of the cumulative loss that is recognised in profit and loss account is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised in profit and loss account.

For unquoted available-for-sale equity securities that are carried at cost, the impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

Impairment losses recognised in profit and loss account in respect of available-for-sale equity securities are not reversed through profit and loss account. Any subsequent increase in the fair value of such assets is recognised directly in equity.

Impairment losses in respect of available-for-sale debt securities are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in profit and loss account.

(iii) Impairment of loans and receivables

The credit losses of loans and receivables are measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. Receivables with a short duration are not discounted if the effect of discounting is immaterial.

The total allowance for credit losses consists of two components: individual impairment allowances, and collective impairment allowances.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

The accuracy of the impairment allowances the Group makes depends on how well the Group can estimate future cash flows for individually assessed impairment allowances and the model assumptions and parameters used in determining collective impairment allowances. While this necessarily involves judgment, the Group believes that the impairment allowances on loans and advances to customers are reasonable and supportable.

Any subsequent changes to the amounts and timing of the expected future cash flows compared to the prior estimates that can be linked objectively to an event occurring after the write-down, will result in a change in the impairment allowances on loans and receivables and be charged or credited to the profit and loss account.

When there is no reasonable prospect of recovery, the loan and the related interest receivables are written off.

(iv) Other assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or, except in the case of goodwill, an impairment loss previously recognised no longer exists or may have decreased:

- property and equipment (other than properties carried at revalued amounts);
- investments in subsidiaries and associated companies; and
- goodwill.

If any such indication exists, the asset's recoverable amount is estimated. In addition, for goodwill, the recoverable amount is estimated annually whether or not there is any indication of impairment.

— *Calculation of recoverable amount*

The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

— *Recognition of impairment losses*

An impairment loss is recognised in the profit and loss account whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

— *Reversals of impairment losses*

In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is not reversed.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to the profit and loss account in the year in which the reversals are recognised.

(q) Related parties

Parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals or entities and include entities which are under the significant influence of related parties of the Group where those parties are individuals, and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group.

(r) Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

The Group has chosen business segment information as the primary reporting format and geographical segment information as the secondary reporting format.

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment. Segment revenue, expenses, assets and liabilities are determined before intra-group balances and intra-group transactions are eliminated as part of the consolidation process, except to the extent that such intra-group balances and transactions are between group enterprises within a single segment. Inter-segment pricing is based on similar terms as those available to other external parties.

Segment capital expenditure is the total cost incurred during the year to acquire segment assets (both tangible and intangible) that are expected to be used for more than one year.

(s) Cash equivalents

Cash and cash equivalents comprise cash and balances with banks and other financial institutions, and short-term, highly liquid inter-bank placements and investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition. Balances of banks and other financial institutions that are repayable on demand and form an integral part of the Group's cash management are also included as a component of cash and cash equivalents for the purpose of the cash flow statement.

(t) Employee benefits

- (i) Salaries, annual bonuses, paid annual leave and the cost to the Group of non-monetary benefits are accrued in the year in which the associated services are rendered by employees of the Group.

- (ii) Contributions to Mandatory Provident Funds as required under the Hong Kong Mandatory Provident Funds Scheme Ordinance are recognised as an expense in the profit and loss account when incurred.
- (iii) When the Group grants employees options to acquire shares of the Bank, the considerations received are recognised as “Other accounts and provisions” at the date of grant. The fair value of the options is measured at the grant date and is charged to the profit and loss account and credited to shareholders’ funds between the grant date and the vesting date. When the options are exercised, shareholders’ fund is increased by the amount of the proceeds and consideration received.
- (iv) When the Group grants employees awards to acquire shares of the Bank under Employee Incentive Plan (“EIP”). The fair value of the awards is measured at the grant date and is charged to the profit and loss account and credited to shareholders’ funds between the grant date and the vesting date. The cash amount equal to the dividend that would have been paid during the period up to vesting will be charged to the profit and loss account as bonus expenses on an accrual basis.

(u) Subordinated notes issued

Subordinated notes issued are included in the balance sheet at the value of the net proceeds received upon issue.

Interest on subordinated notes issued is charged to the profit and loss account at the coupon rate adjusted for the amortisation of any premium or discount arising on issue so as to achieve a constant rate of charge over the period from the date of issue to the date of redemption.

When notes issued are repurchased or settled before maturity, any difference between the amount repaid and the carrying amount is recognised immediately in the profit and loss account.

3. ACCOUNTING ESTIMATES AND JUDGEMENTS

The preparation of accounts requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of these financial statements and the reported amounts of revenues and expenses for the years presented. Changes in assumptions may have a significant impact on the financial statements in the periods where the assumptions are changed. The application of assumptions and estimates means that any selection of different assumptions would cause the Group’s reporting to differ. The Group believes that the assumptions that have been made are appropriate and that the financial statements therefore present the financial position and results fairly, in all material respects.

Management discussed with the Audit Committee the development, selection and disclosure of the Group’s significant accounting policies and estimates and the application of these policies and estimates.

Notes 26, 42 and 43 contain information about the assumptions and their risk factors relating to goodwill impairment, fair value of share options granted and fair values of financial instruments. Other key sources of estimation uncertainty are as follows:

(a) Key sources of estimation uncertainty

Impairment losses

(i) Loan and advances

Loan portfolios are reviewed periodically to assess whether impairment losses exist. The assessment process consists of two stages. During the first stage, the Group makes judgements as to whether there is any objective evidence that a loan portfolio is impaired, i.e. whether there is a decrease in estimated future cash flows. Objective evidence for impairment includes observable data that the payment status of borrowers in a group has adversely changed. It may also include observable data that correlate with defaults on the assets in the group. If management has determined, based on their judgement, that objective evidence for impairment exists, expected future cash flows are estimated individually or based on historical loss experience for assets with credit risk characteristics similar to those of the group. Historical loss experience is adjusted on the basis of the current observable data. Management reviews the methodology and assumptions used in estimating future cash flows regularly to reduce any difference between loss estimates and actual loss experience.

(ii) Available-for-sale equity investments

The Group determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. The determination of when a decline in fair value below cost is not recoverable within a reasonable time period is judgmental by nature, so profit and loss could be affected by differences in this judgement.

(b) Critical accounting judgements in applying the Group's accounting policies

Certain critical accounting judgements in applying the Group's accounting policies are described below.

Held-to maturity investments

The Group classifies non-derivative financial assets with fixed or determinable payments and fixed maturity and where the Group has a positive intention and ability to hold to maturity as held-to-maturity investments. In making this judgement, the Group evaluates its intention and ability to hold such investments till maturity.

If the Group fails to hold these investments to maturity other than for certain specific circumstances, the Group will have to reclassify the entire portfolio of held-to-maturity investments as available-for sale, as such class is deemed to have been tainted.

This would result in held-to-maturity investments being measured at fair value instead of at amortised cost.

4. CHANGES IN ACCOUNTING POLICIES

The HKICPA has issued a number of new and revised HKFRSs that are effective for accounting periods beginning on or after 1st January, 2005.

The accounting policies of the Group and/or the Bank after the adoption of these new and revised HKFRSs have been summarised in note 2. The following sets out information on the significant changes in accounting policies for the current and prior accounting periods reflected in this financial report.

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period as disclosed in note 44.

(a) Restatement of prior year and opening balances

The following tables disclose the adjustments that have been made in accordance with the transitional provisions of the respective HKFRSs to each of the line items in the consolidated profit and loss account and balance sheet and the Bank's balance sheet and other significant related disclosure items as previously reported for the year ended 31st December, 2004. The effects of the changes in accounting policies on the balances at 1st January, 2004 and 2005 are disclosed in note 35.

(i) *Effect on the consolidated financial statements*

Consolidated profit and loss account for the year ended 31st December, 2004:

Effect of new policy (increase/(decrease) in profit for the year)						
	2004 (as previously reported)	HKFRS 2 (note 4(c))	HKAS 1 (note 4(g))	HK (SIC) Interpretation 21 & HKAS 40 (note 4(d))	Sub-total	2004 (restated)
Interest income	2,877,006	—	—	—	—	2,877,006
Interest expenses.....	(1,082,689)	—	—	—	—	(1,082,689)
Net interest income.....	1,794,317	—	—	—	—	1,794,317
Other operating income	640,070	—	—	(53)	(53)	640,017
Operating income.....	2,434,387	—	—	(53)	(53)	2,434,334
Operating expenses	(1,028,107)	(4,932)	—	—	(4,932)	(1,033,039)
Operating profit before provisions.....	1,406,280	(4,932)	—	(53)	(4,985)	1,401,295
Charge for bad and doubtful debts	(54,434)	—	—	—	—	(54,434)
Operating profit	1,351,846	(4,932)	—	(53)	(4,985)	1,346,861
Gains on revaluation of investment properties, disposal of tangible fixed assets and associated company	43,743	—	—	11,809	11,809	55,552
Profits on disposal of held-to-maturity securities	201	—	—	—	—	201
Profits on disposal of non-trading securities	6,307	—	—	—	—	6,307
Provisions written back for held-to- maturity securities	4,848	—	—	—	—	4,848
Profit/(loss) on ordinary activities	1,406,945	(4,932)	—	11,756	6,824	1,413,769
Share of net profits/ (losses) in associated companies	5,229	—	(684)	—	(684)	4,545
Profit/(loss) before taxation	1,412,174	(4,932)	(684)	11,756	6,140	1,418,314
Taxation	(242,561)	—	684	(8,156)	(7,472)	(250,033)
Profit/(loss) after taxation.....	1,169,613	(4,932)	—	3,600	(1,332)	1,168,281
Profits/(losses) attributable to:						
Shareholders of the Bank.....	1,168,021	(4,932)	—	3,600	(1,332)	1,166,689
Minority interests	1,592	—	—	—	—	1,592
Profit/(loss) after taxation.....	1,169,613	(4,932)	—	3,600	(1,332)	1,168,281
Earnings per share						
Basic	3.97	(0.01)	—	0.01	—	3.97
Diluted	3.97	(0.02)	—	0.01	(0.01)	3.96

Effect of new policy (increase/(decrease) in total assets, total equity and liabilities)						
	HK (SIC) Interpretation 21 & HKAS 40					
	2004 (as previously reported)	HKFRS 2 (note 4(c))	HKAS 1 (note 4(g))	HKAS 40 (note 4(d))	Sub-total	2004 (restated)
Assets						
Cash and short-term funds.....	20,529,318	—	—	—	—	20,529,318
Placements with banks and other financial institutions maturing between one and twelve months	1,435,527	—	—	—	—	1,435,527
Trade bills less provisions	551,124	—	—	—	—	551,124
Certificates of deposit held.....	30,000	—	—	—	—	30,000
Trading securities.....	12,067	—	18,741	—	18,741	30,808
Advances to customers and other accounts less provisions.....	49,712,008	—	(18,741)	—	(18,741)	49,693,267
Held-to-maturity securities	18,867,918	—	—	—	—	18,867,918
Non-trading securities.....	1,520,822	—	—	—	—	1,520,822
Investments in associated companies...	135,706	—	—	—	—	135,706
Tangible fixed assets						
— Investment properties	209,560	—	—	—	—	209,560
— Other properties, plants and equipment	1,563,010	—	—	—	—	1,563,010
Goodwill	847,713	—	—	—	—	847,713
Current tax recoverable	5,381	—	—	—	—	5,381
Deferred tax assets.....	27,950	—	—	—	—	27,950
Total assets	<u>95,448,104</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>95,448,104</u>

Effect of new policy (increase/(decrease) in total assets, total equity and liabilities)

		HK (SIC) Interpretation					
	2004 (as previously reported)	HKFRS 2 (note 4(c))	HKAS 1 (note 4(g))	21 & HKAS 40 (note 4(d))	Sub-total	2004 (restated)	
Equity and liabilities							
Deposits and balances of banks and other financial institutions.....	1,209,582	—	—	—	—	1,209,582	
Deposits from customers	78,569,161	—	—	—	—	78,569,161	
Certificates of deposit issued.....	4,616,090	—	—	—	—	4,616,090	
Trading liabilities.....	—	—	8,628	—	8,628	8,628	
Current tax payable	63,381	—	—	—	—	63,381	
Deferred tax liabilities	55,884	—	—	9,069	9,069	64,953	
Other accounts and provisions.....	983,750	—	(8,628)	—	(8,628)	975,122	
Loan capital	2,526,485	—	—	—	—	2,526,485	
Total liabilities	88,024,333	—	—	9,069	9,069	88,033,402	
Share capital	293,911	—	—	—	—	293,911	
Reserves							
— Share premium	342,102	4,932	—	—	4,932	347,034	
— Capital reserve	215,909	—	—	—	—	215,909	
— General reserve	2,091,174	—	—	—	—	2,091,174	
— Bank premises revaluation reserve	269,039	—	—	—	—	269,039	
— Investment properties revaluation reserve.....	12,683	—	—	(12,683)	(12,683)	—	
— Investment revaluation reserve ..	22,241	—	—	—	—	22,241	
— Capital redemption reserve	769	—	—	—	—	769	
— Unappropriated profits	4,156,059	(4,932)	—	3,614	(1,318)	4,154,741	
Reserves.....	7,109,976	—	—	(9,069)	(9,069)	7,100,907	
Shareholders’ funds.....	7,403,887	—	—	(9,069)	(9,069)	7,394,818	
Minority interests.....	19,884	—	—	—	—	19,884	
Total equity.....	7,423,771	—	—	(9,069)	(9,069)	7,414,702	
Total equity and liabilities	95,448,104	—	—	—	—	95,448,104	

(ii) Effect on the Bank's balance sheet

With effect from 1st January, 2005, in order to comply with HKFRS 2, the Group recognises the fair value of share options granted to employee as staff expense in the profit and loss account between the grant date and the vesting date. A corresponding credit is recognised in the share premium in equity.

The changes have been applied retrospectively, resulting in prior year adjustments with the opening balance of unappropriated profits as at 1st January, 2005 decreasing by HK\$4,932,000 and share premium increasing by same amount. In addition, the fair value of trading financial derivatives amounting of HK\$18,741,000 and HK\$8,628,000 were reclassified as "Trading assets" and "Trading Liabilities" from "Advances to customers and other accounts less impairment allowances" and "Other accounts and provisions" respectively.

(b) Estimated effect of changes in accounting policies on the current year

The following tables provide estimates of the extent to which each of the line items in the consolidated profit and loss account and balance sheet and the Bank's balance sheet and other significant related disclosure items for the year ended 31st December, 2005 is higher or lower than it would have been had the previous policies still been applied in the year, where it is practicable to make such estimates.

(i) Effect on the consolidated financial statements

Estimated effect on the consolidated profit and loss account for the year ended 31st December, 2005:

	Effect of new policy (increase/(decrease) in profit for the year)					
	HKFRS 2	HKFRS 3	HKAS 1	HKAS 32	HK (SIC) Interpretation 21 & HKAS 40	Total
	(note 4(c))	(note 4(f))	(note 4(g))	& 39 (note 4(e))	(note 4(d))	
Interest income	—	—	—	(229,950)	—	(229,950)
Interest expenses.....	—	—	—	110,181	—	110,181
Net interest income.....	—	—	—	(119,769)	—	(119,769)
Net interest income on financial instruments held for trading and measured at fair value through profit or loss.....	—	—	—	135,876	—	135,876
Total net interest income	—	—	—	16,107	—	16,107
Other operating income	—	—	—	96,732	—	96,732
Operating income.....	—	—	—	112,839	—	112,839
Operating expenses.....	(6,588)	45,196	—	—	—	38,608
Operating profit before impairment allowances on impaired loans and advances.....	(6,588)	45,196	—	112,839	—	151,447
Impairment losses and allowances release for impaired loans and advances.....	—	—	—	24,162	—	24,162
Operating profit	(6,588)	45,196	—	137,001	—	175,609
Gains on revaluation of investment properties, disposal of tangible fixed assets and associated company.....	—	—	—	—	12,797	12,797
Profits on disposal of held-to-maturity and available-for-sale financial assets	—	—	—	—	—	—
Impairment allowances release for held-to-maturity financial assets	—	—	—	—	—	—
Profit/(loss) on ordinary activities	(6,588)	45,196	—	137,001	12,797	188,406
Share of net profits in associated companies.....	—	—	(2,597)	—	—	(2,597)
Profit/(loss) before taxation.....	(6,588)	45,196	(2,597)	137,001	12,797	185,809
Taxation	—	—	2,597	(24,538)	(2,239)	(24,180)
Profit/(loss) after taxation.....	(6,588)	45,196	—	112,463	10,558	161,629
Profits/(losses) attributable to:						
Shareholders of the Bank.....	(6,588)	45,196	—	112,463	10,558	161,629
Minority interests	—	—	—	—	—	—
Profit/(loss) after taxation.....	(6,588)	45,196	—	112,463	10,558	161,629
Earnings per share						
Basic and diluted	(0.02)	0.15	—	0.38	0.04	0.55

Estimated effect on the consolidated balance sheet at 31st December, 2005:

Effect of new policy (increase/(decrease) in total assets, total equity and liabilities)					
	HKFRS 2 (note 4(c))	HKFRS 3 (note 4(f))	HKAS 1 (note 4(g))	HKAS 32 & 39 (note 4(e))	HK (SIC) Interpretation 21 & HKAS 40 (note 4(d)) Total
Assets					
Cash and short-term funds.....	—	—	—	—	—
Placements with banks and other financial institutions maturing between one and twelve months	—	—	—	—	—
Trade bills less impairment allowances	—	—	—	—	—
Certificates of deposit held.....	—	—	—	—	—
Trading assets	—	—	—	816,431	816,431
Financial assets measured at fair value through profit or loss	—	—	—	5,924,424	5,924,424
Advances to customers and other accounts less impairment allowances	—	—	—	345,360	345,360
Held-to-maturity and available-for- sale financial assets.....	—	—	—	(4,833,845)	(4,833,845)
Non-trading securities.....	—	—	—	(1,175,115)	(1,175,115)
Investments in associated companies...	—	—	—	—	—
Tangible fixed assets					
— Investment properties	—	—	—	—	—
— Other properties, plants and equipment	—	—	—	—	—
Goodwill	—	45,196	—	—	45,196
Current tax recoverable	—	—	—	—	—
Deferred tax assets.....	—	—	—	—	—
Total assets	<u>—</u>	<u>45,196</u>	<u>—</u>	<u>1,077,255</u>	<u>1,122,451</u>

Effect of new policy (increase/(decrease) in total assets, total equity and liabilities)

	HK (SIC) Interpretation					
	HKFRS 2 (note 4(c))	HKFRS 3 (note 4(f))	HKAS 1 (note 4(g))	HKAS 32 & 39 (note 4(e))	21 & HKAS 40 (note 4(d))	Total
Equity and liabilities						
Deposits and balances of banks and other financial institutions.....	—	—	—	—	—	—
Deposits from customers	—	—	—	—	—	—
Certificates of deposit issued.....	—	—	—	(145,102)	—	(145,102)
Trading liabilities.....	—	—	—	857,334	—	857,334
Current tax payable	—	—	—	2,408	—	2,408
Deferred tax liabilities	—	—	—	54,952	11,308	66,260
Other accounts and provisions.....	—	—	—	13,501	—	13,501
Loan capital	—	—	—	—	—	—
Total liabilities.....	—	—	—	783,093	11,308	794,401
Share capital	—	—	—	—	—	—
Reserves						
— Share premium	11,520	—	—	—	—	11,520
— Capital reserve	—	—	—	—	—	—
— General reserve	—	—	—	—	—	—
— Bank premises revaluation reserve	—	—	—	—	—	—
— Investment properties revaluation reserve.....	—	—	—	—	(25,480)	(25,480)
— Investment revaluation reserve ..	—	—	—	(506)	—	(506)
— Capital redemption reserve	—	—	—	—	—	—
— Unappropriated profits	(11,520)	45,196	—	294,668	14,172	342,516
Reserves.....	—	45,196	—	294,162	(11,308)	328,050
Shareholders' funds.....	—	45,196	—	294,162	(11,308)	328,050
Minority interests.....	—	—	—	—	—	—
Total equity.....	—	45,196	—	294,162	(11,308)	328,050
Total equity and liabilities	—	45,196	—	1,077,255	—	1,122,451

Estimated effect on net income recognised directly in consolidated equity for the year ended 31st December, 2005:

	Effect of new policy (increase/(decrease) in total equity)		
	HKAS 39 (note 4(e))	HKAS 40 (note 4(d))	Total
Attributable to shareholders of the Bank	(5,637)	(12,797)	(18,434)
Minority interests	—	—	—
Total equity	(5,637)	(12,797)	(18,434)

Estimated effect on amounts recognised as capital transactions with owners of the Group for the year ended 31st December, 2005:

