Liu Chong Hing Bank Limited

(incorporated with limited liability in Hong Kong)

US$125,000,000 Floating Rate Subordinated Notes due 2016

Issue Price: 100 per cent.

The Floating Rate Subordinated Notes due 2016 (the "**Notes**") will be issued in an initial aggregate principal amount of US$125,000,000 by Liu Chong Hing Bank Limited (the "**Issuer**" or the "**Bank**"). Subject as provided below, the Notes will bear interest at the rate of 0.93 per cent. per annum above the London interbank offered rate for three month US dollar deposits ("**3-month USD LIBOR**") from and including 15 December 2006 to, but excluding, 16 December 2016, payable quarterly in arrear on 16 March, 16 June, 16 September and 16 December of each year, save that the first payment of interest, which will be made on 16 March 2007 will be in respect of the period from and including 15 December 2006 to, but excluding, 16 March 2007.

Unless the Notes are previously redeemed or purchased and cancelled, interest payable on the Notes from and including 16 December 2011 will be reset to a per annum rate which equals 3-month USD LIBOR plus 1.93 per cent. See "*Terms and Conditions of the Notes – Interest*". Interest at the reset rate will be payable on the Notes quarterly in arrear on 16 March, 16 June, 16 September and 16 December of each year, commencing on 16 March 2012.

The Notes will mature on 16 December 2016, if not redeemed or purchased and cancelled earlier. Subject to satisfaction of certain regulatory approval requirements, the Notes will be redeemable at the option of the Issuer in whole but not in part on 16 December 2011 at a redemption price equal to their principal amount. See "*Terms and Conditions of the Notes – Redemption and Purchase*". In addition, subject to satisfaction of certain regulatory approval requirements, the Notes will be redeemable at the option of the Issuer in whole but not in part, at a redemption price equal to their principal amount together with accrued and unpaid interest to the date fixed for redemption, upon the occurrence of certain changes in taxation in Hong Kong requiring the payment of additional amounts. See "*Terms and Conditions of the Notes – Redemption and Purchase*".

The Notes will constitute unsecured and subordinated obligations of the Issuer. The Notes will rank *pari passu* among themselves and at least equally with all other outstanding unsecured and subordinated obligations of the Issuer. See "*Terms and Conditions of the Notes – Status*".

The Notes are rated "Baa3" 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 Notes and maybe subject to revision, suspension or withdrawal at any time by the assigning rating organisation.

See "*Investment Considerations*" beginning on page 9 for a discussion of certain considerations to be taken into account in connection with an investment in the Notes.

Application has been made to The Stock Exchange of Hong Kong Limited (the "**HKSE**") for the listing of, and permission to deal in, the Notes by way of selectively marketed securities (as defined in the Rules Governing the Listing of Securities on the HKSE (the "**Listing Rules**")) and such permission is expected to become effective on 18 December 2006.

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 or to, or for the account or benefit of, U.S. persons (as defined in Regulation S under the Securities Act ("**Regulation S**")).

The Notes will be evidenced by a global certificate (the "**Global Certificate**") in registered form, which will be registered in the name of a nominee of, and deposited with a common depositary for, Euroclear Bank S.A./N.V. ("**Euroclear**") and Clearstream Banking, société anonyme ("**Clearstream, Luxembourg**") on or about 15 December 2006 (the "**Closing Date**"). Beneficial interests in the Global Certificate will be shown on, and transfers thereof will be effected only through, the records maintained by Euroclear and Clearstream, Luxembourg and their respective accountholders. Except in the limited circumstances set out herein, individual certificates for Notes will not be issued in exchange for beneficial interests in the Global Certificate. See "*The Global Certificate*".

Joint Bookrunners and Joint Lead Managers

Goldman Sachs (Asia) L.L.C. **HSBC**

Offering Circular dated 8 December 2006

IMPORTANT NOTICE

The contents of this document have not been reviewed by any regulatory authority in Hong Kong. You are advised to exercise caution in relation to the offer. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

This Offering Circular includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Issuer and the Notes. The Issuer, having made all reasonable enquiries, confirms that (i) this Offering Circular contains all information with respect to the Issuer and the Issuer's subsidiaries (collectively, the "**Group**"), and the issue of the Notes, which is material in the context of the issue and offering of the Notes; (ii) the statements contained herein relating to the Issuer and the Group are in every material respect true and accurate and not misleading; (iii) the opinions and intentions expressed in this Offering Circular with regard to the Issuer and the Group are honestly held, have been reached after considering all relevant circumstances and are based on reasonable assumptions; (iv) there are no other facts in relation to the Issuer, the Group or the Notes, the omission of which would, in the context of the issue and offering of the Notes, make any statement in this Offering Circular misleading in any material respect; and (v) all reasonable enquiries have been made by the Issuer to ascertain such facts and to verify the accuracy of all such information and statements. In addition, the Issuer accepts full responsibility for the accuracy of the information contained in this Offering Circular.