	Effect of new policy (increase/(decrease) in total equity)	
	HKFRS 2 (note 4(c))	Total
Attributable to shareholders of the Bank.....	6,588	6,588
Minority interests.....	—	—
Total equity.....	<u>6,588</u>	<u>6,588</u>

(ii) Effect on the Bank's balance sheet

Estimated effect on the balance sheet at 31st December, 2005:

	Effect of new policy (increase/(decrease) in total assets, total equity and liabilities)					
	HK (SIC) Interpretation					
	HKFRS 2 (note 4(c))	HKFRS 3 (note 4(f))	HKAS 1 (note 4(g))	HKAS 32 & 39 (note 4(e))	HKAS 21 & HKAS 40 (note 4(d))	Total
Assets						
Cash and short-term funds.....	—	—	—	—	—	—
Placements with banks and other financial institutions maturing between one and twelve months	—	—	—	—	—	—
Trade bills less impairment allowances.....	—	—	—	—	—	—
Certificates of deposit held.....	—	—	—	—	—	—
Trading assets	—	—	—	842,877	—	842,877
Financial assets measured at fair value through profit or loss	—	—	—	5,924,424	—	5,924,424
Advances to customers and other accounts less impairment allowances.....	—	—	—	255,793	—	255,793
Held-to-maturity and available-for- sale financial assets.....	—	—	—	(4,859,466)	—	(4,859,466)
Non-trading securities.....	—	—	—	(1,175,115)	—	(1,175,115)
Investments in associated companies...	—	—	—	—	—	—
Tangible fixed assets						
— Investment properties	—	—	—	—	—	—
— Other properties, plants and equipment	—	—	—	—	—	—
Goodwill	—	45,196	—	—	—	45,196
Deferred tax assets.....	—	—	—	—	—	—
Total assets	—	45,196	—	988,513	—	1,033,709

Effect of new policy (increase/(decrease) in total assets, total equity and liabilities)

	HK (SIC) Interpretation					
	HKFRS 2 (note 4(c))	HKFRS 3 (note 4(f))	HKAS 1 (note 4(g))	HKAS 32 & 39 (note 4(e))	21 & HKAS 40 (note 4(d))	Total
Equity and liabilities						
Deposits and balances of banks and other financial institutions.....	—	—	—	—	—	—
Deposits from customers	—	—	—	—	—	—
Certificates of deposit issued.....	—	—	—	(145,102)	—	(145,102)
Trading liabilities.....	—	—	—	861,120	—	861,120
Current tax payable	—	—	—	2,183	—	2,183
Deferred tax liabilities	—	—	—	41,911	910	42,821
Other accounts and provisions.....	—	—	—	13,501	—	13,501
Loan capital	—	—	—	—	—	—
Total liabilities.....	—	—	—	773,613	910	774,523
Share capital	—	—	—	—	—	—
Reserves						
— Share premium	11,520	—	—	—	—	11,520
— Capital reserve	—	—	—	—	—	—
— General reserve	—	—	—	—	—	—
— Bank premises revaluation reserve	—	—	—	—	—	—
— Investment properties revaluation reserve.....	—	—	—	—	(5,200)	(5,200)
— Investment revaluation reserve ..	—	—	—	(506)	—	(506)
— Capital redemption reserve	—	—	—	—	—	—
— Unappropriated profits	(11,520)	45,196	—	215,406	4,290	253,372
Reserves.....	—	45,196	—	214,900	(910)	259,186
Shareholders' funds.....	—	45,196	—	214,900	(910)	259,186
Minority interests.....	—	—	—	—	—	—
Total equity.....	—	45,196	—	214,900	(910)	259,186
Total equity and liabilities	—	45,196	—	988,513	—	1,033,709

Estimated effect on net income recognised directly in the Bank's equity for the year ended 31st December, 2005:

	Effect of new policy (increase/(decrease) in total equity)		
	HKAS 39 (note 4(e))	HKAS 40 (note 4(d))	Total
Attributable to shareholders of the Bank	<u>(5,637)</u>	<u>(5,200)</u>	<u>(10,837)</u>

Estimated effect on amounts recognised as capital transactions with owners of the Bank for the year ended 31st December, 2005:

	Effect of new policy (increase/(decrease) in total equity)	
	HKFRS 2 (note 4(c))	Total
Attributable to shareholders of the Bank.....	<u>6,588</u>	<u>6,588</u>

(c) Employee share option scheme (HKFRS 2, “Share-based payment”)

In prior years, no amounts were recognised when certain executives were granted share options over shares in the Bank. If the employees chose to exercise the options, the nominal amount of share capital and share premium were credited only to the extent of the option's exercise price receivable.

With effect from 1st January, 2005, in order to comply with HKFRS 2, the Group recognises the fair value of such share options as staff expense in the profit and loss account between the grant date and vesting date. A corresponding increase is recognised in share premium in equity.

If an employee chooses to exercise options, the exercise price is transferred to share capital and share premium. If the options lapse unexercised, the related share premium is transferred directly to unappropriated profits.

The new accounting policy has been applied retrospectively with comparatives restated in accordance with HKFRS 2, except that the Group has taken advantage of the transitional provisions set out in paragraph 53 of HKFRS 2 under which the new recognition and measurement policies have not been applied to the following grants of options:

- (i) all options granted to employees on or before 7th November, 2002; and
- (ii) all options granted to employees after 7th November, 2002 but which had vested before 1st January, 2005.

The amount of prior year adjustments and the effect on the results for the year ended 31st December, 2005, and the share premium in equity as of that date, are set out in notes 4(a) and 4(b). No adjustments to the opening balances as at 1st January, 2004 are required as no options existed at that time which were unvested at 1st January, 2005.

Details of the employee share option scheme can be found in note 42.

(d) Investment properties (HKAS 40, “Investment property”, and HK(SIC) Interpretation 21, “Income taxes — Recovery of revalued non-depreciable assets”)

Change in accounting policies relating to investment properties are as follows.

(i) *Timing of recognition of movements in fair value in the profit and loss account*

In prior years, movements in the fair value of the Group's investment properties were recognised directly in the investment properties revaluation reserve except when, on a portfolio basis, the reserve was insufficient to cover a deficit on the portfolio, or when a deficit previously recognised in the profit and loss account had reversed, or when an individual investment property was disposed of. In these limited circumstances, movements in the fair value were recognised in the profit and loss account.

In addition, in prior years land (including leasehold land) which the Group held for an undetermined future purpose was accounted for under the valuation model in SSAP 17 “Property, plant and equipment”, whereby the land was carried at fair value, with any movements in the fair value of the land being normally taken to the bank premises revaluation reserve, net of deferred tax thereon.

As from 1st January, 2005, the Group recognises any gain or loss arising from change in fair value in the profit and loss account. In addition, land held for an undetermined future purpose is recognised as “investment property” if the property is freehold or, if the property is leasehold, the Group has chosen to recognise such land as investment property rather than as land held under an operating lease.

(ii) *Measurement of deferred tax on movements in fair value*

In prior years, the Group was required to apply the tax rate that would be applicable to the sale of investment properties to determine whether any amounts of deferred tax should be recognised on the revaluation of investment properties. As there would have been no tax payable on the disposal of the Group's investment properties, no deferred tax was provided in prior years.

As from 1st January, 2005, in accordance with HK(SIC) Interpretation 21, the Group recognises deferred tax on movements in the value of an investment property using tax rates that are applicable to the property's use. If the Group has no intention to sell it and the property would have been depreciable had the Group not adopted the fair value model.

(iii) *Description of transitional provisions and effect of adjustments*

The amount of prior year adjustments and the effect on the results for the year ended 31st December, 2005, and the reserves as of that date, are set out in notes 4(a) and 4(b).

(e) **Financial instruments (HKAS 32, “Financial instruments: Disclosure and presentation” and HKAS 39, “Financial instruments: Recognition and measurement”)**

(i) In prior years, the accounting policies for certain financial instruments were as follows:

- Dated debt securities that the Group had the ability and intention to hold to maturity were classified as held-to-maturity securities. Held-to-maturity securities were stated in the balance sheet at amortised cost less any provisions for diminution in value. The carrying amounts of held-to-maturity securities were reviewed as at each balance sheet date in order to assess the credit risk and whether the carrying amounts were expected to be recovered. Provisions were made when carrying amounts were not expected to be recovered and were recognised as an expense in the profit and loss account.
- Trading securities were stated in the balance sheet at fair value. Changes in fair value were recognised in the profit and loss account as they arose.
- Non-trading securities were stated in the balance sheet at fair value. Changes in the fair value were recognised in the investment revaluation reserve until the security was sold, collected, or otherwise disposed of, or until there was objective evidence that the security was impaired, at which time the relevant cumulative gain or loss was transferred from the investment revaluation reserve to the profit and loss account.
- Derivatives carried in dealing portfolios were marked-to-market, and gains and losses were included in dealing profits or losses.
- Derivatives used in balance sheet management to hedge open positions for specific assets or liabilities, were accounted for on an accrual basis, consistent with the underlying assets and liabilities held in these portfolios.
- Certificates of deposit issued were stated at cost.
- Provisions for bad and doubtful debts included general provision which reflected the inherent risk of losses based on the past experience and judgments about current conditions; and specific provisions reflected the expected loss for non-performing loans following guidelines established by the Directors.
- Loan fee income and expense were recognised on an accrual basis using the relative contract or coupon interest rates. The interest accrued on non-performing loans was not taken as income but credited to a suspense account, which was netted in the balance sheet against the appropriate balance sheet headings.

From 1st January, 2005, the Group has adopted HKAS 32 and HKAS 39. Details of new accounting policies in respect of classification of financial instruments, initial and subsequent recognition and measurement, fair value measurement principles, hedging, impairment testing and recognition of allowance and revenue recognition are set out in note 2 to the accounts.

(ii) Description of transitional provisions and effect of adjustments

The change in accounting policies of the above items were adopted by way of opening balance adjustments to certain reserves and redesignation of financial instruments as at 1st January, 2005. As a result of these opening balance adjustments, the unappropriated profits and investment revaluation reserve of the Group as at 1st January, 2005 has been increased by HK\$182,205,000 and HK\$5,131,000 respectively. Comparative amounts have not been restated as this is prohibited by the transitional arrangements in HKAS 39.

(f) **Amortisation of positive and negative goodwill (HKFRS 3, “Business combinations” and HKAS 36, “Impairment of assets”)**

In prior years, positive goodwill was amortised to the profit and loss account on a straight-line basis over not more than 20 years. In respect of controlled subsidiaries, positive goodwill was stated in the consolidated balance sheet at cost less any accumulated amortisation and any impairment losses. In respect of acquisition of associated companies, the cost of positive goodwill less any accumulated amortisation and any impairment losses was included in the carrying amount of the investments in associated companies.

With effect from 1st January, 2005, in accordance with HKFRS 3 and HKAS 36, the Group no longer amortises positive goodwill. Such goodwill is tested annually for impairment, including in the year of its initial recognition, as well as when there are indications of impairment. Impairment losses are recognised when the carrying amount of the cash generating unit to which the goodwill has been allocated exceeds its recoverable amount.

Also with effect from 1st January, 2005 and in accordance with HKFRS 3, if the fair value of the net assets acquired in a business combination exceeds the consideration paid (i.e. an amount arises which would have been known as negative goodwill under the previous accounting policy), the excess is recognised immediately in the profit and loss account as it arises.

The new policy in respect of positive goodwill has been applied prospectively in accordance with the transitional arrangements under HKFRS 3. The adjustments for each consolidated financial statement line affected for the year ended 31st December, 2005 are set out in note 4(b).

Also in accordance with the transitional arrangements under HKFRS 3, goodwill which had previously been taken directly to reserves (i.e. goodwill which arose before 1st January, 2001) will not be recognised in profit and loss account on disposal or impairment of the acquired business or under any other circumstances.

The change in policy relating to negative goodwill had no effect on the financial statements as there was no negative goodwill deferred as at 31st December, 2004.

(g) Changes in presentation

(i) *Presentation of profit and loss account and balance sheet (HKAS 30, “Disclosures in financial statements of banks and similar financial institutions”)*

In prior years, there were no specific accounting standards governing the presentation of the accounts of banks. Management, having regard to the overall clarity and the disclosure requirements of the Hong Kong Monetary Authority, exercised its judgement in deciding on the relative prominence given to each item presented on the face of the profit and loss account and balance sheet.

With effect from 1st January, 2005, in order to comply with HKAS 30 and take into account the measurement basis that has been applied, the Group has changed its presentation of certain items on the face of the profit and loss account.

With effect from 1st January, 2005, in order to comply with HKAS 30 and to assist in an understanding of the performance in financial instruments, the Group has reclassified and grouped the interest income and interest expenses arising from financial instruments for trading and measured at fair value through profit or loss from “Interest income”, “Interest expense” and “Other operating income” to “Net interest income on financial instruments held for trading and measured at fair value through profit or loss”.

(ii) *Presentation of shares of associated companies’ and jointly controlled entities’ taxation (HKAS 1, “Presentation of financial statements”)*

In prior years, the Group’s share of taxation of associated companies and jointly controlled entities accounted for using the equity method was included as part of the Group’s income tax in the consolidated profit and loss account. With effect from 1st January, 2005, in accordance with the implementation guidance in HKAS 1, the Group has changed the presentation and includes the share of taxation of associated companies and jointly controlled entities accounted for using the equity method in the respective shares of profit or loss reported in the consolidated profit and loss account before arriving at the Group’s profit or loss before tax. These changes in presentation have been applied retrospectively with comparatives restated as shown in notes 4(a) and 4(b).

(iii) *Minority interests (HKAS 1, “Presentation of financial statements” and HKAS 27, “Consolidated and separate financial statements”)*

In prior years, minority interests at the balance sheet date were presented in the consolidated balance sheet separately from liabilities and as deduction from net assets. Minority interests in the results of the Group for the year were also separately presented in the profit and loss account as a deduction before arriving at the profit attributable to shareholders (the shareholders of the Bank).

With effect from 1st January, 2005, in order to comply with HKAS 1 and HKAS 27, the Group has changed its accounting policy relating to presentation of minority interests. Under the new policy, minority interests are presented as part of equity, separately from interests attributable to the shareholders of the Bank. Further details of the new policy are set out in note 2(c).

(h) Definition of related parties (HKAS 24, “Related party disclosures”)

As a result of the adoption of HKAS 24, “Related party disclosures”, the definition of related parties as disclosed in note 2(q) has been expanded to clarify that related parties include entities that are under the significant influence of a related party that is an individual (i.e. key management personnel, significant shareholders and/or their close family members) and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group. The clarification of the definition of related parties has not resulted in any material changes to the previously reported disclosures of related party transactions; nor has it had any material effect on the disclosures made in the current period, as compared to those that would have been reported had SSAP 20, “Related party disclosures”, still been in effect.

5. OPERATING PROFIT

(a) Interest income

	2005	2004 (restated)
Placement with banks and other financial institutions	909,644	525,890
Advances to customers	2,515,713	1,768,627
Listed investments	58,361	79,680
Unlisted investments	522,511	484,199
Other interest income	35,550	18,610
	<u>4,041,779</u>	<u>2,877,006</u>

Other interest income includes the amount of interest income accrued on impaired financial assets of HK\$22,824,000, which includes interest income on unwinding of impairment provision discount of HK\$10,465,000 (Note 20) for the year ended 31st December, 2005.

(b) Interest expense

	2005	2004 (restated)
Deposits and balances of banks and other financial institutions	66,375	18,465
Deposits from customers	2,051,916	858,989
Certificates of deposit issued	60,216	41,438
Loan capital (Note 37(a))	134,148	134,514
Other interest expenses	—	29,283
	<u>2,312,655</u>	<u>1,082,689</u>

(c) Net interest income on financial instruments held for trading and measured at fair value through profit or loss

	2005	2004
Trading assets	138	—
Trading liabilities	(562)	—
Financial assets measured at fair value through profit or loss	234,309	—
Financial liabilities measured at fair value through profit or loss	(84,776)	—
Trading financial derivatives interest income	55,869	—
Trading financial derivatives interest expense	(69,102)	—
	<u>135,876</u>	<u>—</u>

The comparative figures for 2004 have not been adjusted as the amount was immaterial.

(d) Other operating income

	2005	2004 (restated)
Fees and commissions		
Credit commission and fees.....	120,456	91,751
Credit card related fees.....	67,947	63,416
Trade related fees.....	80,605	87,889
Insurance commission.....	56,761	52,723
Stockbroking fees.....	58,147	70,623
Other fees and commission income.....	173,087	155,035
Less: Fees and commission paid.....	(36,041)	(37,341)
	<u>520,962</u>	<u>484,096</u>
Gains arising from dealing in foreign currencies.....	113,480	114,288
Gains on other dealing activities.....	981	1,848
Net realised and unrealised profits on trading financial instruments.....	33,038	4,847
Net realised and unrealised profits on financial instruments measured at fair value through profit or loss.....	59,531	—
Dividend income from unlisted available-for-sale investments.....	6,071	4,124
Dividend income from listed available-for-sale investments.....	1,629	6,373
Dividend income from listed trading investments.....	149	—
Others.....	19,929	24,441
	<u>755,770</u>	<u>640,017</u>

(e) Operating expenses

	2005	2004 (restated)
Staff costs		
Salaries and other staff costs.....	579,729	563,934
Retirement benefit costs (Note 42).....	36,267	35,203
Share option scheme cost (Note 37(a)).....	6,588	4,932
EIP cost (Note 37(a)).....	3,372	2,248
	<u>625,956</u>	<u>606,317</u>
Premises and equipment expenses, excluding depreciation.....	105,179	102,841
Depreciation (Note 25).....	75,407	108,058
Auditors' remuneration		
Audit services.....	3,238	2,800
Tax services.....	532	779
Other services.....	868	40
	<u>4,638</u>	<u>3,619</u>
Amortisation of goodwill (Note 26).....	—	44,997
Impairment losses on goodwill (Note 26).....	1,170	—
Others.....	163,439	167,207
	<u>975,789</u>	<u>1,033,039</u>

6. (a) Gains on revaluation of investment properties and disposal of tangible fixed assets and associated company

The amount included an unrealised gain on revaluation of investment properties of HK\$12,797,000 (2004 (restated): HK\$68,849,000).

(b) Profits on disposal of held-to-maturity and available-for-sale financial assets

	2005	2004
Profit on disposal of held-to-maturity financial assets.....	—	201
Net revaluation losses transferred from investment revaluation reserves (note 35).....	(7,424)	—
Losses on disposal of available-for-sale financial assets.....	(1,624)	—
	<u>(9,048)</u>	<u>201</u>

7. TAXATION

(a) Taxation in the consolidated profit and loss account represents:

	2005	2004 (restated)
Current tax — Provision for Hong Kong profits tax		
Tax for the year	239,151	194,659
Overprovision in respect of prior year.....	(6,866)	(9,703)
	<u>232,285</u>	<u>184,956</u>
Current tax — Overseas		
Tax for the year	32,609	50,315
Overprovision in respect of prior year.....	(6,779)	(222)
	<u>25,830</u>	<u>50,093</u>
Deferred taxation		
Origination and reversal of temporary differences	7,423	14,984
Effect of decrease in tax rate on deferred tax balances at 1 January	(677)	—
	<u>6,746</u>	<u>14,984</u>
	<u>264,861</u>	<u>250,033</u>

The provision for Hong Kong profits tax is calculated at 17.5% (2004: 17.5%) of the estimated assessable profits for the year ended 31st December 2005. Overseas taxation is provided at the appropriate current rates of taxation ruling in the countries in which the relevant units of the Group operate.

(b) Reconciliation between tax expenses and accounting profit at applicable tax rates:

	2005		2004 (restated)	
		%		%
Profit before tax	1,615,806	100	1,418,314	100
Notional tax on profit before tax, calculated at the rates applicable to profits in the countries concerned.....	267,845	16.57	247,917	17.48
Tax effect of non-deductible expenses	18,588	1.15	49,614	3.50
Tax effect of non-taxable revenue	(9,147)	(0.57)	(39,171)	(2.76)
Tax effect of unused tax losses not recognised.....	1,897	0.12	1,599	0.11
Effect on opening deferred tax balances resulting from a decrease in tax rate during the year.....	(677)	(0.04)	—	—
Overprovision in prior years	(13,645)	(0.84)	(9,926)	(0.70)
	<u>264,861</u>	<u>16.39</u>	<u>250,033</u>	<u>17.63</u>

(c) **Current tax recoverable and payable**

The components of current tax (recoverable)/payable in the balance sheets are as follows:

	The Group		The Bank	
	2005	2004 (restated)	2005	2004 (restated)
Current tax recoverable				
Provision for Hong Kong profits tax	(1,211)	(5,381)	—	—
Provision for overseas tax	—	—	—	—
	<u>(1,211)</u>	<u>(5,381)</u>	<u>—</u>	<u>—</u>
Current tax payable				
Provision for Hong Kong profits tax	67,760	24,423	53,641	16,472
Provision for overseas tax	35,038	38,958	4,109	3,734
	<u>102,798</u>	<u>63,381</u>	<u>57,750</u>	<u>20,206</u>

All current tax recoverable and payable are expected to be settled within 1 year.