This Offering Circular has been prepared by the Issuer solely for use in connection with the proposed offering of the Notes described in this Offering Circular. The distribution of this Offering Circular and the offering of the Notes in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by the Issuer and the managers as set forth in "*Subscription and Sale*" (the "**Managers**") to inform themselves about and to observe any such restrictions. No action is being taken to permit a public offering of the Notes or the distribution of this Offering Circular in any jurisdiction where action would be required for such purposes. There are restrictions on the offer, sale and resale of the Notes, and the circulation of documents relating thereto, in certain jurisdictions including, without limitation, the United States, the European Economic Area (including the United Kingdom), Hong Kong, Singapore, Japan and Italy, and to persons connected therewith. For a description of certain further restrictions on offers, sales and resales of the Notes and distribution of this Offering Circular, see "*Subscription and Sale*".

No person has been or is authorised to give any information or to make any representation concerning the Issuer, the Group or the Notes other than as contained herein and, if given or made, any such other information or representation should not be relied upon as having been authorised by the Issuer, the Managers or the Trustee or the Agents (each as defined in the Terms and Conditions of the Notes). Neither the delivery of this Offering Circular nor any offering, sale or delivery made in connection with the issue of the Notes shall, under any circumstances, constitute a representation that there has been no change or development reasonably likely to involve a change in the affairs of the Issuer, the Group or any member of the Group since the date hereof or create any implication that the information contained herein is correct as at any date subsequent to the date hereof. This Offering Circular does not constitute an offer of, or an invitation by or on behalf of the Issuer, the Managers, the Trustee or the Agents to subscribe for or purchase any of the Notes and may not be used for the purpose of an offer to, or a solicitation by, anyone in any jurisdiction or in any circumstances in which such offer or solicitation is not authorised or is unlawful.

No representation or warranty, express or implied, is made or given by the Managers, the Trustee or the Agents as to the accuracy, completeness or sufficiency of the information contained in this Offering Circular, and nothing contained in this Offering Circular is, or shall be relied upon as, a promise, representation or warranty by the Managers, the Trustee or the Agents. This Offering Circular is not intended to provide the basis of any credit or other evaluation nor should it be considered as a recommendation by either the Issuer, the Managers, the Trustee or the Agents that any recipient of this Offering Circular should purchase the Notes. Each potential purchaser of the Notes should determine for itself the relevance of the information contained in this Offering Circular and its purchase of the Notes should be based upon such investigations with its own tax, legal and business advisers as it deems necessary.

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.

Any purchase or acquisition of the Notes is in all respects conditional on the satisfaction of certain conditions set out in the Subscription Agreement (as defined in "*Subscription and Sale*") and the issue of the Notes by the Issuer to the Managers pursuant to the Subscription Agreement. Any offer, invitation to offer or agreement made in connection with the purchase or acquisition of the Notes pursuant to this Offering Circular shall (without liability or responsibility on the part of the Issuer or the Managers) lapse and cease to have any effect if (for any reason whatsoever) the Notes are not issued by the Issuer to the Managers pursuant to the Subscription Agreement.

The HKSE 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.

In making an investment decision, investors must rely on their own examination of the Issuer, the Group and the terms of the offering of the Notes, including the merits and risks involved. See "*Investment Considerations*" for a discussion of certain considerations to be taken into account in connection with an investment in the Notes.

Each person receiving this Offering Circular acknowledges that such person has not relied on the Managers or any person affiliated with the Managers in connection with its investigation of the accuracy of such information or its investment decision.