(d) **Deferred tax assets and liabilities recognised**

The components of deferred tax (assets)/liabilities recognised in the balance sheets and the movements during the year are as follows:

	The Group						
	2005						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Revaluation of available- for-sale financial assets	Collective impairment allowances for impaired loans and advances	Tax losses	Others	Total
At 1st January, 2005							
— as previously reported	28,944	76,410	3,747	(78,527)	(2,640)	—	27,934
— prior year adjustments in respect of investment properties	—	9,069	—	—	—	—	9,069
— as restated	<u>28,944</u>	<u>85,479</u>	<u>3,747</u>	<u>(78,527)</u>	<u>(2,640)</u>	<u>—</u>	<u>37,003</u>
Opening balance adjustments in respect of:							
— financial instruments	—	—	1,088	—	—	—	1,088
— release of impairment allowances on advances to customers	—	—	—	44,036	—	—	44,036
	—	—	1,088	44,036	—	—	45,124
— as restated, after opening balance adjustments	<u>28,944</u>	<u>85,479</u>	<u>4,835</u>	<u>(34,491)</u>	<u>(2,640)</u>	<u>—</u>	<u>82,127</u>
Charged/(credited) to consolidated profit and loss account	1,811	2,239	—	2,733	100	(137)	6,746
Credited to reserves	—	(2,900)	(2,389)	—	—	—	(5,289)
At 31st December, 2005	<u>30,755</u>	<u>84,818</u>	<u>2,446</u>	<u>(31,758)</u>	<u>(2,540)</u>	<u>(137)</u>	<u>83,584</u>

The Bank						
2005						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Revaluation of available- for-sale financial assets	Collective impairment allowances for impaired loans and advances	Others	Total
At 1st January, 2005	24,032	73,021	3,434	(60,303)	—	40,184
Opening balance adjustments in respect of:						
— financial instruments	—	—	1,088	—	—	1,088
— release of impairment allowances on advances to customers	—	—	—	25,611	—	25,611
	—	—	1,088	25,611	—	26,699
— as restated, after opening balance adjustments	24,032	73,021	4,522	(34,692)	—	66,883
Charged/(credited) to profit and loss account ..	1,504	910	—	3,218	(137)	5,495
Credited to reserves	—	(4,527)	(2,079)	—	—	(6,606)
At 31st December, 2005	<u>25,536</u>	<u>69,404</u>	<u>2,443</u>	<u>(31,474)</u>	<u>(137)</u>	<u>65,772</u>

The Group						
2004 (restated)						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Revaluation of non- trading securities	General provision for bad and doubtful debts	Tax losses	Total
At 1st January, 2004	18,777	87,465	2,742	(74,698)	(3,130)	31,156
Charged/(credited) to consolidated profit and loss account	10,167	8,156	—	(3,829)	490	14,984
(Credited)/charged to reserves	—	(10,142)	1,005	—	—	(9,137)
At 31st December, 2004	<u>28,944</u>	<u>85,479</u>	<u>3,747</u>	<u>(78,527)</u>	<u>(2,640)</u>	<u>37,003</u>

The Bank						
2004 (restated)						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Revaluation of non- trading securities	General provision for bad and doubtful debts	Total	
At 1st January, 2004	19,571	52,083	1,890	(39,787)	33,757	
Addition through merger with CFB	838	20,356	—	(20,883)	311	
Charged to profit and loss account	3,623	—	—	367	3,990	
Charged to reserves	—	582	1,544	—	2,126	
At 31st December, 2004	<u>24,032</u>	<u>73,021</u>	<u>3,434</u>	<u>(60,303)</u>	<u>40,184</u>	

	The Group		The Bank	
	2005	2004 (restated)	2005	2004
Net deferred tax assets recognised on the balance sheet.	(7,986)	(27,950)	(3,479)	(9,324)
Net deferred tax liabilities recognised on the balance sheet.....	91,570	64,953	69,251	49,508
	<u>83,584</u>	<u>37,003</u>	<u>65,772</u>	<u>40,184</u>

8. PROFIT ATTRIBUTABLE TO THE SHAREHOLDERS

The profit attributable to the shareholders includes an amount of HK\$1,124,275,000 (2004 (restated): HK\$968,472,000) which has been dealt with in the accounts of the Bank.

9. DIVIDENDS

(a) Dividends attributable to the year

	2005	2004
Interim dividend declared and paid of HK\$0.70 (2004: HK\$0.53) per share on 294,000,500 (2004: 293,910,500) shares	205,800	155,773
Underprovision of final dividend in respect of the previous year.....	57	140
Final dividend proposed after the balance sheet date of HK\$1.60 (2004: HK\$1.43) per share on 294,020,500 (2004: 293,910,500) shares	470,433	420,292
	<u>676,290</u>	<u>576,205</u>

The final dividend proposed after the balance sheet date has not been recognised as a liability at the balance sheet date.

(b) Dividends attributable to the previous year, approved and paid during the year

	2005	2004
Final dividend in respect of the previous year, approved and paid during the year, of HK\$1.43 (2004: HK\$1.08) per share on 293,950,500 (2004: 293,910,500) shares.....	<u>420,349</u>	<u>317,423</u>

10. DIRECTORS' EMOLUMENTS

Directors' emoluments disclosed pursuant to section 161 of the Hong Kong Companies Ordinance are as follows:

2005						
	Directors' fee	Salaries and other emoluments	Pension contributions	Performance bonuses	Share-based payment	Total
Executive directors						
Patrick Y B Fung	229	5,200	600	4,026	1,908	11,963
Frank J Wang	115	2,460	—	2,666	1,356	6,597
Michael Y S Fung	115	2,704	312	2,013	1,234	6,378
Louis C W Ho	115	1,609	186	571	798	3,279
Non-executive directors						
Alan R Griffith	100	—	—	—	—	100
Aloysius H Y Tse	100	89	—	—	—	189
Ambrose H C Lau	100	—	—	—	—	100
Andrew M Gordon	100	50	—	—	—	150
Cheng Hon Kwan	100	50	—	—	—	150
Kenneth A Lopian	100	—	—	—	—	100
Simon K Y Lee	100	50	—	—	—	150
Tung Chee Chen	100	—	—	—	—	100
Total	<u>1,374</u>	<u>12,212</u>	<u>1,098</u>	<u>9,276</u>	<u>5,296</u>	<u>29,256</u>
2004 (restated)						
	Directors' fee	Salaries and other emoluments	Pension contributions	Performance bonuses	Share-based payment	Total
Executive directors						
Patrick Y B Fung	241	5,200	600	7,106	1,222	14,369
Frank J Wang	123	2,059	—	4,566	864	7,612
Michael Y S Fung	123	2,542	292	3,553	783	7,293
Louis C W Ho	123	1,609	186	705	491	3,114
Non-executive directors						
Alan R Griffith	100	—	—	—	—	100
Aloysius H Y Tse	100	50	—	—	—	150
Ambrose H C Lau	100	—	—	—	—	100
Andrew M Gordon	100	50	—	—	—	150
Cheng Hon Kwan	100	50	—	—	—	150
Ho Soo Ching	100	50	—	—	—	150
Kenneth A Lopian	100	—	—	—	—	100
Simon K Y Lee	166	50	—	—	—	216
Tung Chee Chen	166	—	—	—	—	166
Total	<u>1,642</u>	<u>11,660</u>	<u>1,078</u>	<u>15,930</u>	<u>3,360</u>	<u>33,670</u>

The above share-based payments were fair value of share options and awards granted under the Bank's Share Option Scheme and EIP. The details of these benefits in kind are disclosed under "Share Option Scheme" and "Employee Incentive Plan" in Note 42(b).

11. EXECUTIVES' EMOLUMENTS

The five highest paid individuals included four (2004: three) directors, details of whose emoluments are set out in Note 10 above. The emoluments of the remaining one individual (2004: two) are as follows:

	<u>2005</u>	<u>2004</u>
Salaries and other emoluments	1,922	2,868
Pension contributions.....	220	338
Performance bonuses	1,200	3,660
Share-based payment	554	556
	<u>3,896</u>	<u>7,422</u>

The emoluments of the executive are within the following band:

	<u>2005</u>	<u>2004</u>
	<u>Number of</u> <u>Executives</u>	<u>Number of</u> <u>Executives</u>
HK\$2,500,001 — HK\$3,000,000	—	1
HK\$3,500,001 — HK\$4,000,000	1	—
HK\$4,000,001 — HK\$4,500,000	—	1
	<u>1</u>	<u>2</u>

12. EARNINGS PER SHARE

The calculation of basic earnings per share is based on profit attributable to the shareholders of HK\$1,348,718,000 (2004 (restated): HK\$1,166,689,000) and on the weighted average number of 293,970,062 (2004: 293,897,112) ordinary shares in issue during the year.

	<u>2005</u>	<u>2004</u>
	<u>Number of</u> <u>shares of</u> <u>HK\$1.00 each</u>	<u>Number of</u> <u>shares of</u> <u>HK\$1.00 each</u>
Issued ordinary shares at 1st January	293,910,500	293,780,500
Effect of share option exercised	59,562	116,612
Weighted average number of ordinary shares used in calculating basic earnings per share	<u>293,970,062</u>	<u>293,897,112</u>

The calculation of diluted earnings per share is based on profit attributable to the shareholders of HK\$1,348,718,000 (2004 (restated): HK\$1,166,689,000) and on the weighted average number of 294,844,825 (2004: 294,567,557) ordinary shares in issue during the year after adjustment for the effects of all dilutive potential ordinary shares of 874,763 (2004: 670,445).

	2005	2004
	Number of shares of HK\$1.00 each	Number of shares of HK\$1.00 each
Weighted average number of ordinary shares used in calculating basic earnings per share	293,970,062	293,897,112
Deemed exercise of share option scheme	733,918	347,069
Deemed exercise of EIP	140,845	323,376
Weighted average number of ordinary shares used in calculating diluted earnings per share	<u>294,844,825</u>	<u>294,567,557</u>

13. CASH AND SHORT-TERM FUNDS

	The Group		The Bank	
	2005	2004	2005	2004
Cash and balances with banks and other financial institutions (Note 33)	1,781,679	1,394,069	1,387,648	1,106,702
Money at call and short notice (Note 33)	16,998,025	18,548,891	16,958,098	18,481,417
Treasury bills (Note 33)	1,274,094	586,358	399,029	402,416
	<u>20,053,798</u>	<u>20,529,318</u>	<u>18,744,775</u>	<u>19,990,535</u>

Cash and balances with banks and other financial institutions are analysed as follows:

	The Group		The Bank	
	2005	2004	2005	2004
Cash balances	381,624	325,855	271,043	244,298
Balances and placement with central banks	413,531	260,313	228,574	101,351
Balances and placement with banks	986,524	807,874	888,031	761,026
Balances with other financial institutions	—	27	—	27
	<u>1,781,679</u>	<u>1,394,069</u>	<u>1,387,648</u>	<u>1,106,702</u>

Money at call and short notice are analysed as follows:

	The Group		The Bank	
	2005	2004	2005	2004
Placement with banks (Note 33)	<u>16,998,025</u>	<u>18,548,891</u>	<u>16,958,098</u>	<u>18,481,417</u>

All treasury bills are held-to-maturity, issued by central governments and central banks and are unlisted.

14. PLACEMENTS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS MATURING BETWEEN ONE AND TWELVE MONTHS

Placements with banks and other financial institutions are analysed as follows:

	The Group		The Bank	
	2005	2004	2005	2004
Placement with banks (Note 33)	<u>2,657,380</u>	<u>1,435,527</u>	<u>2,629,507</u>	<u>1,408,389</u>

15. TRADE BILLS LESS IMPAIRMENT ALLOWANCES

	The Group		The Bank	
	2005	2004	2005	2004
Trade bills.....	653,992	552,613	414,160	388,671
Individual impairment allowances for impaired loans and advances (Note 20)	(961)	—	(961)	—
Collective impairment allowances for impaired loans and advances (Note 20)	(656)	—	(655)	—
Specific provisions for bad and doubtful debts (Note 20).....	—	(54)	—	(54)
General provisions for bad and doubtful debts (Note 20).....	—	(1,435)	—	(1,374)
(Note 33)	<u>652,375</u>	<u>551,124</u>	<u>412,544</u>	<u>387,243</u>

16. CERTIFICATES OF DEPOSIT HELD

All the certificates of deposit held were held-to-maturity and were unlisted.

17. TRADING ASSETS

	The Group		The Bank	
	2005	2004 (restated)	2005	2004 (restated)
Debt securities:				
Listed in Hong Kong	299	153	299	153
Unlisted.....	<u>1,413</u>	—	<u>1,413</u>	—
	1,712	153	1,712	153
Equity securities listed in Hong Kong	<u>74,380</u>	<u>11,914</u>	<u>66,380</u>	—
Total trading securities	76,092	12,067	68,092	153
Positive fair values of derivative financial instruments (Note 36(b))	<u>835,172</u>	<u>18,741</u>	<u>861,618</u>	<u>18,741</u>
(Note 33)	<u>911,264</u>	<u>30,808</u>	<u>929,710</u>	<u>18,894</u>

Trading assets of the Bank included positive fair values of derivative financial instruments transacted with a subsidiary amounting to HK\$26,445,000 (2004: Nil).

Trading securities analysed by counterparty are as follows:

	The Group		The Bank	
	2005	2004	2005	2004
Issued by:				
Central government and central banks.....	201	50	201	50
Banks and other financial institutions	42,036	5,364	37,014	—
Corporate entities.....	33,757	6,550	30,779	—
Public sector	98	103	98	103
	<u>76,092</u>	<u>12,067</u>	<u>68,092</u>	<u>153</u>

18. FINANCIAL ASSETS MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS

	The Group		The Bank	
	2005	2004	2005	2004
Debt securities (Note 33):				
Listed in Hong Kong	93,506	—	93,506	—
Listed outside Hong Kong	1,230,053	—	1,230,053	—
Unlisted.....	4,600,865	—	4,600,865	—
	<u>5,924,424</u>	<u>—</u>	<u>5,924,424</u>	<u>—</u>

Financial assets measured at fair value through profit or loss analysed by counterparty are as follows:

	The Group		The Bank	
	2005	2004	2005	2004
Issued by:				
Banks and other financial institutions	2,886,507	—	2,886,507	—
Corporate entities.....	2,527,422	—	2,527,422	—
Public sector	510,495	—	510,495	—
	<u>5,924,424</u>	<u>—</u>	<u>5,924,424</u>	<u>—</u>

Following the adoption of HKAS 39 in 2005, certain financial assets and financial liabilities were re-designated as financial assets/liabilities measured at fair value through profit or loss on 1st January, 2005. There was no such re-designation in 2004 as retrospective application of HKAS 39 is not permitted.

The carrying amount of financial assets designated at fair value through profit or loss as at 1st January, 2005 was HK\$5,277,726,000 and these assets were classified as held-to-maturity and non-trading securities at HK\$4,125,330,000 and HK\$1,134,545,000 respectively as at 31st December, 2004.

19. ADVANCES TO CUSTOMERS AND OTHER ACCOUNTS LESS IMPAIRMENT ALLOWANCES

(a) Advances to customers and other accounts less impairment allowances

	The Group		The Bank	
	2005	2004 (restated)	2005	2004 (restated)
Advances to customers	54,401,834	49,189,126	42,518,513	39,437,861
Individual impairment allowances for impaired loans and advances (Note 20)	(119,720)	—	(104,194)	—
Collective impairment allowances for impaired loans and advances (Note 20)	(207,842)	—	(178,795)	—
Specific provisions for bad and doubtful debts (Note 20)	—	(127,731)	—	(83,611)
General provisions for bad and doubtful debts (Note 20)	—	(494,779)	—	(347,786)
(Note 33)	54,074,272	48,566,616	42,235,524	39,006,464
Advances to banks and other financial institutions (Note 33)	79,191	110,865	79,191	110,865
Accrued interest and other accounts	1,310,822	1,012,793	897,608	648,873
Derivative financial instruments — hedging (Note 36(b))	8,598	2,993	8,598	2,225
	<u>55,472,883</u>	<u>49,693,267</u>	<u>43,220,921</u>	<u>39,768,427</u>

(b) Impaired loans

The gross impaired advances to customers and individual impairment allowances made after taking into account the discounted value of future recoverable amounts in respect of such advances are as follows:

	The Group	
	2005	2004
Gross impaired advances to customers	560,065	824,995
Gross impaired advances as a percentage of total advances to customers	1.03%	1.68%
Amount of collateral held	412,530	671,350
Individual impairment allowances	119,720	—
Specific provisions	—	127,731

There were no individual impairment allowances made on advances to banks and other financial institutions on 31st December, 2005 and 31st December, 2004.

(c) **Included in advances to customers are net investments in finance leases:**

The total minimum lease payments receivable under finance leases and their present values are as follows:

	The Group					
	2005			2004		
	Present value of the minimum lease payments	Interest income relating to future periods	Total minimum lease payments	Present value of the minimum lease payments	Interest income relating to future periods	Total minimum lease payments
Amount receivable:						
Within 1 year.....	1,766,192	213,682	1,979,874	1,506,382	160,574	1,666,956
After 1 year but within 5 years.....	2,086,306	195,957	2,282,263	1,767,630	141,653	1,909,283
After 5 years.....	181,878	81,236	263,114	239,480	56,966	296,446
	<u>4,034,376</u>	<u>490,875</u>	<u>4,525,251</u>	<u>3,513,492</u>	<u>359,193</u>	<u>3,872,685</u>
Individual impairment allowances for impaired loans and advances.....	(2,434)			—		
Collective impairment allowances for impaired loans and advances.....	(15,209)			—		
Provisions for bad and doubtful debts.....	—			(2,366)		
Net investment in finance leases.....	<u>4,016,733</u>			<u>3,511,126</u>		

The Bank had no finance lease receivable as at 31st December, 2005 and 31st December, 2004.

(d) **Advances to customers — by industry sectors**

The information concerning advances to customers by industry sectors has been classified according to the usage of the loan and is stated gross of any impairment allowances.