Unless otherwise specified or the context requires, references herein to "**Hong Kong dollars**", "**HK dollars**" and "**HK$**" are to the lawful currency of the Hong Kong Special Administrative Region of the People's Republic of China ("**Hong Kong**"), references herein to "**US dollars**" or "**US$**" are to the lawful currency of the United States of America, references herein to "**Renminbi**" or "**RMB**" are to the lawful currency of the People's Republic of China (the "**PRC**"), references to "**mainland China**" are to the PRC excluding Hong Kong, Macau and Taiwan, references to "**HKFRSs**" are to Hong Kong Financial Reporting Standards and references to "**IFRS**" are to International Financial Reporting Standards.

The Bank has prepared audited consolidated financial statements for the years ended 31 December 2003, 2004 and 2005 and unaudited consolidated interim financial statements for the six months ended 30 June 2005 and 2006 in accordance with HKFRSs. See "*Summary of Certain Effects of New and Revised HKFRSs*".

Unless otherwise specified, where financial information as at and for the six months ended 30 June 2006 has been translated into US dollars, it has been so translated, for information purposes only, at the rate of HK$7.7675 equal to US$1.00 (being the average of the buying and selling rates of the opening indicative counter exchange rate published by the Hong Kong Association of Banks as at 30 June 2006), and for financial information as at and for the year ended 31 December 2005, it has been so translated, for information purposes only, at the rate of HK$7.7551 equal to US$1.00 (being the average of the buying and selling rates of the opening indicative counter exchange rate published by the Hong Kong Association of Banks as at 31 December 2005). No representation is made that the Hong Kong dollar or US dollar amounts referred herein 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.

In this Offering Circular, where information has been presented in thousands or millions of units, amounts may have been rounded up or down. Accordingly, totals of columns or rows of numbers in tables may not be equal to the apparent total of the individual items and actual numbers may differ from those contained herein due to rounding. References to information in billions of units are to the equivalent of a thousand million units.

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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 considerations that should be made in connection with an investment in the Notes, see "Investment Considerations".

The Bank is a full service bank which operates primarily in Hong Kong. As at the date of this Offering Circular, the Bank had an established network comprising a head office and a total of 44 branches, including 41 branches in Hong Kong, three overseas branches located in Shantou, Macau and San Francisco, and two representative offices located in Guangzhou and Shanghai.

The Bank provides a wide range of corporate and retail banking services and other related financial services. Corporate and retail banking services provided by the Bank include lending and trade finance facilities, consumer financing, overdraft facilities, mandatory provident fund services, provision of fixed deposits, current and savings accounts, credit card services and personal wealth management services. Other related financial services offered by the Bank include remittance and money exchange, safe deposit boxes, auto pay and direct debit services. The Bank is also engaged in treasury activities, which include inter-bank placement and deposit transactions, the management of overall interest rate risk and liquidity of the Bank and centralised cash management as well as other business activities such as investment holding and property investment. The Bank also offers futures and securities trading and insurance services through certain of its wholly-owned subsidiaries.

Since its inception in 1948, the Bank has expanded steadily and believes that it has successfully established itself as a reliable and prudent bank in Hong Kong as well as the other jurisdictions in which it operates. Despite its relatively small size, the Bank enjoys long-standing relationships with many of its key customers and believes that it possesses a strong and stable deposit base. As at 30 June 2006, the Bank's total assets, shareholders' funds, advances to customers and customer deposits amounted to HK$54,927 million (US$7,071 million), HK$5,924 million (US$763 million), HK$25,448 million (US$3,276 million) and HK$47,728 million (US$6,145 million), respectively.

For the year ended 31 December 2005 and the six months ended 30 June 2006, the Bank recorded a net profit of HK$398 million (US$51 million) and HK$249 million (US$32 million), respectively. As at 30 June 2006, the Bank's capital adequacy ratio, loan-to-deposit ratio and average liquidity ratio were 14.79%, 47.98% and 55.39%, respectively. For the six months ended 30 June 2006, the Bank achieved a return on average assets of 0.95% and a return on average shareholders' funds of 8.47%. See "*Summary Financial and Other Information — Other Selected Financial Data*".

The Bank maintains correspondent banking relationships with approximately 300 foreign banks and provides services such as Hong Kong dollar clearing services for foreign banks that maintain Hong Kong dollar and/or US dollar accounts with the Bank, negotiation and advisory services in relation to letters of credit as well as trade enquiries, transfers and remittances.