	The Group		Change
	2005	2004	%
Loans for use in Hong Kong			
Industrial, commercial and financial			
— Property development.....	652,264	652,393	—
— Property investment.....	9,628,817	8,502,635	13.3
— Financial concerns.....	508,747	631,997	-19.5
— Stockbrokers.....	307,150	244,082	25.8
— Wholesale and retail trade.....	835,833	974,803	-14.3
— Manufacturing.....	1,460,996	1,745,129	-16.3
— Transport and transport equipment.....	2,827,696	2,721,053	3.9
— Share financing.....	256,776	205,011	25.2
— Others.....	2,899,347	3,032,779	-4.4
Individuals			
— Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme.....	1,500,857	1,618,601	-7.3
— Loans for the purchase of other residential properties.....	13,917,497	13,872,283	0.3
— Credit card advances.....	385,932	358,582	7.6
— Others.....	3,523,120	3,272,558	7.7
Trade finance.....	3,057,178	2,575,916	18.7
Loans for use outside Hong Kong			
— Macau.....	4,817,591	4,026,596	19.6
— People's Republic of China.....	7,801,900	4,729,891	64.9
— Others.....	20,133	24,817	-18.9
	<u>54,401,834</u>	<u>49,189,126</u>	<u>10.6</u>

20. IMPAIRMENT ALLOWANCES FOR IMPAIRED LOANS AND ADVANCES AND PROVISIONS FOR BAD AND DOUBTFUL DEBTS

	The Group		
	2005		
	Individual	Collective	Total
At 1st January	127,785	496,214	623,999
Opening balance adjustments in respect of new accounting policy.....	(3,806)	(273,884)	(277,690)
As restated, after opening balance adjustments	123,979	222,330	346,309
Additions	105,066	16,106	121,172
Releases.....	(37,178)	(29,938)	(67,116)
Net charge/(credit) to profit and loss account	67,888	(13,832)	54,056
Unwind of discount of loans impairment loss (Note 5(a))	(10,465)	—	(10,465)
Recoveries of advances written off in previous years	86,136	—	86,136
Amounts written off.....	(146,857)	—	(146,857)
At 31st December	<u>120,681</u>	<u>208,498</u>	<u>329,179</u>
Representing:			
Trade bills (Note 15).....	961	656	1,617
Advances to customers (Note 19(a)).....	<u>119,720</u>	<u>207,842</u>	<u>327,562</u>
	<u>120,681</u>	<u>208,498</u>	<u>329,179</u>

	The Bank		
	2005		
	Individual	Collective	Total
At 1st January	83,665	349,160	432,825
Opening balance adjustments in respect of new accounting policy.....	(460)	(152,914)	(153,374)
As restated, after opening balance adjustments	83,205	196,246	279,451
Additions	85,289	9,687	94,976
Releases.....	(21,852)	(26,483)	(48,335)
Net charge/(credit) to profit and loss account	63,437	(16,796)	46,641
Unwind of discount of loans impairment loss	(10,465)	—	(10,465)
Recoveries of advances written off in previous years	74,108	—	74,108
Amounts written off.....	(105,130)	—	(105,130)
At 31st December	<u>105,155</u>	<u>179,450</u>	<u>284,605</u>
Representing:			
Trade bills (Note 15).....	961	655	1,616
Advances to customers (Note 19(a)).....	<u>104,194</u>	<u>178,795</u>	<u>282,989</u>
	<u>105,155</u>	<u>179,450</u>	<u>284,605</u>

The Group			
2004			
	Specific	General	Total
At 1st January	276,859	467,919	744,778
New provisions	51,085	31,864	82,949
Releases.....	(24,850)	(3,665)	(28,515)
Net charge to profit and loss account	26,235	28,199	54,434
Recoveries of advances written off in previous years	85,556	—	85,556
Amounts written off.....	(260,865)	94	(260,771)
Exchange adjustment.....	—	2	2
At 31st December	<u>127,785</u>	<u>496,214</u>	<u>623,999</u>
Representing:			
Trade bills (Note 15).....	54	1,435	1,489
Advances to customers (Note 19(a)).....	<u>127,731</u>	<u>494,779</u>	<u>622,510</u>
	<u>127,785</u>	<u>496,214</u>	<u>623,999</u>

The Bank			
2004			
	Specific	General	Total
At 1st January	145,385	219,461	364,846
Addition through merger with CFB	80,645	122,000	202,645
New provisions	35,039	11,265	46,304
Releases.....	(17,804)	(3,575)	(21,379)
Net charge to profit and loss account	17,235	7,690	24,925
Recoveries of advances written off in previous years	80,298	—	80,298
Amounts written off.....	(239,898)	—	(239,898)
Exchange adjustment.....	—	9	9
At 31st December	<u>83,665</u>	<u>349,160</u>	<u>432,825</u>
Representing:			
Trade bills (Note 15).....	54	1,374	1,428
Advances to customers (Note 19(a)).....	<u>83,611</u>	<u>347,786</u>	<u>431,397</u>
	<u>83,665</u>	<u>349,160</u>	<u>432,825</u>

21. HELD-TO-MATURITY AND AVAILABLE-FOR-SALE FINANCIAL ASSETS

	The Group		The Bank	
	2005	2004	2005	2004
Held-to-maturity debt securities:				
Listed				
— in Hong Kong	85,348	87,766	85,348	87,766
— outside Hong Kong	202,232	677,995	202,232	677,995
	287,580	765,761	287,580	765,761
Unlisted.....	9,838,934	18,102,157	9,295,630	17,616,773
	10,126,514	18,867,918	9,583,210	18,382,534
Available-for-sale debt securities:				
Listed (at market value)				
— in Hong Kong	12,467	—	—	—
— outside Hong Kong	2,782,418	—	2,730,229	—
	2,794,885	—	2,730,229	—
Unlisted.....	2,879,968	—	2,839,435	—
	5,674,853	—	5,569,664	—
Available-for-sale equity securities:				
Listed in Hong Kong (at market value).....	1,856	—	1,470	—
Unlisted.....	106,207	—	95,608	—
	108,063	—	97,078	—
	5,782,916	—	5,666,742	—
(Note 33)	15,909,430	18,867,918	15,249,952	18,382,534
Market value of listed held-to-maturity debt securities...	288,331	779,768	288,331	779,768
Fair value of unlisted held-to-maturity debt securities....	9,757,850	18,080,092	9,220,546	17,590,212

Following the adoption of HKAS 39 in 2005, certain held-to-maturity securities were reclassified as financial assets at fair value through profit or loss and available-for-sale on 1st January, 2005. There was no such reclassification in 2004 as retrospective application of HKAS 39 is not permitted.

Except the above reclassification, no held-to-maturity debt securities was disposed during the year. In 2004, held-to-maturity debt securities with an amortised cost of HK\$67,503,000 were disposed of at a profit of HK\$84,000 being recognised in the profit and loss account. Management, as approved by the Asset and Liability Management Committee, sold these held-to-maturity securities to modify the maturity and risk profile of the investment portfolios.

Following the adoption of HKAS 39 in 2005, certain financial assets were reclassified as available-for-sale financial assets on 1st January, 2005. There was no such reclassification in 2004 as retrospective application of HKAS 39 is not permitted.

The carrying amount of available-for-sale financial assets as at 1st January, 2005 was HK\$1,671,490,000 and these assets were classified as held-to-maturity as at 31st December 2004.

Held-to-maturity and available-for-sale financial assets analysed by counterparty are as follows:

	The Group		The Bank	
	2005	2004	2005	2004
Issued by:				
Central governments and central banks	7,764	7,774	7,764	7,774
Banks and other financial institutions	13,564,685	14,050,979	13,069,702	13,682,686
Corporate entities.....	1,996,214	4,457,969	1,857,352	4,340,878
Public sector	340,767	351,196	315,134	351,196
	15,909,430	18,867,918	15,249,952	18,382,534

Held-to-maturity treasury bills and certificates of deposit are disclosed separately in the balance sheets, notes 13 and 16 to the accounts.

22. NON-TRADING SECURITIES

	The Group		The Bank	
	2005	2004	2005	2004
Non-trading debt securities:				
Listed (at market value)				
— in Hong Kong	—	29,196	—	—
— outside Hong Kong	—	858,144	—	802,692
Unlisted.....	—	352,783	—	331,853
	—	<u>1,240,123</u>	—	<u>1,134,545</u>
Non-trading equity securities:				
Listed in Hong Kong (at market value).....	—	93,463	—	93,213
Unlisted.....	—	187,236	—	179,550
	—	<u>280,699</u>	—	<u>272,763</u>
(Note 33)	—	<u>1,520,822</u>	—	<u>1,407,308</u>

Non-trading securities analysed by counterparty are as follows:

	The Group		The Bank	
	2005	2004	2005	2004
Issued by:				
Banks and other financial institutions	—	325,715	—	278,978
Corporate entities.....	—	633,040	—	593,375
Public sector	—	562,067	—	534,955
	—	<u>1,520,822</u>	—	<u>1,407,308</u>

Following the adoption of HKAS 39 in 2005, non-trading debt securities at carrying amount of HK\$1,134,545,000 were reclassified as securities measured at fair value through profit or loss on 1st January, 2005. There was no such re-designation in 2004 as retrospective application of HKAS 39 is not permitted.

23. INVESTMENTS IN SUBSIDIARIES

	2005	2004
Unlisted shares, at cost.....	<u>682,707</u>	<u>633,416</u>

The following list contains only the particulars of principal subsidiaries:

Name of company	Place of incorporation and operation	Nominal value of issued ordinary shares	Percentage held	Principal activities
Banco Weng Hang, S.A.....	Macau	MOP120,000,000	100%	Banking
Wing Hang Bank (Cayman) Limited.....	Cayman Islands	US\$25,000,000	100%	Banking
Wing Hang Finance Company Limited	Hong Kong	HK\$130,000,000	100%	Deposit Taking and Hire Purchase
Wing Hang Zurich Insurance Company Limited.....	Hong Kong	HK\$45,000,000	65%	Insurance
Cyber Wing Hang Limited	Hong Kong	HK\$30,000,000	100%	Information Technology Investment
Wing Hang Credit Limited.....	Hong Kong	HK\$20,000,000	100%	Consumer Lending
Wing Hang Shares Brokerage Company Limited.....	Hong Kong	HK\$10,000,000	100%	Securities Dealing
Wing Hang Bank (Trustee) Limited	Hong Kong	HK\$3,000,000	100%	Trustee Services
Wing Hang Insurance Brokers Limited	Hong Kong	HK\$100,000	100%	Insurance Broker
Wing Hang Insurance Agency Limited.....	Hong Kong	HK\$50,000	100%	Insurance Agency
Wing Hang Bank (Nominees) Limited.....	Hong Kong	HK\$10,000	100%	Nominee Services
Cheuk Woo Enterprises Company Limited.....	Hong Kong	HK\$10,000	100%	Property Investment
Wing Hang Financial Holdings (BVI) Limited	British Virgin Islands	US\$10	100%	Issuer of Subordinated Notes
Honfirst Land Limited.....	Hong Kong	HK\$27,000,000	100%	Property Investment
Honfirst Investment Limited.....	Hong Kong	HK\$13,000,000	100%	Futures Trading
Chekiang First Securities Company Limited	Hong Kong	HK\$6,000,000	100%	Securities Dealing

24. INVESTMENTS IN ASSOCIATED COMPANIES

	The Group		The Bank	
	2005	2004	2005	2004
Unlisted shares, at cost.....	—	—	112,000	112,000
Share of net assets.....	84,955	73,706	—	—
Loans to associated companies.....	62,000	62,000	62,000	62,000
	<u>146,955</u>	<u>135,706</u>	<u>174,000</u>	<u>174,000</u>

Loans to associated companies are unsecured, interest-free and repayable in 2008.

The following list contains the particulars of associated companies:

Name of company	Place of incorporation and operation	Nominal value of issued ordinary shares	Percentage held	Voting power	Principal activities
Bank Consortium Holding Limited	Hong Kong	HK\$150,000,000	27%	2 out of 7*	Provision of Services for Retirement Schemes
Hong Kong Life Insurance Limited	Hong Kong	HK\$210,000,000	33%	1 out of 3*	Insurance
Joint Electronic Teller Services Limited ...	Hong Kong	HK\$10,023,800	20%(a)	1 out of 5*	ATM Network

* Representing the number of votes on the board of directors attributable to the Group.

Notes:

- (a) The Group's share of net asset in Joint Electronic Teller Services Limited is based on the Group's share of dividend received from this associated company during this year.

2005						
	Assets	Liabilities	Equity	Total operating income	Tax	Profit after tax
100 percent.....	2,056,313	1,485,507	570,806	210,159	12,288	64,149
Group's effective interest	561,119	476,164	84,955	39,844	2,597	11,249
2004						
	Assets	Liabilities	Equity	Total operating income	Tax	Profit after tax
100 percent.....	1,599,631	1,075,437	524,194	158,591	3,185	22,653
Group's effective interest	415,209	341,503	73,706	29,230	684	4,545

25. TANGIBLE FIXED ASSETS

The Group					
2005					
	Investment Properties	Bank Premises	Equipment	Bank Premises and equipment	Total
Cost or valuation					
At 1st January, 2005	209,560	1,502,092	578,024	2,080,116	2,289,676
Additions	—	668	55,231	55,899	55,899
Disposals	(5,000)	(27,180)	(49,135)	(76,315)	(81,315)
Transfers from bank premises to investment properties	18,338	(18,743)	—	(18,743)	(405)
Transfers from investment properties to bank premises	(4,248)	4,248	—	4,248	—
Surplus on revaluation	12,797	9,297	—	9,297	22,094
At 31st December, 2005	<u>231,447</u>	<u>1,470,382</u>	<u>584,120</u>	<u>2,054,502</u>	<u>2,285,949</u>
The analysis of cost or valuation of the above assets is as follows:					
At cost	—	1,076,780	584,120	1,660,900	1,660,900
At valuation					
2005	231,447	—	—	—	231,447
1990	—	357,888	—	357,888	357,888
1989	—	9,347	—	9,347	9,347
1984	—	26,367	—	26,367	26,367
	<u>231,447</u>	<u>1,470,382</u>	<u>584,120</u>	<u>2,054,502</u>	<u>2,285,949</u>
Accumulated depreciation					
At 1st January, 2005	—	135,867	381,239	517,106	517,106
Charge for the year (Note 5(e))	—	25,700	49,707	75,407	75,407
Written back on disposals	—	(2,175)	(41,472)	(43,647)	(43,647)
Transfers from bank premises to Investment properties	—	(405)	—	(405)	(405)
At 31st December, 2005	<u>—</u>	<u>158,987</u>	<u>389,474</u>	<u>548,461</u>	<u>548,461</u>
Net book value					
At 31st December, 2005	<u>231,447</u>	<u>1,311,395</u>	<u>194,646</u>	<u>1,506,041</u>	<u>1,737,488</u>

The Bank					
2005					
	Investment Properties	Bank Premises	Equipment	Bank Premises and equipment	Total
Cost or valuation					
At 1st January, 2005	13,100	1,126,174	487,862	1,614,036	1,627,136
Additions	—	668	47,677	48,345	48,345
Disposals	—	(27,000)	(46,899)	(73,899)	(73,899)
Surplus on revaluation	5,200	—	—	—	5,200
At 31st December, 2005	<u>18,300</u>	<u>1,099,842</u>	<u>488,640</u>	<u>1,588,482</u>	<u>1,606,782</u>
The analysis of cost or valuation of the above assets is as follows:					
At cost	—	741,104	488,640	1,229,744	1,229,744
At valuation					
2005	18,300	—	—	—	18,300
1990	—	357,888	—	357,888	357,888
1989	—	850	—	850	850
	<u>18,300</u>	<u>1,099,842</u>	<u>488,640</u>	<u>1,588,482</u>	<u>1,606,782</u>
Accumulated depreciation					
At 1st January, 2005	—	99,968	319,072	419,040	419,040
Charge for the year	—	19,302	41,512	60,814	60,814
Written back on disposals	—	(2,175)	(39,389)	(41,564)	(41,564)
At 31st December, 2005	<u>—</u>	<u>117,095</u>	<u>321,195</u>	<u>438,290</u>	<u>438,290</u>
Net book value					
At 31st December, 2005	<u>18,300</u>	<u>982,747</u>	<u>167,445</u>	<u>1,150,192</u>	<u>1,168,492</u>

The Group					
2004					
	Investment Properties	Bank Premises	Equipment	Bank Premises and equipment	Total
Cost or valuation					
At 1st January, 2004	225,785	1,383,428	775,706	2,159,134	2,384,919
Additions	18,187	72,018	61,085	133,103	151,290
Disposals	(29,222)	(27,541)	(258,789)	(286,330)	(315,552)
Transfers.....	(74,150)	74,150	—	74,150	—
Exchange adjustment.....	111	37	22	59	170
Surplus on revaluation	68,849	—	—	—	68,849
At 31st December, 2004	<u>209,560</u>	<u>1,502,092</u>	<u>578,024</u>	<u>2,080,116</u>	<u>2,289,676</u>
The analysis of cost or valuation of the above assets is as follows:					
At cost	—	1,108,490	578,024	1,686,514	1,686,514
At valuation					
2004	209,560	—	—	—	209,560
1990	—	357,888	—	357,888	357,888
1989	—	9,347	—	9,347	9,347
1984	—	26,367	—	26,367	26,367
	<u>209,560</u>	<u>1,502,092</u>	<u>578,024</u>	<u>2,080,116</u>	<u>2,289,676</u>
Accumulated depreciation					
At 1st January, 2004	270	114,196	540,836	655,032	655,302
Charge for the year (Note 5(e))	733	23,313	84,012	107,325	108,058
Written back on disposals	(1,004)	(1,642)	(243,621)	(245,263)	(246,267)
Exchange adjustment.....	1	—	12	12	13
At 31st December, 2004	<u>—</u>	<u>135,867</u>	<u>381,239</u>	<u>517,106</u>	<u>517,106</u>
Net book value					
At 31st December, 2004	<u>209,560</u>	<u>1,366,225</u>	<u>196,785</u>	<u>1,563,010</u>	<u>1,772,570</u>

The Bank					
2004					
	Investment Properties	Bank Premises	Equipment	Bank Premises and equipment	Total
Cost or valuation					
At 1st January, 2004	72,000	874,106	359,939	1,234,045	1,306,045
Additions through merger with CFB.....	6,200	171,430	320,684	492,114	498,314
Additions.....	—	22,568	55,542	78,110	78,110
Disposals	—	(13,930)	(248,305)	(262,235)	(262,235)
Transfer	(72,000)	72,000	—	72,000	—
Exchange adjustment.....	—	—	2	2	2
Surplus on revaluation	6,900	—	—	—	6,900
At 31st December, 2004	<u>13,100</u>	<u>1,126,174</u>	<u>487,862</u>	<u>1,614,036</u>	<u>1,627,136</u>
The analysis of cost or valuation of the above assets is as follows:					
At cost	—	767,436	487,862	1,255,298	1,255,298
At valuation					
2004	13,100	—	—	—	13,100
1990	—	357,888	—	357,888	357,888
1989	—	850	—	850	850
	<u>13,100</u>	<u>1,126,174</u>	<u>487,862</u>	<u>1,614,036</u>	<u>1,627,136</u>
Accumulated depreciation					
At 1st January, 2004	—	81,025	239,990	321,015	321,015
Additional through merger with CFB	—	1,847	239,135	240,982	240,982
Charge for the year	—	17,375	75,629	93,004	93,004
Written back on disposals	—	(279)	(235,683)	(235,962)	(235,962)
Exchange adjustment.....	—	—	1	1	1
At 31st December, 2004	<u>—</u>	<u>99,968</u>	<u>319,072</u>	<u>419,040</u>	<u>419,040</u>
Net book value					
At 31st December, 2004	<u>13,100</u>	<u>1,026,206</u>	<u>168,790</u>	<u>1,194,996</u>	<u>1,208,096</u>

Bank premises were stated at cost or directors' valuation. The revaluation surplus of HK\$9,297,000 (2004: Nil) has been transferred to the bank premises revaluation reserve of the Group, net of deferred tax of HK\$1,627,000 (2004: Nil).

Investment properties were revalued by an independent firm of surveyors, FPD Savills who have among their staff, Fellows of the Hong Kong Institute of Surveyors, on an open market value basis as at 31st December, 2005.

The carrying amount of bank premises of the Group and the Bank would have been HK\$996,800,000 (2004: HK\$1,049,641,000) and HK\$688,763,000 (2004: HK\$730,406,000) respectively had they been stated at cost less accumulated depreciation.

The net book value of bank premises and investment properties comprises:

	The Group		The Bank	
	2005	2004	2005	2004
FREEHOLD				
— Held outside Hong Kong	47,870	48,803	—	—
LEASEHOLD				
— Held in Hong Kong				
Long leases (over 50 years unexpired)	871,447	774,591	519,436	544,195
Medium-term leases (10 to 50 years unexpired)....	523,900	650,841	444,620	457,200
— Held outside Hong Kong				
Long leases (over 50 years unexpired)	2,031	2,069	2,031	2,069
Medium-term leases (10 to 50 years unexpired)....	44,261	71,752	34,960	35,842
Short leases (less than 10 years unexpired)	53,333	27,729	—	—
	<u>1,542,842</u>	<u>1,575,785</u>	<u>1,001,047</u>	<u>1,039,306</u>

The Group leases out investment properties under operating leases. The leases typically run for an initial period of two to three years. None of the leases includes contingent rentals.

All properties held under operating leases that would otherwise meet the definition of investment property are classified as investment property.

The Group's total future minimum lease payments under non-cancellable operating leases are receivables as follows:

	The Group	
	2005	2004
1 year or less	8,508	5,317
5 years or less but over 1 years	<u>4,660</u>	<u>2,044</u>
	<u>13,168</u>	<u>7,361</u>

26. GOODWILL

(a) Goodwill

	The Group		The Bank	
	2005	2004	2005	2004
Cost				
At 1st January	909,733	972,156	903,917	—
Addition through acquisition of subsidiary	879	—	—	—
Addition through merger with CFB	—	—	—	966,340
Amount recovered during the year	—	(66,864)	—	(66,864)
Amount paid during the year	—	4,441	—	4,441
Opening balance adjustment to eliminate accumulated amortisation	<u>(62,020)</u>	<u>—</u>	<u>(56,495)</u>	<u>—</u>
At 31st December	<u>848,592</u>	<u>909,733</u>	<u>847,422</u>	<u>903,917</u>
Accumulated amortisation and impairment loss				
At 1st January	62,020	17,023	56,495	—
Addition through merger with CFB	—	—	—	12,079
Amortisation for the year (Notes 5(e))	—	44,997	—	44,416
Eliminated against cost at 1st January 2005	<u>(62,020)</u>	<u>—</u>	<u>(56,495)</u>	<u>—</u>
Impairment loss for the year (Note 5(e))	<u>1,170</u>	<u>—</u>	<u>—</u>	<u>—</u>
At 31st December	<u>1,170</u>	<u>62,020</u>	<u>—</u>	<u>56,495</u>
Net book value as at 31st December	<u>847,422</u>	<u>847,713</u>	<u>847,422</u>	<u>847,422</u>

In 2004, positive goodwill not already recognised directly in reserves was amortised on a straight-line basis not more than 20 years. The amortisation of positive goodwill for the year ended 31st December 2004 was included in “operating expenses” in the consolidated profit and loss account.