The Bank has been listed on the HKSE since July 1994. As at 30 June 2006, the authorised share capital of the Bank was 600 million ordinary shares of HK$0.50 each, of which 435 million ordinary shares have been issued and are outstanding and fully paid. Based on the closing price of its shares on the HKSE on 16 November 2006, the Bank had a market capitalisation of approximately HK$7,178 million.

The Bank intends to change its name from "Liu Chong Hing Bank Limited" to "Chong Hing Bank Limited". Shareholders' approval for the proposed change of name was obtained at an extraordinary general meeting of shareholders held on 29 November 2006. It is expected that the change of name will take effect by the end of the year.

The Bank's long-term strategy is to continue to strengthen its foundation, enhance its overall competitiveness, expand its operations both locally and overseas and provide its customers with quality financial and banking products and services. The Bank has formulated a strategic plan for the years 2005 to 2009 governing the directions and strategies for the Bank's future business development and growth.

The major components of the strategic plan are as follows:

- increase the Bank's coverage geographically by strategically expanding its established branch network;
- expand the Bank's deposit base by introducing new deposit products and enhancing its services;
- improve and diversify the Bank's customer mix and income sources;
- prudently grow and actively enhance its credit portfolios through the offering of new products and services, targeted marketing and enhanced customer service; and
- continue to seek strategic investments in the form of jointly controlled entities.

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 "Terms and Conditions of the Notes".

The Issuer	Liu Chong Hing Bank Limited, a company incorporated with limited liability in Hong Kong.
The Notes	US$125,000,000 Floating Rate Subordinated Notes due 2016.
Issue Price	100 per cent.
Interest Payment Dates	The 16th day of March, June, September and December of each year (each an "**Interest Payment Date**"), save that the first payment of interest which will be made on 16 March 2007 will be in respect of the period from and including 15 December 2006 to, but excluding, 16 March 2007. If any Interest Payment Date would fall on a day which is not a Business Day in Hong Kong, London and New York City, that Interest Payment Date will be the next succeeding Business Day in Hong Kong, London and New York City unless that day falls in the next calendar month, in which case the Interest Payment Date will be the immediately preceding Business Day in Hong Kong, London and New York City.
Interest	The Notes will bear interest at the rate equal to 3-month USD LIBOR plus 0.93 per cent. per annum from and including 15 December 2006 to but excluding the Interest Payment Date falling in December 2011, payable quarterly in arrear on the Interest Payment Date falling in March, June, September and December of each year, commencing on the Interest Payment Date falling in March 2007; and thereafter at a rate per annum equal to 3-month USD LIBOR plus 1.93 per cent., payable quarterly in arrear on the Interest Payment Date falling in March, June, September and December of each year, commencing on the Interest Payment Date falling in March 2012.
Maturity Date	The Interest Payment Date falling on or about 16 December 2016.
Final Redemption	Unless previously redeemed or purchased and cancelled, the Notes will mature and become payable at their principal amount on the Maturity Date.
Redemption at the Option of the Issuer	The Notes are redeemable in whole but not in part at the option of the Issuer on the Interest Payment Date falling in December 2011 at their principal amount, upon obtaining the approval of the Hong Kong Monetary Authority ("**HKMA**"), and upon giving not less than 15 nor more than 60 days' notice to the Noteholders.
Use of Proceeds	The Notes will represent Tier II capital which will help strengthen the Bank's capital base for future growth. The proceeds from the issue of the Notes will be used for the general funding purposes of the Bank. See "*Use of Proceeds*".