As explained further in note 4(f), with effect from 1st January 2005 the Group no longer amortises goodwill. In accordance with the transitional provisions set out in HKFRS 3, the accumulated amortisation of goodwill as at 1st January 2005 has been eliminated against the cost of goodwill as at that date.

(b) Impairment tests for cash-generating units containing goodwill

Goodwill is allocated to the Group’s cash-generating units (“CGU”) identified according to country of operation and business segment as follows:

	<u>2005</u>
Retail banking business acquired	560,128
Corporate banking business acquired	233,741
Treasury business acquired	<u>53,553</u>
	<u>847,422</u>

The recoverable amount of the CGU is determined based on value in use calculations. These calculations use cash flow projections based on financial budgets approved by management covering a five-year period. Cash flows beyond the five-year period are extrapolated using the estimate rates stated below. The growth rate does not exceed the long-term average growth rate for the business in which the CGU operates.

Key assumptions used for value in use calculations:

	<u>2005</u>
	%
Growth rate	6.54
Discount rate	11.85

27. DEPOSITS AND BALANCES OF BANKS AND OTHER FINANCIAL INSTITUTIONS

Deposits and balances of banks and other financial institutions are analysed as follows:

	<u>The Group</u>		<u>The Bank</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Deposits from central banks	84,377	6,373	84,377	6,373
Deposits from banks	<u>1,618,649</u>	<u>1,203,209</u>	<u>1,610,236</u>	<u>1,199,036</u>
(Note 33)	<u>1,703,026</u>	<u>1,209,582</u>	<u>1,694,613</u>	<u>1,205,409</u>

28. DEPOSITS FROM CUSTOMERS

	<u>The Group</u>		<u>The Bank</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Demand deposits and current accounts	8,309,633	9,871,231	7,624,367	9,345,063
Savings deposits	11,578,904	16,800,082	8,176,603	13,141,655
Time, call and notice deposits	<u>65,784,915</u>	<u>51,897,848</u>	<u>52,101,927</u>	<u>40,611,573</u>
(Note 33)	<u>85,673,452</u>	<u>78,569,161</u>	<u>67,902,897</u>	<u>63,098,291</u>

29. CERTIFICATES OF DEPOSIT ISSUED

	The Group		The Bank	
	2005	2004	2005	2004
Certificates of deposit issued at amortised cost	1,902,640	4,616,090	1,902,640	4,621,145
Structured certificates of deposit issued designated at inception as fair value through profit or loss	1,921,699	—	1,926,612	—
(Note 33)	<u>3,824,339</u>	<u>4,616,090</u>	<u>3,829,252</u>	<u>4,621,145</u>

At 1st January 2005, the Group designated on initial recognition HK\$2,215,679,000 (Bank: HK\$2,220,734,000) of certificates of deposit issued at fair value through profit or loss upon the adoption of HKAS 39.

At 31st December 2005, the difference between the carrying amount and the contractual amount payable at maturity for the Group amounted to HK\$144,974,000 (Bank: HK\$145,102,000) due to changes in benchmark interest rate.

30. TRADING LIABILITIES

	The Group		The Bank	
	2005	2004 (restated)	2005	2004 (restated)
Negative fair values of derivative financial instruments (Notes 33 & 36(b))	865,962	8,628	869,748	8,628

Trading liabilities of the Bank included negative fair values of derivative financial instruments transacted with a subsidiary amounting to HK\$3,842,000 (2004: Nil).

31. OTHER ACCOUNTS AND PROVISIONS

	The Group		The Bank	
	2005	2004 (restated)	2005	2004 (restated)
Derivative financial instruments — hedging (Note 36(b))	13,047	26,672	13,501	26,672
Other payable and interest payable	<u>1,190,483</u>	<u>948,450</u>	<u>796,356</u>	<u>539,567</u>
	<u>1,203,530</u>	<u>975,122</u>	<u>809,857</u>	<u>566,239</u>

Other accounts and provisions of the Bank included negative fair values of derivative financial instruments transacted with a subsidiary amounting to HK\$454,000 (2004: Nil).

32. LOAN CAPITAL

Loan capital with face value of HK\$2,519,888,000 (Note 33) (US\$325,000,000) represents 5.25% subordinated notes qualifying as tier 2 capital which were issued during 2003 by Wing Hang Financial Holdings (BVI) Limited, a single purpose wholly owned finance subsidiary of the Bank. The Bank unconditionally and irrevocably guarantees all amounts payable under the notes which are listed on the Singapore Exchange Trading Limited. The notes will mature on 10th October, 2013.

33. MATURITY PROFILE

The Group								
2005								
	Repayable on demand	1 month or less	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	Total
Assets								
— Cash and balances with banks and other financial institutions (Note 13).....	1,781,679	—	—	—	—	—	—	1,781,679
— Money at call and short notice (Note 13)	—	16,998,025	—	—	—	—	—	16,998,025
— Treasury bills (Note 13).....	—	1,074,883	199,211	—	—	—	—	1,274,094
— Placements with banks and other financial institutions maturing between 1 and 12 months (Note 14).....	—	—	2,559,271	98,109	—	—	—	2,657,380
— Trade bills less impairment allowances (Note 15)	59,356	283,050	291,217	6,813	—	—	11,939	652,375
— Trading assets (Note 17).....	—	—	—	300	1,412	—	909,552	911,264
— Financial assets measured at fair value through profit or loss (Note 18)	—	—	155,331	1,139,979	3,991,252	637,862	—	5,924,424
— Advances to customers less impairment allowances (Note 19(a)).....	2,412,503	3,244,921	3,951,024	6,777,178	16,612,653	20,941,046	134,947	54,074,272
— Advances to banks and other financial institutions (Note 19(a))	208	—	—	31,593	47,390	—	—	79,191
— Held-to-maturity and available-for-sale financial assets (Note 21).....	—	—	13,939	682,115	14,015,122	1,090,191	108,063	15,909,430
— Other assets.....	12,435	921,303	88,051	57,945	134,619	—	2,846,129	4,060,482
Total assets	4,266,181	22,522,182	7,258,044	8,794,032	34,802,448	22,669,099	4,010,630	104,322,616
Liabilities								
— Deposits and balances of banks and other financial institutions (Note 27).....	186,926	615,900	390,732	432,567	76,901	—	—	1,703,026
— Deposits from customers (Note 28).....	19,830,717	48,583,380	14,785,225	1,644,926	829,204	—	—	85,673,452
— Certificates of deposit issued (Note 29)	—	429,215	1,448,126	684,067	1,262,931	—	—	3,824,339
— Trading liabilities (Note 30).....	—	—	—	—	—	—	865,962	865,962
— Loan capital (Note 32).....	—	—	—	—	—	2,519,888	—	2,519,888
— Other liabilities	—	732,897	233,517	298,044	83,774	—	49,666	1,397,898
Total liabilities	20,017,643	50,361,392	16,857,600	3,059,604	2,252,810	2,519,888	915,628	95,984,565
Net assets/(liabilities) gap.....	(15,751,462)	(27,839,210)	(9,599,556)	5,734,428	32,549,638	20,149,211	3,095,002	8,338,051

The Bank								
2005								
	Repayable on demand	1 month or less	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	Total
Assets								
— Cash and balances with banks and other financial institutions (Note 13).....	1,387,648	—	—	—	—	—	—	1,387,648
— Money at call and short notice (Note 13)	—	16,958,098	—	—	—	—	—	16,958,098
— Treasury bills (Note 13).....	—	199,818	199,211	—	—	—	—	399,029
— Placements with banks and other financial institutions maturing between 1 and 12 months (Note 14).....	—	—	2,531,398	98,109	—	—	—	2,629,507
— Trade bills less impairment allowances (Note 15)	59,322	156,114	181,550	6,809	—	—	8,749	412,544
— Trading assets (Note 17).....	—	—	—	300	1,412	—	927,998	929,710
— Financial assets measured at fair value through profit or loss (Note 18)	—	—	155,331	1,139,979	3,991,252	637,862	—	5,924,424
— Advances to customers less impairment allowances (Note 19(a)).....	2,164,747	2,692,787	3,032,671	4,506,517	12,141,555	17,663,043	34,204	42,235,524
— Advances to banks and other financial institutions (Note 19(a))	208	—	—	31,593	47,390	—	—	79,191
— Amounts due from subsidiaries	4,196	75,118	60,000	2,641,131	1,448,840	1,845,000	—	6,074,285
— Held-to-maturity and available-for-sale financial assets (Note 21).....	—	—	13,939	643,613	13,544,101	951,221	97,078	15,249,952
— Other assets.....	9,444	642,143	85,981	50,234	86,809	—	2,907,695	3,782,306
Total assets	<u>3,625,565</u>	<u>20,724,078</u>	<u>6,260,081</u>	<u>9,118,285</u>	<u>31,261,359</u>	<u>21,097,126</u>	<u>3,975,724</u>	<u>96,062,218</u>
Liabilities								
— Deposits and balances of banks and other financial institutions (Note 27).....	178,513	615,900	390,732	432,567	76,901	—	—	1,694,613
— Deposits from customers (Note 28).....	15,807,745	39,609,656	11,129,575	1,180,104	175,817	—	—	67,902,897
— Certificates of deposit issued (Note 29)	—	429,215	1,448,127	688,980	1,262,930	—	—	3,829,252
— Trading liabilities (Note 30).....	—	—	—	—	—	—	869,748	869,748
— Amounts due to subsidiaries.....	836,150	4,364,485	2,034,712	3,360,063	1,093,945	2,512,396	—	14,201,751
— Other liabilities	—	450,236	224,258	197,182	48,074	—	17,108	936,858
Total liabilities	<u>16,822,408</u>	<u>45,469,492</u>	<u>15,227,404</u>	<u>5,858,896</u>	<u>2,657,667</u>	<u>2,512,396</u>	<u>886,856</u>	<u>89,435,119</u>
Net assets/(liabilities) gap.....	<u>(13,196,843)</u>	<u>(24,745,414)</u>	<u>(8,967,323)</u>	<u>3,259,389</u>	<u>28,603,692</u>	<u>18,584,730</u>	<u>3,088,868</u>	<u>6,627,099</u>

The Group								
2004 (restated)								
	Repayable on demand	1 month or less	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	Total
Assets								
— Cash and balances with banks and other financial institutions (Note 13).....	1,394,069	—	—	—	—	—	—	1,394,069
— Money at call and short notice (Note 13)	—	18,548,891	—	—	—	—	—	18,548,891
— Treasury bills (Note 13).....	—	511,631	74,727	—	—	—	—	586,358
— Placements with banks and other financial institutions maturing between 1 and 12 months (Note 14).....	—	—	1,337,360	98,167	—	—	—	1,435,527
— Trade bills less impairment allowances (Note 15)	82,740	189,612	256,029	10,255	—	—	12,488	551,124
— Certificates of deposit held.....	—	—	30,000	—	—	—	—	30,000
— Trading assets (Note 17).....	—	—	—	—	153	—	30,655	30,808
— Advances to customers less impairment allowances (Note 19(a)).....	2,221,277	3,451,871	3,668,403	6,421,395	14,250,929	18,230,858	321,883	48,566,616
— Advances to banks and other financial institutions (Note 19(a))	—	—	—	15,838	95,027	—	—	110,865
— Held-to-maturity securities (Note 21).....	—	627,168	304,022	1,975,310	12,522,093	3,439,325	—	18,867,918
— Non-trading securities (Note 22)	—	—	3,050	8,288	325,498	903,287	280,699	1,520,822
— Other assets.....	11,120	654,718	76,550	77,783	119,756	—	2,865,179	3,805,106
Total assets	<u>3,709,206</u>	<u>23,983,891</u>	<u>5,750,141</u>	<u>8,607,036</u>	<u>27,313,456</u>	<u>22,573,470</u>	<u>3,510,904</u>	<u>95,448,104</u>
Liabilities								
— Deposits and balances of banks and other financial institutions (Note 27).....	141,924	211,738	639,695	216,225	—	—	—	1,209,582
— Deposits from customers (Note 28).....	26,715,919	41,214,382	7,890,533	2,123,116	625,211	—	—	78,569,161
— Certificates of deposit issued (Note 29)	—	183,205	1,519,945	1,703,388	1,209,552	—	—	4,616,090
— Trading liabilities (Note 30)	—	—	—	—	—	—	8,628	8,628
— Loan capital.....	—	—	—	—	—	2,526,485	—	2,526,485
— Other liabilities	—	711,012	29,205	242,363	54,824	—	66,052	1,103,456
Total liabilities	<u>26,857,843</u>	<u>42,320,337</u>	<u>10,079,378</u>	<u>4,285,092</u>	<u>1,889,587</u>	<u>2,526,485</u>	<u>74,680</u>	<u>88,033,402</u>
Net assets/(liabilities) gap.....	<u>(23,148,637)</u>	<u>(18,336,446)</u>	<u>(4,329,237)</u>	<u>4,321,944</u>	<u>25,423,869</u>	<u>20,046,985</u>	<u>3,436,224</u>	<u>7,414,702</u>

The Bank								
2004 (restated)								
	Repayable on demand	1 month or less	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Undated	Total
Assets								
— Cash and balances with banks and other financial institutions (Note 13).....	1,106,702	—	—	—	—	—	—	1,106,702
— Money at call and short notice (Note 13)	—	18,481,417	—	—	—	—	—	18,481,417
— Treasury bills (Note 13).....	—	402,416	—	—	—	—	—	402,416
— Placements with banks and other financial institutions maturing between 1 and 12 months (Note 14).....	—	—	1,310,222	98,167	—	—	—	1,408,389
— Trade bills less impairment allowances (Note 15)	82,662	158,786	131,379	10,245	—	—	4,171	387,243
— Certificates of deposit held.....	—	—	30,000	—	—	—	—	30,000
— Trading assets (Note 17).....	—	—	—	—	153	—	18,741	18,894
— Advances to customers less impairment allowances (Note 19(a)).....	2,013,710	2,985,671	3,045,067	4,425,823	10,586,539	15,787,427	162,227	39,006,464
— Advances to banks and other financial institutions (Note 19(a))	—	—	—	15,838	95,027	—	—	110,865
— Amounts due from subsidiaries	5,423	139,948	60,000	2,032,360	1,442,307	1,305,000	—	4,985,038
— Held-to-maturity securities (Note 21).....	—	627,168	304,022	1,886,961	12,296,135	3,268,248	—	18,382,534
— Non-trading securities (Note 22)	—	—	—	—	286,709	847,836	272,763	1,407,308
— Other assets.....	7,818	432,228	76,103	51,203	64,190	—	2,891,814	3,523,356
Total assets	<u>3,216,315</u>	<u>23,227,634</u>	<u>4,956,793</u>	<u>8,520,597</u>	<u>24,771,060</u>	<u>21,208,511</u>	<u>3,349,716</u>	<u>89,250,626</u>
Liabilities								
— Deposits and balances of banks and other financial institutions (Note 27).....	137,751	211,738	639,695	216,225	—	—	—	1,205,409
— Deposits from customers (Note 28).....	22,526,588	32,536,640	6,124,008	1,704,866	206,189	—	—	63,098,291
— Certificates of deposit issued (Note 29)	—	183,205	1,519,945	1,708,443	1,209,552	—	—	4,621,145
— Trading liabilities (Note 30).....	—	—	—	—	—	—	8,628	8,628
— Amounts due to subsidiaries.....	852,395	4,731,105	988,026	1,799,493	2,751,115	2,518,974	—	13,641,108
— Other liabilities	—	399,963	25,904	149,517	31,062	—	29,507	635,953
Total liabilities	<u>23,516,734</u>	<u>38,062,651</u>	<u>9,297,578</u>	<u>5,578,544</u>	<u>4,197,918</u>	<u>2,518,974</u>	<u>38,135</u>	<u>83,210,534</u>
Net assets/(liabilities) gap.....	<u>(20,300,419)</u>	<u>(14,835,017)</u>	<u>(4,340,785)</u>	<u>2,942,053</u>	<u>20,573,142</u>	<u>18,689,537</u>	<u>3,311,581</u>	<u>6,040,092</u>

34. SHARE CAPITAL

	2005	2004
Authorised:		
450,000,000 (2004: 450,000,000) ordinary shares of HK\$1.00 each	<u>450,000</u>	<u>450,000</u>
Issued and fully paid:		
At 1st January	293,911	293,781
Shares issued under share option scheme.....	110	130
294,020,500 (2004: 293,910,500) ordinary shares of HK\$1.00 each	<u>294,021</u>	<u>293,911</u>

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Bank. All ordinary shares rank equally with regard to the Bank's residual assets.

During the year, options were exercised to subscribe for 110,000 ordinary shares in the Bank at a consideration of HK\$4,010,000 of which HK\$110,000 was credited to share capital and the balance of HK\$3,900,000 was credited to the share premium account. At 31st December, 2005, the outstanding options are 1,285,000 (2004: 1,105,000) shares.

In 2004, a new EIP was approved. At 31st December, 2005, the outstanding awards are 495,000 (2004: 495,000) shares.

The fair value of the awards as at the date of grant was HK\$21,186,000.

The details of share option scheme and EIP are disclosed separately in note 42 to the accounts.

35. RESERVES

	The Group								
	2005								
	Share premium	Capital reserve	General reserve	Bank premises revaluation reserve	Investment properties revaluation reserve	Investment revaluation reserve	Capital redemption reserve	Unappropriated profits	Total
At 1st January, 2005									
— as previously reported.....	342,102	215,909	2,091,174	269,039	12,683	22,241	769	4,156,059	7,109,976
— prior year adjustments in respect of:									
— share option scheme.....	4,932	—	—	—	—	—	—	(4,932)	—
— investment properties	—	—	—	—	(11,770)	—	—	11,770	—
— deferred tax on investment properties.....	—	—	—	—	(913)	—	—	(8,156)	(9,069)
— as restated	347,034	215,909	2,091,174	269,039	—	22,241	769	4,154,741	7,100,907
Opening balance adjustments in respect of:									
— financial instruments.....	—	—	—	—	—	5,131	—	(51,449)	(46,318)
— release of collective and individual impairment allowances on advances to customers	—	—	—	—	—	—	—	233,654	233,654
— as restated, after opening balance adjustments	347,034	215,909	2,091,174	269,039	—	27,372	769	4,336,946	7,288,243
Exchange adjustments	—	—	(759)	—	—	—	—	—	(759)
Shares issued under share option scheme	3,900	—	—	—	—	—	—	—	3,900
Shares premium under share option scheme	6,588	—	—	—	—	—	—	—	6,588
Shares premium under EIP	2,407	—	—	—	—	—	—	—	2,407
Losses on revaluation after deferred tax credit.....	—	—	—	—	—	(20,650)	—	—	(20,650)
Losses on revaluation transferred to profit and loss account on disposal	—	—	—	—	—	7,424	—	—	7,424
Gain on revaluation of bank premises	—	—	—	9,297	—	—	—	—	9,297
Deferred tax credited to revaluation reserve.....	—	—	—	2,900	—	—	—	—	2,900
Dividends paid	—	—	—	—	—	—	—	(626,149)	(626,149)
Profit for the year	—	—	—	—	—	—	—	1,348,718	1,348,718
At 31st December, 2005.....	359,929	215,909	2,090,415	281,236	—	14,146	769	5,059,515	8,021,919

The Bank

	2005							
	Share premium	General reserve	Bank premises revaluation reserve	Investment properties revaluation reserve	Investment revaluation reserve	Capital redemption reserve	Unappro- priated profits	Total
At 1st January, 2005								
— as previously reported.....	342,102	1,802,376	268,320	—	18,681	769	3,313,933	5,746,181
— prior year adjustment in respect of share option scheme	4,932	—	—	—	—	—	(4,932)	—
— as restated.....	347,034	1,802,376	268,320	—	18,681	769	3,309,001	5,746,181
Opening balance adjustments in respect of:								
— financial instruments.....	—	—	—	—	5,131	—	(51,623)	(46,492)
— release of collective impairment allowances on advances to customers.....	—	—	—	—	—	—	127,763	127,763
	—	—	—	—	5,131	—	76,140	81,271
— as restated, after opening balance adjustment.....	347,034	1,802,376	268,320	—	23,812	769	3,385,141	5,827,452
Exchange adjustments.....	—	(117)	—	—	—	—	—	(117)
Shares issued under share option scheme.....	3,900	—	—	—	—	—	—	3,900
Shares premium under share option scheme.....	6,588	—	—	—	—	—	—	6,588
Shares premium under EIP	2,407	—	—	—	—	—	—	2,407
Losses on revaluation after deferred tax charge.	—	—	—	—	(17,229)	—	—	(17,229)
Losses on revaluation transferred to profit and loss account on disposal.....	—	—	—	—	7,424	—	—	7,424
Deferred tax credited to revaluation reserve.....	—	—	4,527	—	—	—	—	4,527
Dividends paid	—	—	—	—	—	—	(626,149)	(626,149)
Profit for the year	—	—	—	—	—	—	1,124,275	1,124,275
At 31st December, 2005	<u>359,929</u>	<u>1,802,259</u>	<u>272,847</u>	<u>—</u>	<u>14,007</u>	<u>769</u>	<u>3,883,267</u>	<u>6,333,078</u>