Subordination	The Notes constitute direct, unsecured and subordinated obligations of the Issuer, ranking *pari passu* without any preference among themselves. The claims of the holders of the Notes will, in the event of the winding up of the Issuer, be subordinated in right of payment in the manner provided in the Trust Deed to the claims of depositors and all other unsubordinated creditors of the Issuer and will rank, in the event of the winding up of the Issuer, at least *pari passu* in right of payment with all other Subordinated Indebtedness, present and future, of the Issuer. Claims in respect of the Notes will rank in priority to the rights and claims of holders of subordinated liabilities which by their terms rank in right of payment junior to the Notes and all classes of equity securities of the Issuer, including holders of preference shares, if any.
Events of Default and Enforcement	If default is made in the payment of principal or interest due in respect of the Notes or any of them and the default continues for a period of five Business Days in Hong Kong (in the case of principal) or ten Business Days in Hong Kong (in the case of interest) (each such event, an "**Event of Default**"), then the Trustee at its discretion may, without further notice, institute proceedings for the winding up of the Issuer in Hong Kong, but may take no further action in respect of such default. If an order is made or an effective resolution is passed for the winding up, liquidation or dissolution of the Issuer in Hong Kong (except for the purposes of a reconstruction, amalgamation or reorganisation the terms of which have previously been approved by an Extraordinary Resolution of the Noteholders) (each event also, an "**Event of Default**"), then the Trustee at its discretion may give written notice to the Issuer that the Notes are, and they shall forthwith thereupon become, immediately due and repayable at their principal amount together with accrued interest as provided in the Trust Deed. The Trustee may, subject as provided below, at its discretion and without further notice, institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition or provision binding on the Issuer under the Notes or the Trust Deed (other than any obligation for the payment of any principal or interest in respect of the Notes), provided that the Issuer shall not as a consequence of such proceedings be obliged to pay any sum or sums representing or measured by reference to principal or interest in respect of the Notes sooner than the same would otherwise have been payable by it. The Trustee shall not be bound to take action upon any Event of Default or as referred to in the preceding paragraph unless (i) it shall have been so requested in writing by Noteholders holding at least one-quarter of the principal amount of the Notes then

	outstanding or if so directed by an Extraordinary Resolution of the Noteholders and (ii) it shall have been indemnified and/or secured to its satisfaction. 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.
Redemption for Taxation Reasons	Upon obtaining the approval of the HKMA and satisfying the Trustee immediately before the giving of the notice referred to below that (a) as a result of any change in, or amendment to, the laws or regulations in Hong Kong, or any change in the official interpretation of the laws or regulations in Hong Kong, which change or amendment becomes effective after 8 December 2006, on the occasion of the next payment due in respect of the Notes the Issuer would be required to pay additional amounts, and (b) the requirement cannot be avoided by the Issuer taking reasonable measures available to it, the Issuer may at its option, having given not less than 30 nor more than 60 days' notice to the Noteholders, redeem all the Notes, but not some only, on the next Interest Payment Date at their principal amount together with interest accrued to but excluding the date of redemption, provided that, prior to the Optional Redemption Date, no such notice of redemption shall be given earlier than 90 days before the earliest date on which the Issuer would be required to pay the additional amounts were a payment in respect of the Notes then due. See *"Terms and Conditions of the Notes — Redemption and Purchase — Redemption for Taxation Reasons"*.
Trustee	DB Trustees (Hong Kong) Limited
Trust Deed	The Notes will be constituted by a Trust Deed to be dated 15 December 2006 between the Issuer and the Trustee.
Form and Denomination	The Notes will be issued in registered form in denominations of US$100,000 each and integral multiples of US$1,000 in excess thereof. The Notes will initially be represented by the Global Certificate, in registered form, deposited on or about the Closing Date with, and registered in the name of a nominee of, a common depositary for Euroclear and Clearstream, Luxembourg. Beneficial interests in the Global Certificate will be shown on, and transfer thereof will be effected only through, the records maintained by Euroclear and Clearstream, Luxembourg and their respective accountholders. Except as described herein, definitive certificates of Notes will not be issued in exchange for beneficial interests in the Global Certificate. See *"The Global Certificate — Change of Registration of Title"*.

Payments	All payments of principal and interest by the Issuer will be made without withholding or deduction for, or on account of, any present or future taxes or duties of whatever nature imposed by or on behalf of Hong Kong or any political subdivision or taxing authority thereof or therein, unless the withholding or deduction of such taxes or duties is required by law. In that event, the Issuer will pay such additional amounts as may be necessary in order that the net amounts received by the holder of a Note, after such withholding or deduction, shall equal the respective amounts of principal or interest that would have been received in respect of such Note in the absence of such withholding or deduction, subject to certain exceptions.
Ratings	The Notes are rated "Baa3" by Moody's and "BBB" by Fitch. A rating is not a recommendation to buy, sell or hold Notes and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.
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 relating to subordination shall be governed by the laws of Hong Kong.
Listing	Application has been made to list the Notes as selectively marketed securities on the HKSE.

Summary Consolidated Financial and Other Information Relating to the Group

The following tables set forth the summary consolidated financial information relating to the Bank as at and for the years ended 31 December 2003, 2004 and 2005 and the six months ended 30 June 2005 and 2006, which have been extracted from and restated as appropriate, and should be read in conjunction with, the Bank's audited consolidated financial statements for the years ended 31 December 2003, 2004 and 2005 and the Bank's unaudited consolidated interim financial statements for the six months ended 30 June 2005 and 2006, respectively. The Bank has prepared and presented its audited consolidated financial statements for the years ended 31 December 2003, 2004 and 2005 in accordance with HKFRSs applicable, respectively, as at 31 December 2003, 2004 and 2005. Certain changes in HKFRSs which became effective on or from 1 January 2005 and 2006 have since been adopted by the Bank and such changes will have an impact on the financial statements of the Bank for the relevant future periods. The Bank's financial results for any past period are not and should not be taken as an indication of the Bank's performance, financial position and results of operations in future years.

CONSOLIDATED INCOME STATEMENTS

	Year ended 31 December			Six months ended 30 June	
	2003 (restated)	**2004 (restated)**	**2005**	**2005**	**2006**
	(HK$ thousands, except for earnings per share)			*(HK$ thousands, except for earnings per share)*	
Interest income	1,034,173	990,813	1,719,338	668,178	1,336,416
Interest expense	(363,995)	(341,316)	(966,486)	(313,501)	(895,020)
Net interest income	670,178	649.497	752,852	354,677	441,396
Fees and commission income	111,824	129,811	118,679	58,497	87,432
Fees and commission expense	(2,140)	(3,197)	(2,231)	(1,157)	(2,123)
Net gain on dealing in foreign currencies	34,269	27,562	27,737	12,118	9,322
Net gain on sale of trading securities	—	562	—	—	—
Net gain on financial assets at fair value through profit or loss	—	—	651	—	—
Dividend income	6,788	53,429	10,243	5,972	6,865
Insurance underwriting	—	—	5,671	—	7,457
Others	63,099	59,886	56,379	27,068	28,175
Other operating income	213,840	268,053	217,129	102,498	137,128
Operating income	884,018	917,550	969,981	457,175	578,524
Staff costs	(235,169)	(243,228)	(270,250)	(128,505)	(160,156)
Depreciation	(34,642)	(38,784)	(35,605)	(17,321)	(13,933)
Amortisation of prepaid lease payments on land	(5,068)	(5,063)	(5,063)	(5,499)	(2,567)
Other operating expenses	(182,399)	(170,139)	(182,211)	(87,030)	(101,967)
Operating expenses	(457,278)	(457,214)	(493,129)	(238,355)	(278,623)
Operating profit before impairment allowances/provision, fair value adjustments and disposal of long-term assets	426,740	460,336	476,852	218,820	299,901
Charge for bad and doubtful debts/ impairment allowances	(62,803)	(51,175)	(67,807)	(13,769)	(38,289)
Net gain(loss) on disposal of property and equipment	(2,403)	4,912	1,150	(800)	36
Net gain on disposal of available-for-sale securities	—	—	47,534	22,353	27,947
Net gain on disposal of other securities and an associate	22,192	3,863	—	—	—
Net gain on fair value adjustment on investment properties	—	—	7,500	—	—
Net loss on liquidation of a subsidiary	—	—	(4)	—	—
Provision for impairment loss in respect of other securities	(7,809)	—	—	—	—
Profit from operations	375,917	417,936	465,225	226,604	289,595
Share of results of jointly controlled entities	(2,000)	11,319	3,576	568	6,391
Profit before taxation	373,917	429,255	468,801	227,172	295,986
Taxation	(57,691)	(69,398)	(70,818)	(35,183)	(47,145)
Profit for the year/period	316,226	359,857	397,983	191,989	248,841
Dividends	217,500	247,950	261,000	78,300	82,650
Earnings per share, basic and diluted (HK$)	0.73	0.83	0.91	0.44	0.57