The Group									
2004 (restated)									
	Share premium	Capital reserve	General reserve	Bank premises revaluation reserve	Investment properties revaluation reserve	Investment revaluation reserve	Capital redemption reserve	Unappropriated profits	Total
At 1st January, 2004									
— as previously reported.....	337,330	215,909	2,091,079	268,917	14	17,848	769	3,461,234	6,393,100
— prior year adjustments in respect of:	—	—	—	—	(14)	—	—	14	—
— as restated	337,330	215,909	2,091,079	268,917	—	17,848	769	3,461,248	6,393,100
Exchange adjustments	—	—	95	—	—	—	—	—	95
Shares issued under share option scheme	3,168	—	—	—	—	—	—	—	3,168
Shares premium under new EIP.....	1,604	—	—	—	—	—	—	—	1,604
Gain on revaluation after deferred tax charge.....	—	—	—	—	—	4,393	—	—	4,393
Deferred tax credited to bank premises revaluation reserve.....	—	—	—	122	—	—	—	—	122
Dividends paid	—	—	—	—	—	—	—	(473,196)	(473,196)
Profit for the year									
— as previously reported.....	—	—	—	—	—	—	—	1,168,021	1,168,021
— prior year adjustments in respect of:	—	—	—	—	—	—	—	—	—
— share option scheme.....	4,932	—	—	—	—	—	—	(4,932)	—
— investment properties	—	—	—	—	—	—	—	11,756	11,756
— deferred tax on investment properties	—	—	—	—	—	—	—	(8,156)	(8,156)
— as restated	4,932	—	—	—	—	—	—	1,166,689	1,171,621
At 31st December, 2004.....	<u>347,034</u>	<u>215,909</u>	<u>2,091,174</u>	<u>269,039</u>	<u>—</u>	<u>22,241</u>	<u>769</u>	<u>4,154,741</u>	<u>7,100,907</u>

	The Bank							
	2004 (restated)							
	Share premium	General reserve	Bank premises revaluation reserve	Investment properties revaluation reserve	Investment revaluation reserve	Capital redemption reserve	Unappro- priated profits	Total
At 1st January, 2004.....	337,330	1,802,370	268,917	—	11,399	769	2,729,062	5,149,847
Addition through merger with CFB.....	—	—	—	—	—	—	84,654	84,654
Exchange adjustment	—	6	—	—	—	—	(6)	—
Shares issued under share option scheme.....	3,168	—	—	—	—	—	—	3,168
Shares premium under new EIP	1,604	—	—	—	—	—	—	1,604
Gain on revaluation after deferred tax charge	—	—	—	—	7,282	—	—	7,282
Deferred tax charged to revaluation reserve	—	—	(597)	—	—	—	—	(597)
Dividends paid	—	—	—	—	—	—	(473,196)	(473,196)
Profit for the year								
— as previously reported.....	—	—	—	—	—	—	973,404	973,404
— prior year adjustment in respect of:.....								
— share option scheme	4,932	—	—	—	—	—	(4,932)	—
— investment properties	—	—	—	—	—	—	15	15
— as restated	4,932	—	—	—	—	—	968,487	973,419
At 31st December, 2004	347,034	1,802,376	268,320	—	18,681	769	3,309,001	5,746,181

The Group's unappropriated profits as at 31st December, 2005 included the accumulated losses of HK\$25,966,000 (2004: HK\$37,215,000) of the associated companies and HK\$336,176,000 (2004: Nil) as the regulatory reserve arising from the differences between the impairment allowances made under HKAS 39 and for regulatory purposes.

The application of the share premium account and the capital redemption reserve is governed by Section 48B and 49H of the Hong Kong Companies Ordinance.

The general reserve was set up from the transfer of retained earnings and exchange differences arising from translation of the accounts of overseas branches and subsidiaries (note 2(k)). The capital reserve comprises retained earnings capitalised on the issue of bonus shares by subsidiaries in previous years and a legal reserve established by Banco Weng Hang, S.A. in accordance with regulations in Macau. Revaluation reserves have been set up and are dealt with in accordance with the accounting policies adopted for the revaluation of premises and available-for-sale financial assets (notes 2(l) and 2(f)).

Capital reserve, bank premises revaluation reserve, investment revaluation reserve and capital redemption reserve do not represent realised profits and are not available for distribution.

The Bank and its financial subsidiaries operate under regulatory jurisdictions which require the maintenance of minimum capital adequacy ratios which could therefore potentially restrict the amount of retained profits which can be distributed to shareholders.

36. OFF-BALANCE SHEET EXPOSURES

(a) Contingent liabilities and commitments

Contingent liabilities and commitments are credit-related instruments which include acceptances, letters of credit, guarantees and commitments to extend credit. The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client default. Since a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of the contractual amounts is not representative of future liquidity requirements. The following is a summary of the contractual amounts of each significant class of contingent liabilities and commitments:

	The Group		The Bank	
	2005	2004	2005	2004
Direct credit substitutes.....	848,908	809,560	944,422	700,750
Transaction-related contingencies.....	105,582	33,450	305,582	233,450
Trade-related contingencies.....	1,482,947	1,416,358	1,320,491	1,235,039
Other commitments:				
With an original maturity of under 1 year or which are unconditionally cancellable.....	9,211,179	9,041,062	9,066,228	9,087,940
With an original maturity of 1 year and over.....	1,329,636	834,023	1,072,475	834,023
Forward forward deposits placed	2,000,600	2,241,972	2,000,600	2,241,972
Total (Note 38(b))	<u>14,978,852</u>	<u>14,376,425</u>	<u>14,709,798</u>	<u>14,333,174</u>

(b) Derivative financial instruments

(i) *Derivatives refer to financial contracts whose value depends on the value of one or more underlying assets or indices.*

Derivative financial instruments arise from forward, swap and option transactions undertaken by the Group and the Bank in the foreign exchange, interest rate and equity markets.

The notional amounts of these instruments indicate the volume of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

The following table is a summary of the notional amounts of each significant type of derivatives.

	The Group		The Bank	
	2005	2004	2005	2004
Exchange rate contracts				
Forwards — trading	6,866,513	3,286,625	7,441,234	3,847,888
Forwards — hedging	—	919,593	—	919,593
Option purchased — trading	242,524	277,016	242,524	277,016
Option written — trading	242,524	277,016	242,524	277,016
Total exchange rate contracts	<u>7,351,561</u>	<u>4,760,250</u>	<u>7,926,282</u>	<u>5,321,513</u>
Interest rate contracts				
Swaps — trading - receiving fixed rate	79,759,074	37,191,480	80,022,841	37,191,480
Swaps — trading - paying fixed rate	83,558,435	37,070,388	84,347,273	37,070,388
Swaps — hedging - receiving fixed rate	—	14,854,793	16,000	15,456,305
Swaps — hedging - paying fixed rate	535,485	25,096,124	535,485	25,529,993
Total interest rate contracts	<u>163,852,994</u>	<u>114,212,785</u>	<u>164,921,599</u>	<u>115,248,166</u>
Equity contracts				
Option written — trading	76,210	140,902	76,210	140,902
Total equity contracts	<u>76,210</u>	<u>140,902</u>	<u>76,210</u>	<u>140,902</u>
	<u>171,280,765</u>	<u>119,113,937</u>	<u>172,924,091</u>	<u>120,710,581</u>

The trading transactions include positions arising from the execution of trade orders from customers or transactions undertaken to hedge these positions.

(ii) *Fair value of derivative financial instruments*

(1) *as hedging instruments*

The following is a summary of the fair values of derivatives held for hedging purposes by product type entered into by the Group and the Bank:

	The Group		The Bank	
	2005			
	Assets	Liabilities	Assets	Liabilities
Interest rate contracts (Notes 19(a) & 31)	<u>8,598</u>	<u>13,047</u>	<u>8,598</u>	<u>13,501</u>

Fair value hedges

The fair value hedges consist principally of interest rate swaps that are used to protect against changes in the fair value of asset due to movements in market interest rates.

(2) *as trading instruments*

The following is a summary of the fair values of derivatives held for trading purposes by product type entered into by the Group and the Bank:

	The Group		The Bank	
	2005			
	Assets	Liabilities	Assets	Liabilities
Exchange rate contracts.....	59,496	24,157	59,496	24,101
Interest rate contracts	774,582	841,740	801,028	845,582
Equity contracts (Notes 17 & 30)	1,094	65	1,094	65
	<u>835,172</u>	<u>865,962</u>	<u>861,618</u>	<u>869,748</u>

(iii) *Remaining life of derivative financial instruments*

The following tables provide an analysis of the notional amounts of derivatives of the Group by relevant maturity groupings based on the remaining periods to settlement at the balance sheet date. The notional amounts of the derivatives indicate the volume of transactions of derivative financial instruments.

	The Group			
	2005			
	Up to 1 year	5 years or less but over 1 year	More than 5 years	Total
Exchange rate contracts.....	7,351,561	—	—	7,351,561
Interest rate contracts	103,946,999	57,938,993	1,967,002	163,852,994
Equity contracts	76,210	—	—	76,210
	<u>111,374,770</u>	<u>57,938,993</u>	<u>1,967,002</u>	<u>171,280,765</u>

	The Bank			
	2005			
	Up to 1 year	5 years or less but over 1 year	More than 5 years	Total
Exchange rate contracts.....	7,926,282	—	—	7,926,282
Interest rate contracts	104,112,999	58,766,598	2,042,002	164,921,599
Equity contracts	76,210	—	—	76,210
	<u>112,115,491</u>	<u>58,766,598</u>	<u>2,042,002</u>	<u>172,924,091</u>

	The Group			
	2004			
	Up to 1 year	5 years or less but over 1 year	More than 5 years	Total
Exchange rate contracts.....	4,760,250	—	—	4,760,250
Interest rate contracts	43,605,894	69,250,713	1,356,178	114,212,785
Equity contracts	140,902	—	—	140,902
	<u>48,507,046</u>	<u>69,250,713</u>	<u>1,356,178</u>	<u>119,113,937</u>

The Bank				
2004				
	Up to 1 year	5 years or less but over 1 year	More than 5 years	Total
Exchange rate contracts.....	5,321,513	—	—	5,321,513
Interest rate contracts	44,029,215	69,737,773	1,481,178	115,248,166
Equity contracts.....	140,902	—	—	140,902
	<u>49,491,630</u>	<u>69,737,773</u>	<u>1,481,178</u>	<u>120,710,581</u>

(c) The replacement costs and credit risk weighted amounts of the above off-balance sheet exposures are as follows. These amounts do not take into account the effects of bilateral netting arrangements.

The Group				
2005		2004		
Replacement cost	Credit risk weighted amount	Replacement cost	Credit risk weighted amount	
Contingent liabilities and commitments	N/A	1,954,688	N/A	1,757,281
Exchange rate contracts.....	59,494	41,391	22,192	20,229
Interest rate contracts	783,180	259,614	554,187	211,702
Equity contracts.....	1,094	—	—	—
	<u>843,768</u>	<u>2,255,693</u>	<u>576,379</u>	<u>1,989,212</u>

The Bank				
2005		2004		
Replacement cost	Credit risk weighted amount	Replacement cost	Credit risk weighted amount	
Contingent liabilities and commitments	N/A	2,120,970	N/A	1,742,443
Exchange rate contracts.....	59,496	42,518	22,258	20,545
Interest rate contracts	809,626	265,955	561,840	214,095
Equity contracts.....	1,094	—	—	—
	<u>870,216</u>	<u>2,429,443</u>	<u>584,098</u>	<u>1,977,083</u>

The tables above give the contractual or notional amounts, replacement cost and credit risk weighted amounts of off-balance sheet transactions. These are assessed in accordance with the Hong Kong Monetary Authority's guidelines which implement the Basle agreement on capital adequacy and depend on the status of the counterparty and the maturity characteristics.

The risk weights used range from 0% to 100% for contingent liabilities and commitments, and from 0% to 50% for exchange rate, interest rate and equity contracts. Replacement cost represents the cost of replacing all contracts which have a positive value when marked to market. The credit risk weighted amount refers to the amount as computed in accordance with the Third Schedule to the Hong Kong Banking Ordinance.

(d) **Capital commitments**

Capital commitments for acquisition of property, plant and equipment outstanding at 31st December not provided for in the accounts were as follows:

	The Group		The Bank	
	2005	2004	2005	2004
Expenditure authorised and contracted for.....	121,438	4,391	115,380	1,415
Expenditure authorised but not contracted for	—	438	—	—
	<u>121,438</u>	<u>4,829</u>	<u>115,380</u>	<u>1,415</u>

(e) **Lease commitments**

At 31st December, 2005, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

	The Group	
	2005	2004
Properties		
1 year or less	23,350	12,685
5 years or less but over 1 year	33,771	10,677
Over 5 years.....	<u>6,329</u>	<u>—</u>
	<u>63,450</u>	<u>23,362</u>
Others		
1 year or less	344	417
5 years or less but over 1 year	161	1
Over 5 years.....	<u>—</u>	<u>—</u>
	<u>505</u>	<u>418</u>

The Group leases a number of properties and items of equipment under operating leases. The leases run for an initial period of one to ten years, with an option to renew the lease when all terms are renegotiated. Lease payments are usually adjusted annually to reflect market rentals. None of the leases includes contingent rentals.

37. NOTE TO THE CONSOLIDATED CASH FLOW STATEMENT

(a) Reconciliation of operating profit to net cash inflow from operating activities

	2005	2004 (restated)
Operating profit	1,590,925	1,346,861
Depreciation	75,407	108,058
Amortisation of goodwill (Note 26)	—	44,997
Impairment losses on goodwill (Note 26)	1,170	—
Share option scheme cost (Note 5(e))	6,588	4,932
EIP cost (Note 5(e))	3,372	2,248
Interest paid on loan capital (Note 5(b))	134,148	134,514
Profits tax paid	(203,423)	(245,908)
Increase in treasury bills with original maturity of three months or more	(111,285)	(392,786)
Increase in placements with banks and other financial institutions with original maturity of three months or more	(76,617)	(124,247)
(Increase)/decrease in trade bills less impairment allowances	(101,250)	44,771
Decrease in certificates of deposit held	30,000	99,972
(Increase)/decrease in trading assets	(440,966)	515,256
Increase in financial assets measured at fair value through profit or loss	(646,762)	—
Increase in advances to customers and other accounts less impairment allowances	(5,447,396)	(2,614,217)
Increase in deposits and balances of banks and other financial institutions	527,541	813,744
Increase in deposits from customers	7,104,291	6,430,739
Decrease in certificates of deposit issued	(758,233)	(315,049)
Increase in trading liabilities	279,164	8,628
Increase/(decrease) in other accounts and provision	191,709	(937,681)
Net cash inflow from operating activities	<u>2,158,383</u>	<u>4,924,832</u>

(b) Reconciliation with the consolidated balance sheet

	2005	2004
Cash and short term fund	20,053,798	20,529,318
Placements with banks and other financial institutions maturing between one and twelve months	2,657,380	1,435,527
Certificates of deposit held	—	30,000
Amount shown in the consolidated balance sheet	22,711,178	21,994,845
Less: Amount with an original maturity of three months or more	(1,742,988)	(1,619,183)
Cash and cash equivalents in the consolidated cash flow statement	<u>20,968,190</u>	<u>20,375,662</u>

(c) Acquisition of a subsidiary

During 2005, the Group acquired 100% interest in Technico Ltd for HK\$879,000, satisfied in cash.

Net identified assets and liabilities	—
Positive goodwill arising on consolidation	879
Total purchase price paid	879
Less: cash and cash equivalents of the subsidiary acquired	—
Net cash outflow in respect of the purchase of subsidiary	<u>879</u>

38. SEGMENT REPORTING

(a) Business segments

Retail banking activities include acceptance of deposits, residential mortgages, hire purchase and consumer loans.

Corporate banking activities include advance of commercial and industrial loans, trade financing and institutional banking.

Treasury activities include foreign exchange services, management of investment securities and trading activities.

Other business activities include insurance business, stockbroking activities and services for retirement schemes.

Unallocated items mainly comprise the shareholders' funds, investments in premises and property investment and other activities which cannot be reasonably allocated to specific business segments.

	The Group						
	2005						
	Retail banking	Corporate banking	Treasury	Other	Unallocated	Inter- segment elimination	Total
Net interest income.....	1,230,339	378,742	(90,958)	2,855	208,146	—	1,729,124
Net interest income on financial instruments held for trading and measured at fair value through profit or loss.....	—	—	220,652	—	(84,776)	—	135,876
Other operating income	398,322	85,892	131,503	82,326	57,727	—	755,770
Inter-segment income.....	—	—	—	—	56,344	(56,344)	—
Operating income.....	1,628,661	464,634	261,197	85,181	237,441	(56,344)	2,620,770
Operating expenses	(648,406)	(123,753)	(35,108)	(41,919)	(126,603)	—	(975,789)
Inter-segment expenses	(51,468)	(2,377)	(652)	(1,847)	—	56,344	—
Operating profit before impairment allowances on impaired loans and advances	928,787	338,504	225,437	41,415	110,838	—	1,644,981
Impairment losses and allowances on impaired loans and advances.....	(15,604)	(38,452)	—	—	—	—	(54,056)
Operating profit	913,183	300,052	225,437	41,415	110,838	—	1,590,925
Gains/(losses) on revaluation of investment properties, disposal of tangible fixed assets and associated company	(3,146)	(28)	—	(1)	25,855	—	22,680
(Losses)/profits on disposal of held-to- maturity and available-for-sale financial assets	—	—	(8,174)	59	(933)	—	(9,048)
Impairment allowances release for held- to-maturity financial assets	—	—	—	—	—	—	—
Profit on ordinary activities.....	910,037	300,024	217,263	41,473	135,760	—	1,604,557
Share of net profits in associated companies.....	—	—	—	11,005	244	—	11,249
Profit before taxation	910,037	300,024	217,263	52,478	136,004	—	1,615,806
Depreciation (Note 5(e)).....	27,926	3,807	2,029	1,005	40,640	—	75,407
Impairment losses on goodwill (Note 5(e)).....	—	—	—	291	879	—	1,170
Segment assets	40,112,196	21,714,801	21,943,990	122,253	20,282,421	—	104,175,661
Investments in associated companies.....	—	—	—	138,978	7,977	—	146,955
Total assets.....	40,112,196	21,714,801	21,943,990	261,231	20,290,398	—	104,322,616
Total liabilities	84,031,512	1,897,049	662,086	20,550	9,373,368	—	95,984,565
Capital expenditure	24,729	10,557	1,114	238	19,261	—	55,899

The Group							
2004 (restated)							
	Retail banking	Corporate banking	Treasury	Other	Unallocated	Inter- segment elimination	Total
Net interest income	1,213,269	378,961	186,681	3,597	11,809	—	1,794,317
Other operating income	313,230	112,981	86,918	84,417	42,471	—	640,017
Inter-segment income	—	—	—	—	49,087	(49,087)	—
Operating income	1,526,499	491,942	273,599	88,014	103,367	(49,087)	2,434,334
Operating expenses	(661,458)	(165,718)	(60,934)	(43,134)	(101,795)	—	(1,033,039)
Inter-segment expenses	(44,861)	(1,918)	(554)	(1,754)	—	49,087	—
Operating profit before provisions	820,180	324,306	212,111	43,126	1,572	—	1,401,295
Charge for bad and doubtful debts	(35,235)	(19,199)	—	—	—	—	(54,434)
Operating profit	784,945	305,107	212,111	43,126	1,572	—	1,346,861
Gains/(losses) on revaluation of investment properties, disposal of tangible fixed assets and associated company	(978)	(1,895)	(1,235)	(354)	60,014	—	55,552
Profits on disposal of held-to-maturity securities	—	—	201	—	—	—	201
Profits on disposal of non-trading securities	—	—	6,224	83	—	—	6,307
Provisions written back for held-to- maturity securities	—	—	4,848	—	—	—	4,848
Profit on ordinary activities	783,967	303,212	222,149	42,855	61,586	—	1,413,769
Share of net profits in associated companies	—	—	—	4,431	114	—	4,545
Profit before taxation	783,967	303,212	222,149	47,286	61,700	—	1,418,314
Depreciation (Note 5(e))	51,463	14,678	7,666	2,125	32,126	—	108,058
Amortisation of goodwill (Note 5(e))	21,988	11,268	9,139	1,726	876	—	44,997
Segment assets	37,528,072	19,407,218	20,332,953	119,608	17,924,547	—	95,312,398
Investments in associated companies	—	—	—	127,970	7,736	—	135,706
Total assets	37,528,072	19,407,218	20,332,953	247,578	17,932,283	—	95,448,104
Total liabilities	76,886,457	1,318,299	806,869	22,658	8,999,119	—	88,033,402
Capital expenditure	44,285	26,812	3,964	442	75,787	—	151,290

(b) **Geographical segments**

The information concerning geographical segments has been classified by the location of the principal operations of the subsidiaries, or in the case of the Bank itself, of the location of the branch responsible for reporting the results or booking the assets and liabilities.