CONSOLIDATED BALANCE SHEETS

	As at 31 December			As at 30 June	
	2003 (restated)	2004 (restated)	2005	2005 (restated)	2006
		(HK$ thousands)		(HK$ thousands)	
ASSETS					
Cash and short-term funds	12,001,888	13,606,947	11,798,479	12,041,176	9,638,463
Placements with banks and other financial institutions maturing between one and twelve months	1,243,771	1,544,695	2,029,416	2,325,839	4,210,999
Trading securities	220,969	234,663	—	—	—
Financial assets at fair value through profit or loss	—	—	854,767	971,534	533,590
Available-for-sale securities	—	—	801,769	640,119	915,862
Held-to-maturity securities	3,104,561	3,388,300	9,192,906	6,194,051	13,001,827
Other securities	319,947	377,847	—	—	—
Certificates of deposit held	1,292,407	1,309,515	—	—	—
Advances and other accounts	20,081,543	20,246,034	24,508,061	22,207,914	25,761,648
Interest in an associate	396,448	—	—	—	—
Interests in jointly controlled entities	27,108	37,875	65,710	62,702	72,101
Loans to jointly controlled entities	39,130	31,000	31,000	31,000	31,000
Investment properties	47,868	69,360	76,860	69,360	76,860
Property and equipment	167,246	190,005	196,760	187,012	271,605
Prepaid lease payments for land	311,619	306,039	300,969	300,534	299,412
Deferred tax assets	24,923	18,951	6,449	5,750	2,786
Goodwill	—	—	110,606	110,606	110,606
Total assets	39,279,428	41,361,231	49,973,752	45,147,597	54,926,759
LIABILITIES					
Deposits and balances of banks and other financial institutions	1,035,392	1,559,633	2,263,504	1,194,556	736,177
Deposits from customers	32,591,590	33,951,631	41,506,292	37,717,697	47,727,764
Other accounts and accruals	271,327	279,129	340,496	537,745	478,461
Current tax liabilities	13,114	11,187	30,324	29,894	60,410
Total liabilities	33,911,423	35,801,580	44,140,616	39,479,892	49,002,812
SHAREHOLDERS' EQUITY					
Share capital	217,500	217,500	217,500	217,500	217,500
Reserves	5,150,505	5,342,151	5,615,636	5,450,205	5,706,447
Shareholders' funds	5,368,005	5,559,651	5,833,136	5,667,705	5,923,947
Total liabilities and shareholders' equity	39,279,428	41,361,231	49,973,752	45,147,597	54,926,759

OTHER SELECTED FINANCIAL DATA

	As at 31 December			As at 30 June	
	2003 (restated)	2004 (restated)	2005	2005 (restated)	2006
		(percentage)		(percentage)	
Loan-to-deposit ratio	52.80	51.36	51.83	51.42	47.98
Capital adequacy ratio	18.04	18.84	15.20	16.85	14.79
Average liquidity ratio (for the year/period)	52.37	52.34	49.13	48.73	55.39
Return on average assets	0.81	0.89	0.87	0.89(1)	0.95(1)
Return on average shareholders' funds	5.97	6.59	6.99	6.84(1)	8.47(1)
Cost efficiency ratio	51.73	49.83	50.84	52.14	48.16

Note:

(1) Figures as at 30 June 2005 and 2006 are annualised.

INVESTMENT CONSIDERATIONS

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 its 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.

Considerations Relating to the Group

Competition

The Bank is subject to increasing competition from many other Hong Kong incorporated banks and Hong Kong branches of international banks as the Bank's main market for retail and corporate advances is Hong Kong. In addition, the banking industry in Hong Kong is a mature market, with approximately 132 licensed banks, both international and local, competing for a population of approximately 7 million people. There is a limited market, especially for retail banking products such as home mortgage advances, credit cards and personal loans. The HKMA also indicated in its 2005 annual report that continuous competition and pressure on costs are likely to make the operating environment challenging. 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.

Since 2000, certain banks in Hong Kong, including the Group, lowered interest rates charged on new home mortgage loans ("**Mortgage Interest Rates**"). As at 30 June 2006, the Bank charged an average of 2.15% below the Best Lending Rate ("**BLR**") on its home mortgage loans portfolio excluding the Government Home Ownership Scheme ("**GHOS**") mortgage and staff loans, before accounting for the effect of cash incentive payments. Although the downward pressure on the interest rate charged on the Bank's mortgage portfolio has eased, given the size of the Bank's mortgage business, there can be no assurance that competition among banks in Hong Kong for home mortgage advances would not result in further reductions in Mortgage Interest Rates. Further reductions in Mortgage Interest Rates could have an adverse effect on the Group's business, financial condition or results of operations.