	The Group				
	2005				
	Hong Kong	Macau	Other	Less: inter-segment elimination	Total
As at 31st December, 2005					
Total operating income	2,439,037	328,961	138,562	(285,790)	2,620,770
Profit before taxation	1,476,178	233,180	61,249	(154,801)	1,615,806
Total assets	102,123,436	12,823,757	15,733,485	(26,358,062)	104,322,616
Total liabilities	94,384,492	11,981,792	15,320,048	(25,701,767)	95,984,565
Contingent liabilities and commitments (Note 36(a))...	14,190,916	1,236,398	665,151	(1,113,613)	14,978,852
Capital expenditure	40,759	7,554	7,586	—	55,899

	The Group				
	2004				
	(restated)				
	Hong Kong	Macau	Other	Less: inter-segment elimination	Total
As at 31st December, 2004					
Total operating income	2,383,998	268,339	88,430	(306,433)	2,434,334
Profit before taxation	1,347,901	167,817	45,336	(142,740)	1,418,314
Total assets	95,563,311	10,092,742	14,370,127	(24,578,076)	95,448,104
Total liabilities	88,517,021	9,443,949	14,032,574	(23,960,142)	88,033,402
Contingent liabilities and commitments (Note 36(a))...	14,377,018	758,992	45,597	(805,182)	14,376,425
Capital expenditure	103,936	23,160	24,194	—	151,290

39. PLEDGE OF ASSETS

The amount of HK\$7,754,000 (2004: HK\$7,774,000) included in “Cash and short-term funds” represents a demand deposit pledged as collateral with the State of California in compliance with the statutory requirements of the State of California.

40. RELATED PARTY TRANSACTIONS

(a) **Substantial shareholder**

During the year, transactions with The Bank of New York Company Inc. (“BNY”), a substantial shareholder of the Bank, or its subsidiaries were entered into by the Group in the ordinary course of business and on normal commercial terms. The income and expense for the year, average on-balance sheet outstanding for the year and on-balance sheet outstanding at the year end are:

(i) **Income and expense for the year**

	2005	2004
Interest income	2,927	918
Interest expense	612	458

(ii) *Average on-balance sheet outstanding*

	2005	2004
Cash and short-term funds.....	110,776	67,441
Deposits and balances of banks and other financial institutions	22,254	28,587

(iii) *On-balance sheet outstanding at the year end*

	2005	2004
Cash and short-term funds.....	62,379	49,096
Deposits and balances of banks and other financial institutions	46,539	71,114

- (iv) On 27th August, 1999 and 19th September, 2002, the Bank entered into two Delegation Agreements with BNY pursuant to which the Bank agreed to provide various back-up support services to BNY in connection with a securitisation transaction undertaken by BNY. The first Delegation Agreement was terminated on 20th February, 2004.

In 2005, the Bank received from BNY a total service fee of HK\$216,000 (2004: HK\$375,000) and will continue to receive further service fees on an annual basis during the term of the second Delegation Agreement.

(b) Subsidiaries

On 30th June, 1995, Wing Hang Zurich Insurance Company Limited (“WHZ Insurance”), a 65 percent owned subsidiary of the Bank, entered into a Management Agreement with Swiss Insurance Management (Hong Kong) Limited (“Swiss Insurance”), a wholly own subsidiary of Zurich Insurance Limited (“Zurich Insurance”) pursuant to which Swiss Insurance has been appointed as manager of WHZ Insurance in connection with the conduct by WHZ Insurance of its insurance business. Zurich Insurance is a substantial shareholder of WHZ Insurance holding 35 percent of WHZ Insurance’s issued share capital. On 25th May, 2005, the Management Agreement was extended for two years from 1st January, 2005 to 31st December, 2006 but can be terminated by either party with six months’ notice. The revised management fee will be based on a fixed fee plus a certain percentage of gross written premiums received. Under the Management Agreement, WHZ Insurance paid to Swiss Insurance an amount of HK\$5,299,000 (2004: HK\$4,498,000), being the contractual management fees payable.

During the year, the Bank entered into the transactions with subsidiaries owned by the Bank in the ordinary course of business and on normal commercial terms. The income and expense for the year, average on-balance sheet outstanding for the year and on-balance sheet outstanding at the year end are:

(i) *Income and expense for the year*

	2005	2004
Interest income	191,407	152,237
Interest expense	489,175	287,923

(ii) *Average on-balance sheet outstanding*

	2005	2004
Amounts due from subsidiaries	5,708,720	4,420,623
Amounts due to subsidiaries.....	13,818,556	12,002,205

(iii) *On-balance sheet outstanding at the year end*

	2005	2004
Amounts due from subsidiaries	6,074,285	4,985,038
Amounts due to subsidiaries.....	14,201,751	13,641,108

(c) Associated company

The Group maintains an unsecured and interest-free loan of HK\$62,000,000 (2004: HK\$62,000,000) to an associated company which is repayable in 2008.

(d) Key management personnel

During the year, the Group entered into a number of transactions with the Group's related parties, including its associates, and key management personnel and their close family members and companies controlled or significantly influenced by them. All the transactions are in the ordinary course of business and under terms and conditions normally applicable to customers of comparable standing. The interest income, interest expense and emoluments for the year, average on-balance sheet outstandings for the year and on-balance sheet outstanding at the year end are as follows:

(i) Income and expense for the year

	2005	2004 (restated)
Interest income	25,243	17,835
Interest expense	20,909	6,626

(ii) Average advances to customers and deposits from customers outstanding

	2005	2004
Advances to customers	654,791	743,661
Deposits from customers	782,131	924,710

(iii) Advances to customers and deposits from customers outstanding at the year end

	2005	2004
Advances to customers	659,624	654,423
Deposits from customers	776,434	744,230

During the year, no allowance for impairment losses has been made in respect of the above loans to related parties (2004: Nil).

(iv) Emoluments for the year

Remuneration for key management personnel, including amounts paid to the Bank's directors as disclosed in note 10 and certain of the highest paid employees as disclosed in note 11, is as follows:

	2005	2004
Short-term employee benefits	28,240	35,760
Post-employment benefits	1,522	1,416
Equity compensation benefits	6,464	3,916
	<u>36,226</u>	<u>41,092</u>

(e) Loans to officers

Particulars of loans to officers disclosed pursuant to section 161B(9) of the Hong Kong Companies Ordinance are as follows:

	2005	2004
Aggregate amount of relevant loans outstanding at 31st December	<u>424,044</u>	<u>411,328</u>
The maximum aggregate amount of relevant loans outstanding during the year	<u>499,399</u>	<u>552,022</u>

41. MANAGEMENT OF RISKS

The Group has established policies, procedures and limits to manage various types of risk that the Group is exposed to. Risk management processes and management information systems are in place to identify, measure, monitor and control credit risk, liquidity risk, market risk, operational risk etc. The risk management policies, procedures and limits are approved by the Board of Directors or its designated committee, and are monitored and reviewed regularly by relevant risk management committees, such as the Credit Committee and the Asset and Liability Management Committee ("ALMCO"). Internal auditors perform regular audits and independent checking to ensure compliance with the policies and procedures.

(a) Credit risk management

Credit risk arises from the possibility that the counterparty in a transaction may default. It arises from the lending, trade finance, treasury, derivatives and other activities undertaken by the Group. The Board of Directors has delegated the Group's credit risk management to the Credit Committee, which is chaired by the Bank's Chairman and Chief Executive.

The credit risk management function is independent of the business units. It oversees the implementation of credit policies and ensures the quality of credit evaluation and approval. Credit approval is conducted in accordance with the Group's credit policy, which defines the credit extension criteria, the credit approval and monitoring processes, the loan classification system and impairment policy. The credit policy also takes into account the requirements of the Hong Kong Banking Ordinance, guidelines issued by the HKMA and accounting standards issued by the HKICPA with respect to large exposures and impairment requirements.

Guidelines to manage credit risk have been laid down in the Group's Loaning Manual, which is regularly reviewed and approved by the Credit Committee. The Loaning Manual covers the delegated lending authorities, credit extension criteria, credit monitoring process, loan classification system, credit recovery and impairment policy.

(i) Corporate Credit Risk

The corporate credit exposures are diversified among corporates, middle market borrowers and SMEs. The large corporate exposures are generally concentrated among highly rated customers. The principal means of managing credit risk is the credit approval process. The Group has policies and procedures to evaluate the potential credit risk of a particular counterparty or transaction and to approve the transaction. For corporate clients, the Group has a detailed credit review system that is applied to each counterparty on a regular basis. The Group also has limits for funded exposure to individual industries and for borrowers and groups of borrowers, regardless of whether the exposure is in the form of loans or non-funded exposures. The Group also has a review process that ensures the proper level of review and approval depending on the size of the facility and risk grading of the credit.

The Group undertakes ongoing credit review and monitoring at various levels. The credit policies promote early detection of counterparty, industry or product exposures that require special attentions. The Credit Committee oversees the overall portfolio risk as well as individual problem loans and potential problem loans on a regular basis.

(ii) Retail Credit Risk

The Group's retail credit policy and approval process are designed based on the characteristics of the retail banking products: small value but high volume, and relatively homogeneous transactions. Monitoring the credit risk of retail exposures are based primarily on statistical analyses and portfolio review with respect to different products and types of customers. The Group reviews and revises the product terms and customer profiles on a continual basis according to the performance of respective portfolios and the market practices.

(iii) Credit-related commitments

The risks involved in credit-related commitments and contingencies are essentially the same as the credit risk involved in extending loan facilities to customers. These transactions are, therefore, subject to the same credit application, portfolio maintenance and collateral requirements as for customers applying for loans.

(iv) Concentrations of credit risk

Concentration of credit risk exists when changes in geographic, economic or industry factors similarly affect groups of counterparties whose aggregate credit exposure is material in relation to the Group's total exposures. The Group's portfolio is diversified along geographic, industry and product sectors in accordance with the established limits approved by the relevant risk committees.

Analysis of credit risk concentration by economic sector of respective financial assets is disclosed in note 15 to 21 and geographical concentration of the Group's asset is disclosed in note 38(b).

(b) Liquidity risk management

Liquidity risk is the risk of inability to fund an increase in assets or meet obligations as they fall due. The Group has established liquidity management policies for ensuring adequate liquidity is maintained at all times. The Group maintained an average liquidity ratio of 50.8% in 2005, which is well above the statutory requirement of 25%.

Liquidity is managed day-to-day by the treasury under the direction of ALMCO. ALMCO, which comprises personnel from senior management, treasury function, risk management, financial management and other business areas that could affect liquidity risk, is responsible for overseeing the liquidity risk management, in particular implement appropriate liquidity policies and procedures, identify, measure and monitor liquidity risk, and control over the liquidity risk management process. The Board of Directors approves the liquidity risk strategy and policies, maintains continued awareness of the overall liquidity risk profile, and ensures liquidity risk is adequately managed and controlled by senior management within the established risk management framework.

To cater for funding requirements during ordinary course of business, sufficient liquid assets are held and also access to the interbank market is maintained. In addition, adequate standby facilities are maintained in order to meet any unexpected and material cash outflow. The Group also performs regularly stress tests on its liquidity position to ensure adequate liquidity is maintained at all times. The detail of the analysis on the Group's and Bank's material assets and liabilities into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date are set out in the note 33.

(c) Market risk management

Market risk is the risk arising from the movements in market prices of on- and off- balance sheet positions in interest rates, foreign exchange rates as well as equity and commodity prices and the resulting change in the profit / loss or reserve of the Group.

The Group is exposed to market risk on position taken or financial instrument held or taken such as foreign exchange contracts, interest rate contracts, fixed income and equity securities and derivatives instruments.

The Board of Directors reviews and approves the policies for the management of market risks and trading authorities. ALMCO has been delegated the responsibility of controlling and monitoring market risk including regular review of the risk exposures and the risk management framework such as the established limits and stop-losses. The limits are set by ALMCO and reviewed on a periodic basis with reference to market conditions, with any material changes requiring a review by the Board of Directors. It is the Bank's policy that no limit should be exceeded. Middle Office has been delegated the duties of intra-day monitoring and ensure compliance with the policy and limits.

The Group adopts a prudent approach in managing the portfolio of trading instruments. It reduces excessive market risk by offsetting trading transactions or hedging the open positions by executing derivative contracts with other market counterparties. Trading of interest rate and foreign exchange derivative contracts forms an integral part of the Group's trading activities, which are primarily for hedging the trading positions or covering the customer driven positions.

The Group uses Price Value Basis Point ("PVBP") to monitor and limit its interest rate risk exposure. PVBP is a technique calculating the change in present value of a financial instrument or a portfolio of instruments due to a change in one basis point of interest rates. It also provides a quick tool to evaluate the impact on profit and loss due to a basis point movement in interest rates.

(i) Interest rate risk

The Group's interest rate exposures arise from lending, deposit taking as well as treasury activities. Interest rate risk primarily results from the timing differences in the repricing of interest-bearing assets, liabilities and commitments, which may apply to both banking book and trading book. It also relates to positions from non-interest bearing liabilities including shareholders' funds and current accounts, as well as from certain fixed rate loans and liabilities. The Group's interest rate risk is monitored by the ALMCO within limits approved by the Board, including interest rate gap limit, product limit and PVBP limit. The Group also uses interest rate swaps and other derivatives to manage interest rate risk.

Structural interest rate risk arises primarily from the deployment of non-interest bearing liabilities, including shareholders' funds and current accounts, as well as from certain fixed rate loans and liabilities. Structural interest rate risk is monitored by ALMCO.

The following tables indicate the expected next repricing dates (or maturity dates whichever are earlier) for the assets and liabilities at the balance sheet date.

The Group						
2005						
Total	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Non- interest bearing	
Assets						
Cash and short-term funds	20,053,798	19,435,975	95,335	—	—	522,488
Placements with banks and other financial institutions maturing between one and twelve months	2,657,380	2,559,271	98,109	—	—	—
Trade bills less impairment allowances	652,375	645,555	6,820	—	—	—
Trading assets	911,264	—	300	1,412	—	909,552
Financial assets measured at fair value through profit or loss	5,924,424	981,327	1,223,951	3,274,944	444,202	—
Advances to customers and other account less impairment allowances	55,393,692	47,715,104	3,264,783	2,762,867	389,864	1,261,074
Advances to banks	79,191	78,982	—	—	—	209
Held-to-maturity and available-for-sale financial assets	15,909,430	5,789,899	219,240	8,702,037	1,090,191	108,063
Other assets	2,741,062	—	—	—	—	2,741,062
Total assets	104,322,616	77,206,113	4,908,538	14,741,260	1,924,257	5,542,448
Liabilities						
Deposits and balances of banks and other financial institutions	1,703,026	1,160,138	432,567	76,901	—	33,420
Deposits from customers	85,673,452	79,337,292	1,688,551	328,575	1,150	4,317,884
Certificates of deposit issued	3,824,339	3,432,341	384,067	7,931	—	—
Trading liabilities	865,962	—	—	—	—	865,962
Other liabilities	1,397,898	44,236	—	—	—	1,353,662
Loan capital	2,519,888	—	—	2,519,888	—	—
Total liabilities	95,984,565	83,974,007	2,505,185	2,933,295	1,150	6,570,928
Asset-liability gap	8,338,051	(6,767,894)	2,403,353	11,807,965	1,923,107	(1,028,480)

The Bank						
2005						
	Total	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Non- interest bearing
Assets						
Cash and short-term funds.....	18,744,775	18,379,921	—	—	—	364,854
Placements with banks and other financial institutions maturing between one and twelve months.....	2,629,507	2,531,398	98,109	—	—	—
Trade bills less impairment allowances.....	412,544	405,724	6,820	—	—	—
Trading assets.....	929,710	—	300	1,412	—	927,998
Financial assets measured at fair value through profit or loss.....	5,924,424	981,327	1,223,951	3,274,944	444,202	—
Advances to customers and other accounts less impairment allowances.....	43,141,730	39,911,818	1,573,446	491,679	335,544	829,243
Advances to banks.....	79,191	78,982	—	—	—	209
Held-to-maturity and available-for-sale financial assets.....	15,249,952	5,758,880	180,738	8,262,035	951,221	97,078
Amounts due from subsidiaries.....	6,074,285	2,483,291	270,000	1,445,000	1,845,000	30,994
Other assets.....	2,876,100	—	—	—	—	2,876,100
Total assets.....	96,062,218	70,531,341	3,353,364	13,475,070	3,575,967	5,126,476
Liabilities						
Deposits and balances of banks and other financial institutions.....	1,694,613	1,152,206	432,567	76,901	—	32,939
Deposits from customers.....	67,902,897	62,804,506	1,218,022	177,890	—	3,702,479
Certificates of deposit issued.....	3,829,252	3,432,341	388,980	7,931	—	—
Trading liabilities.....	869,748	—	—	—	—	869,748
Amounts due to subsidiaries.....	14,201,751	7,032,897	3,328,411	3,605,499	—	234,944
Other liabilities.....	936,858	44,236	—	—	—	892,622
Total liabilities.....	89,435,119	74,466,186	5,367,980	3,868,221	—	5,732,732
Asset-liability gap.....	6,627,099	(3,934,845)	(2,014,616)	9,606,849	3,575,967	(606,256)

The Group						
2004 (restated)						
	Total	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Non- interest bearing
Assets						
Cash and short-term funds.....	20,529,318	20,018,888	—	—	—	510,430
Placements with banks and other financial institutions maturing between one and twelve months.....	1,435,527	1,337,360	98,167	—	—	—
Trade bills less impairment allowances.....	551,124	540,509	10,282	—	—	333
Certificates of deposit held.....	30,000	30,000	—	—	—	—
Trading assets.....	30,808	—	—	153	—	30,655
Advances to customers and other accounts less impairment allowances.....	49,582,402	40,648,642	3,283,779	3,244,068	1,016,982	1,388,931
Advances to banks.....	110,865	—	110,865	—	—	—
Held-to-maturity and available-for-sale financial assets.....	18,867,918	4,885,228	1,968,270	9,706,763	2,307,657	—
Non-trading securities.....	1,520,822	3,050	8,288	325,498	903,288	280,698
Other assets.....	2,789,320	—	—	—	—	2,789,320
Total assets.....	<u>95,448,104</u>	<u>67,463,677</u>	<u>5,479,651</u>	<u>13,276,482</u>	<u>4,227,927</u>	<u>5,000,367</u>
Liabilities						
Deposits and balances of banks and other financial institutions.....	1,209,582	955,145	216,225	—	—	38,212
Deposits from customers.....	78,569,161	70,618,611	2,364,744	373,048	1,678	5,211,080
Certificates of deposit issued.....	4,616,090	3,653,923	563,567	398,600	—	—
Trading liabilities.....	8,628	—	—	—	—	8,628
Other liabilities.....	1,103,456	41,288	—	—	—	1,062,168
Loan capital.....	2,526,485	—	—	2,526,485	—	—
Total liabilities.....	<u>88,033,402</u>	<u>75,268,967</u>	<u>3,144,536</u>	<u>3,298,133</u>	<u>1,678</u>	<u>6,320,088</u>
Asset-liability gap.....	<u>7,414,702</u>	<u>(7,805,290)</u>	<u>2,335,115</u>	<u>9,978,349</u>	<u>4,226,249</u>	<u>(1,319,721)</u>

	The Bank					
	2004					
	(restated)					
	Total	3 months or less	1 year or less but over 3 months	5 years or less but over 1 year	After 5 years	Non-interest bearing
Assets						
Cash and short-term funds.....	19,990,535	19,546,102	—	—	—	444,433
Placements with banks and other financial institutions maturing between one and twelve months.....	1,408,389	1,310,222	98,167	—	—	—
Trade bills less impairment allowances.....	387,243	376,567	10,282	—	—	394
Certificates of deposit held.....	30,000	30,000	—	—	—	—
Trading assets.....	18,894	—	—	153	—	18,741
Advances to customers and other accounts less impairment allowances.....	39,657,562	34,353,004	1,941,060	1,438,447	964,456	960,595
Advances to banks.....	110,865	—	110,865	—	—	—
Held-to-maturity and available-for-sale financial assets.....	18,382,534	4,726,892	1,944,942	9,511,910	2,198,790	—
Non-trading securities.....	1,407,308	—	—	286,709	847,836	272,763
Amounts due from subsidiaries.....	4,985,038	1,946,062	270,000	1,440,000	1,305,000	23,976
Other assets.....	2,872,258	—	—	—	—	2,872,258
Total assets.....	89,250,626	62,288,849	4,375,316	12,677,219	5,316,082	4,593,160
Liabilities						
Deposits and balances of banks and other financial institutions.....	1,205,409	951,558	216,225	—	—	37,626
Deposits from customers.....	63,098,291	56,475,981	1,720,654	206,189	—	4,695,467
Certificates of deposit issued.....	4,621,145	3,653,924	568,621	398,600	—	—
Trading liabilities.....	8,628	—	—	—	—	8,628
Amounts due to subsidiaries.....	13,641,108	6,435,958	1,765,355	5,269,245	—	170,550
Other liabilities.....	635,953	41,288	—	—	—	594,665
Total liabilities.....	83,210,534	67,558,709	4,270,855	5,874,034	—	5,506,936
Asset-liability gap.....	6,040,092	(5,269,860)	104,461	6,803,185	5,316,082	(913,776)

The following table indicates the effective interest rates for the last month of the year:

	The Group		The Bank	
	2005	2004	2005	2004
Placement with banks and other financial institutions	4.51	3.37	4.51	3.37
Trade bills and advances to customers.....	6.08	3.49	5.92	3.17
Debt securities.....	4.40	3.30	4.45	3.33
	<u>5.37</u>	<u>3.42</u>	<u>5.21</u>	<u>3.26</u>
Deposits and balances of banks and other financial institutions.....	3.71	1.83	3.74	1.87
Deposits from customers.....	3.69	1.58	3.77	1.66
Certificates of deposit issued.....	3.73	2.34	3.73	2.34
Loan capital.....	5.32	5.32	5.32	5.32
	<u>3.74</u>	<u>1.74</u>	<u>3.82</u>	<u>1.85</u>

(ii) *Currency Risk*

The Group foreign exchange positions arise from foreign exchange dealing, commercial banking operations and structural foreign currency exposures arising from capital investment in subsidiaries and branches outside Hong Kong, mainly in US dollar, Macau Patacas and Renminbi, are managed by ALMCO. All foreign exchange positions are managed by the ALMCO within limits approved by the Board of Directors.

The net positions or net structural positions in foreign currencies are disclosed when each currency constitutes 10% or more of the respective total net position or total net structural position in all foreign currencies.

In millions of HK\$ equivalent	The Group			
	2005		2004	
	US\$	Total	US\$	Total
Spot assets	31,689	51,672	27,044	43,484
Spot liabilities	(32,431)	(52,130)	(28,388)	(44,775)
Forward purchases	5,396	7,871	4,307	5,100
Forward sales	(3,257)	(5,783)	(2,417)	(3,233)
Net long positions	<u>1,397</u>	<u>1,630</u>	<u>546</u>	<u>576</u>

In millions of HK\$ equivalent	The Group						
	2005				2004		
	Macau Patacas	Chinese Renminbi	US\$	Total	Macau Patacas	US\$	Total
Net structural positions	<u>204</u>	<u>192</u>	<u>317</u>	<u>713</u>	<u>110</u>	<u>218</u>	<u>328</u>

In millions of HK\$ equivalent	The Bank			
	2005		2004	
	US\$	Total	US\$	Total
Spot assets	30,706	50,587	26,365	42,765
Spot liabilities	(31,683)	(51,291)	(27,752)	(44,067)
Forward purchases	5,396	7,871	4,307	5,073
Forward sales	(3,257)	(5,775)	(2,417)	(3,233)
Net long positions	<u>1,162</u>	<u>1,392</u>	<u>503</u>	<u>538</u>

In millions of HK\$ equivalent	The Bank						
	2005				2004		
	Macau Patacas	Chinese Renminbi	US\$	Total	Macau Patacas	US\$	Total
Net structural positions	<u>(583)</u>	<u>192</u>	<u>317</u>	<u>(74)</u>	<u>(583)</u>	<u>218</u>	<u>(365)</u>

(d) 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.

The Group's risk management framework is established to control risks at both corporate and departmental levels. The underlying management principle is built upon a long-standing culture of high integrity and risk awareness fostered by senior executives of the Group.

The framework consists of governing policies with control measures to ascertain absolute compliance by all operating units. These measures are directed, controlled and held to account by operation management committees chaired by senior executives. Regular reviews are performed by the committees to ensure proper functioning of internal controls and to identify improvement opportunities.

Furthermore, independent reviews are conducted by the Group's Internal Audit Division to measure the effectiveness of the Group's system of internal controls. This division reports to the Audit Committee to ensure the framework is managed with high standards of probity.

42. STAFF BENEFITS

(a) Retirement schemes

	2005	2004
Retirement benefit costs (Note 5(e))	<u>36,267</u>	<u>35,203</u>

The Group operates both a Mandatory Provident Fund Exempt ORSO Scheme (the “ORSO Scheme”) which is registered under the Occupational Retirement Schemes Ordinance and two Mandatory Provident Fund Schemes (the “MPF Schemes”) established under the Mandatory Provident Fund Ordinance to cover all qualifying employees in Hong Kong. As from 1st August, 2004, the ORSO Scheme has been frozen as employees and the employer have made the contributions to MPF Scheme instead. In addition, a defined contribution scheme was established on 3rd January, 2001 to cover all qualifying employees in Macau at various funding rates, in accordance with the local practice and requirements. The costs of these schemes are charged to the profit and loss account for the year and the assets of these schemes are held separately from the Group. Any forfeiture amount under the MPF Scheme is refunded to the Group when the member leaves employment prior to the employer’s voluntary contributions being vested fully.

(b) Equity compensation benefits

(i) Share Option Scheme

Pursuant to the approved Share Option Scheme, the directors are authorised, at their discretion, to invite certain executives, to take up options to purchase ordinary shares in the Bank as incentive to them. Prior to 1st September, 2001, the option price was 80% of the average last dealt price on The Stock Exchange of Hong Kong Limited (“SEHK”) on the five business days immediately preceding the date of offer of such options. After 1st September, 2001, the option price should be at least the higher of the closing price of the shares on the SEHK on the date of the grant, which must be a trading day, and the average closing price of the shares on the SEHK for the five business days immediately preceding the date of grant.

(1) Movements in share options

	2005	2004
	Number of shares	Number of shares
At 1st January.....	1,105,000	740,000
Issued.....	350,000	535,000
Lapsed	(60,000)	(40,000)
Exercised	(110,000)	(130,000)
At 31st December.....	<u>1,285,000</u>	<u>1,105,000</u>

(2) Terms of unexpired and unexercised share options at balance sheet date

		2005	2004
Date of options granted	Option price	Number of shares	Number of shares
	HK\$		
10/03/2001	23.60	190,000	230,000
15/03/2002	26.30	170,000	170,000
14/01/2003	25.80	80,000	80,000
14/03/2003	26.50	130,000	130,000
21/05/2004	43.80	390,000	495,000
14/01/2005	51.25	220,000	—
28/01/2005	50.25	105,000	—
		<u>1,285,000</u>	<u>1,105,000</u>

The options granted under the Scheme will be exercisable between the first and the tenth anniversaries of the date of grant.

(3) Details of share options granted during the year, all of which were granted with HK\$1.00 consideration.

Exercise period	Option price HK\$	2005	2004
		Number of shares	Number of shares
21/05/2005 — 21/05/2014	43.80	—	535,000
14/01/2006 — 14/01/2015	51.25	220,000	—
28/01/2006 — 28/01/2015	50.25	130,000	—
		<u>350,000</u>	<u>535,000</u>

(4) Details of share options exercised during the year

Exercise date	Option price HK\$	Weighted average closing price per share at preceding day before exercise date HK\$	Proceeds received HK\$	2005	2004
				Number of shares	Number of shares
14/01/2004	25.80	49.30	516,000	—	20,000
26/01/2004	25.80	54.25	516,000	—	20,000
27/01/2004	25.80	54.50	516,000	—	20,000
27/01/2004	23.60	54.50	708,000	—	30,000
09/02/2004	25.80	52.75	516,000	—	20,000
13/04/2004	26.30	55.00	526,000	—	20,000
15/04/2005	23.60	48.20	944,000	40,000	—
21/05/2005	43.80	51.00	657,000	15,000	—
31/05/2005	43.80	54.50	657,000	15,000	—
16/08/2005	43.80	58.90	876,000	20,000	—
27/09/2005	43.80	56.40	876,000	20,000	—
				<u>110,000</u>	<u>130,000</u>

(5) Fair value of share options and assumptions

The fair value per option at the dates of grant using the Bi-nominal pricing model with the following assumptions were as follows:

	Option granted on 28/01/2005	Option granted on 14/01/2005	Option granted on 21/05/2004
Risk-free interest rate (%).....	3.63	3.79	4.69
Expected life (in years).....	10.0	10.0	10.0
Volatility (%).....	23.48	24.65	38.38
Expected dividend yield (%).....	3.57	3.57	3.14
Estimated value per option (HK\$)	11.45	11.85	17.19

The Bi-nominal pricing model was used in estimating the fair value of share options after taking into account the exercise price and the life of the option. Such option pricing model requires the input of highly subjective assumptions including the risk-free interest rate, expected volatility and dividend yield of the shares. The changes in subjective input assumptions can materially affect the fair value estimate.

The expected volatility is based on the historic volatility (calculated based on the weighted average remaining life of the share options), adjusted for any expected changes to future volatility due to publicly available information. Expected dividends are based on historical dividends.

Share options were granted under a service condition. This condition has not been taken into account in the grant date fair value measurement of the services received. The fair value of the options were measured at the grant date and are charged to the profit and loss account and credited to shareholders' funds between the grant date and vesting date. There were no market conditions associated with the share option grants.

(ii) *EIP*

In 2004, a new EIP was approved. Pursuant to the approved EIP, the directors are authorised, at their discretion, to invite certain executives, to take up awards to vesting ordinary shares in the Bank as incentive for them to remain in employment with the Bank. The maximum number of awards in respect of which awards may be granted under the EIP may not exceed 1% of the issued share capital of the Bank for the time being in issue within five years of the date of approval of the plan on 22nd April, 2004. The awards are vested between the sixth to the tenth anniversaries after the date of grant with the following percentage of award vesting.

Date	Percentage of Award vesting
Sixth anniversary of the date of grant	5%
Seventh anniversary of the date of grant	10%
Eighth anniversary of the date of grant	15%
Ninth anniversary of the date of grant.....	20%
Tenth anniversary of the date of grant.....	50%

The fair value per award at the date of grant which is based on the closing price of the shares of the Bank at preceding day before date of grant less exercise price of the award. The fair value per award at the date of grant as follows:

	Award granted on 21/05/2004
Closing price of the shares of the Bank at preceding day before date of grant	43.80
Less: Exercise price.....	(1.00)
Estimated value per award (HK\$)	<u>42.80</u>

The Group granted awards at no consideration for certain employees to acquire shares of the Bank under the EIP. The shares will be acquired at the nominal value of HK\$1 per share under the award. The fair value of the awards is measured at the grant date and is charged to the profit and loss account and credited to shareholders' fund between the grant date and vesting date. The cash amount equal to the dividend that would have been paid during the period up to vesting will be charged to the profit and loss account as bonus expenses on an accrual basis.

If the Board determines to select the cash option when shares vest, which is available under the plan, no new shares will be issued on the date of vesting.

At 31st December, 2005, the Directors and employees of the Bank had the following interest in award to purchase the shares of the Bank.

Date of awards granted	Exercise Price HK\$	2005	2004
		Number of shares	Number of shares
21/05/2004	1.00	<u>495,000</u>	<u>495,000</u>

43. FAIR VALUES OF FINANCIAL INSTRUMENTS

Fair value estimates are generally subjective in nature, and are made as of a specific point in time based on the characteristics of the financial instruments and relevant market information. Where available, the most suitable measure for fair value is the quoted market price. In the absence of organised secondary markets for most financial instruments, and in particular for loans, deposits and unlisted derivatives, direct market prices are not available. The fair value of such instruments was therefore calculated on the basis of well-established valuation techniques using current market parameters. In particular, the fair value is a theoretical value applicable at a given reporting date, and hence can only be used as an indicator of the value realisable in a future sale.

All valuation models are validated before they are used as a basis for financial reporting. Wherever possible, the Group compares valuations derived from models with quoted prices of similar financial instruments, and with actual values when realised, in order to further validate and calibrate the models. These techniques involve uncertainties and are significantly affected by the assumptions used and judgments made regarding risk characteristics of various financial instruments, discount rates, estimates of future cash flows, future expected loss experiences and other factors. Changes in assumptions could significantly affect these estimates and the resulting fair values. Derived fair value estimates cannot necessarily be substantiated by comparison to independent markets and, in many cases, could not be realized in an immediate sale of the instruments.

	The Group			
	2005	2004	2005	2004
	Carrying value	Carrying value	Fair value	Fair value
Financial assets				
Cash and short-term funds.....	20,053,798	20,529,318	20,053,798	20,529,318
Placements with banks and other financial institutions maturing between one and twelve months.....	2,657,380	1,435,527	2,657,380	1,435,527
Trade bills less impairment allowances.....	652,375	551,124	652,375	551,124
Certificates of deposit held	—	30,000	—	30,000
Advances to customers less impairment allowances	54,074,272	48,566,616	54,074,272	48,566,616
Advances to banks.....	79,191	110,865	79,191	110,865
Held-to-maturity and available-for-sale financial assets..	15,909,430	18,867,918	15,829,097	18,859,860
Non-trading securities.....	—	1,520,822	—	1,520,822
Financial liabilities				
Deposits and balances of banks and other financial institutions.....	1,703,026	1,209,582	1,703,026	1,209,582
Deposits from customers	85,673,452	78,569,161	85,673,452	78,569,161
Certificates of deposit issued at amortised cost	1,902,640	4,616,090	1,905,045	4,587,346
Structured certificates of deposit issued designated at inception as fair value through profit or loss	1,921,699	—	1,921,699	—
Loan capital	2,519,888	2,526,485	2,479,972	2,559,456

	The Bank			
	2005	2004	2005	2004
	Carrying value	Carrying value	Fair value	Fair value
Financial assets				
Cash and short-term funds.....	18,744,775	19,990,535	18,744,775	19,990,535
Placements with banks and other financial institutions maturing between one and twelve months.....	2,629,507	1,408,389	2,629,507	1,408,389
Trade bills less impairment allowances.....	412,544	387,243	412,544	387,243
Certificates of deposit held	—	30,000	—	30,000
Advances to customers less impairment allowances	42,235,524	39,006,464	42,235,524	39,006,464
Advances to banks.....	79,191	110,865	79,191	110,865
Held-to-maturity and available-for-sale financial assets..	15,249,952	18,382,534	15,175,619	18,369,980
Non-trading securities.....	—	1,407,308	—	1,407,308
Amounts due from subsidiaries	6,074,285	4,985,038	6,074,285	4,985,038
Financial liabilities				
Deposits and balances of banks and other financial institutions.....	1,694,613	1,205,409	1,694,613	1,205,409
Deposits from customers	67,902,897	63,098,291	67,902,897	63,098,291
Certificates of deposit issued at amortised cost	1,902,640	4,621,145	1,905,045	4,592,340
Structured certificates of deposit issued designated at inception as fair value through profit or loss	1,926,612	—	1,926,612	—
Amounts due to subsidiaries.....	14,201,751	13,641,108	14,201,751	13,641,108

The following methods and significant assumptions have been applied in determining the fair values of financial instruments presented in above.

- the fair value of demand deposits and savings accounts with no specific maturity is assumed to be the amount payable on demand at the balance sheet date.
- the fair value of variable rate financial instruments is assumed to approximate their carrying amounts and, in the case of loans and unquoted debt securities, does not, therefore, reflect changes in their credit quality, as the impact of credit risk is recognised separately by deducting the amount of the impairment loss and allowances from both the carrying amount and fair value.
- the fair value of fixed rate loans and mortgages carried at amortized cost is estimated by comparing market interest rates when the loans were granted with current market rates offered on similar loans. Changes in the credit quality of loans within the portfolio are not taken into account in determining gross fair values, as the impact of credit risk is recognised separately by deducting the amount of the impairment loss and allowances from both the carrying amount and fair value.
- the fair value of unquoted equity investments is estimated, if possible, using applicable price/earnings ratios for similar listed companies adjusted to reflect the specific circumstances of the issuers.

- (e) the fair value of forward exchange contracts and interest rate swaps is estimated either using broker quotes or by discounting future cash flows. Broker quotes are back tested using pricing models or discounted cash flow techniques. Future cash flows are estimated based on management's best estimates of the amount it would receive or pay to terminate the contract at the balance sheet date taking into account current market conditions and the current credit worthiness of the counterparties. The discount rate used is a market rate for a similar instrument at the balance sheet date. The fair value of an option contract is determined by applying the Black-Scholes option valuation model. Inputs are based on market related data at the balance sheet date.

44. POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING PERIOD ENDED 31ST DECEMBER, 2005

Up to the date of issue of these financial statements, the HKICPA has issued the following amendments, new standards and interpretations which are not yet effective for the accounting period ending 31st December, 2005 and which have not been adopted in these financial statements:

	Effective for accounting periods beginning on or after
HKFRS 6, Exploration for evaluation of mineral resources.....	1st January, 2006
HK(IFRIC) 4, Determining whether an arrangement contains a lease	1st January, 2006
HK(IFRIC) 5, Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds.....	1st January, 2006
HK(IFRIC) 6, Liabilities arising from participating in a specific market — Waste electrical and electronic equipment	1st December, 2005
HK(IFRIC) 7, Applying the restatement approach under IAS 29 Financial reporting in hyperinflationary economies.....	1st March, 2006
Amendments to HKAS 19, Employee benefits — Actuarial Gains and Losses, Group Plans and Disclosures	1st January, 2006
Amendments to HKAS 21, Net investment in a foreign operation	1st January, 2006
Amendments to HKAS 39, Financial instruments: Recognition and measurement — Cash flow hedge accounting of forecast intragroup transactions	1st January, 2006
— The fair value option	1st January, 2006
— Financial guarantee contracts	1st January, 2006
Amendments, as a consequence of the Hong Kong Companies (Amendment) Ordinance 2005, to:	
— HKAS 1, Presentation of financial statements.....	1st January, 2006
— HKAS 27, Consolidated and separate financial statements	1st January, 2006
— HKFRS 3, Business combinations	1st January, 2006
HKFRS 7, Financial instruments: disclosures	1st January, 2007
Amendment to HKAS 1, Presentation of financial statements: capital disclosures	1st January, 2007

In addition, the Hong Kong Companies (Amendment) Ordinance 2005 came into effect on 1st December, 2005 and would be first applicable to the Group's financial statements for the period beginning 1st January, 2006.

The Group is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far it has concluded that:

- HKFRS 7 requires more detailed qualitative and quantitative disclosures, primarily in respect of fair values and risk management. The adoption of this standard is therefore only expected to affect the level of detail of the disclosures, and is not expected to have any financial impact nor result in any changes to Group's accounting policies.
- The adoption of HKFRS 6 and HK(IFRIC) 5 and the amendments to HKAS 1, HKAS 27 and HKFRS 3 made as a result of the Hong Kong Companies (Amendment) Ordinance 2005 are not applicable to any of the Group's operations and that the adoption of the rest of them is unlikely to have a significant impact on the Group's results of operations and financial position.

45. COMPARATIVE FIGURES

Certain comparative figures have been adjusted as a result of changes in accounting policies. Further details of which are set out in note 4.

46. APPROVAL OF ACCOUNTS

The accounts were approved and authorised for issue by the Board of Directors on 16th March, 2006.

Registered Office of the Bank

161 Queen's Road Central
Hong Kong

Trustee

The Bank of New York
One Canada Square
40th Floor
London E14 5AL
United Kingdom

Principal Paying Agent

The Bank of New York
One Canada Square
40th Floor
London E14 5AL
United Kingdom

Legal Advisers

*To the Bank
as to English and
Hong Kong law*

Freshfields Bruckhaus Deringer
11th Floor
Two Exchange Square
Central
Hong Kong

*To the Managers as to English
and Hong Kong law*

Allen & Overy
9th Floor
Three Exchange Square
Central
Hong Kong

*To the Trustee as to
English law*

Allen & Overy
One Bishops Square
London E1 6AO
United Kingdom

Auditors of the Bank

KPMG
8th Floor Prince's Building
10 Chater Road
Central
Hong Kong