Following the PRC's accession to the World Trade Organization ("**WTO**"), certain foreign banks have received authorisation from the PRC government to provide Renminbi-denominated banking and financial services ("**Renminbi services**") to state-owned enterprises two years after the PRC has joined the WTO, and to individuals five years after the accession. The Bank is in preparation of applying for a licence in relation to the provision of Renminbi services. The Bank is likely to face competition from both existing local Chinese banks and other foreign banks entering the mainland China market. There can be no assurance that the Bank will maintain its current position or expand successfully in mainland China if, as expected, competition in the banking sector in mainland China intensifies following the PRC's accession to the WTO.

Advance Concentration; Exposure to the Hong Kong Property Market

The Bank has significant exposure to the Hong Kong property market due to its portfolio of home mortgage advances. As at 30 June 2006, home mortgage advances (excluding GHOS mortgages), and advances for property development and investment in Hong Kong accounted for 13.5% and 28.7%, respectively, of the Bank's total advances to customers. The Hong Kong property market is highly cyclical and property prices in general have been volatile. Property prices in Hong Kong 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, the interest rate environment, political and economic developments in mainland China, and the relationship between mainland China, Hong Kong and other countries. From the latter half of 1997, property prices in Hong Kong experienced a significant decline, and transaction volumes in the Hong Kong property market also generally declined. However, property prices in Hong Kong have risen significantly since the end of 2003 as the property market recovery gathered momentum. There can be no assurance that the recent increase in property values and/or liquidity of the Hong Kong property market will continue. If the property market slows down, the Bank's business, financial condition and results of operations may be adversely affected.

Quality of the Bank's Credit Portfolio

Any lending activity is exposed to credit risk arising from the risk of default by borrowers. The sustainability of the Bank's growth depends largely on its ability to effectively manage its credit risk and maintain the quality of its loan quality. A number of factors will affect the Bank's ability to control and reduce non-performing and restructured loans. Some of these, including developments in the Hong Kong economy, movements in the global economy, global competition, interest rates and exchange rates, are not within the Bank's control.

Although the Bank has in place credit risk management policies, procedures and systems and the Bank is constantly focusing its efforts on tightening its credit appraisal systems, credit risk monitoring and management systems and improving collections on existing non-performing assets, there can be no assurance that such growth will continue, that the Bank will continue to be successful in its efforts to reduce its level of non-performing assets, that the overall quality of its loan portfolio will not deteriorate in the future or that the business of the Bank's borrowers will grow in line with the economy. If the Bank is not able to control and reduce its non-performing loans, or if there is a further significant increase in its restructured loans, the Group's business, future financial performance and the price of the Notes could be adversely affected.

The Bank's net non-performing assets on a consolidated basis as at 30 June 2006 were HK$536 million (US$69 million), which represented 2.1 per cent. of the Bank's total loan portfolio, and out of which approximately HK$388 million (approximately US$50 million) is attributed to two non-performing loans granted prior to 2003 to two separate groups of customers for funding purposes in respect of property developments in the PRC. Each of these two loans is secured by the underlying property projects. Based on the latest valuations of the mortgaged properties conducted in the last three months, each of these loans is fully secured. The Bank is in discussions with the lenders as to a suitable repayment method for these loans, including potentially a sale of the mortgaged properties. However, there is no assurance that any of these lenders will be able to find suitable buyers for these mortgaged property or sell the mortgaged properties at prices acceptable to the Bank or at all, or that the Bank will ultimately recover the full amount of the non-performing loans.

There is also no assurance that there will be no deterioration in provisions for loan losses as a percentage of non-performing assets or otherwise, that the percentage of non-performing assets that the Bank will be able to recover will be similar to the Bank's past experience of recoveries of non-performing assets or that upon enforcement, the value of any collateral or guarantee securing the Bank's advances will be sufficient. In the event of any deterioration in the Bank's asset portfolio, there could be an adverse impact on the Group's business, future financial performance, shareholders' funds and the price of the Notes.

In addition, the Bank may decide to restructure certain of its non-performing loans. In such restructuring, the Bank usually agrees to set payments of principal and/or interest at a relatively low level for a certain time frame followed by larger payments in later periods to match the Bank's expectation of the borrowers' ability to service the debt. The relatively low payments improve the likelihood that a restructured loan will be categorised as performing during the period of such payments. However, future higher payments may cause the loan to again become non-performing if the borrower is unable to make such larger payments in the later periods. If a significant number of the Bank's customers are unable to make larger payments for their respective restructured loans, such restructured loans may become non-performing, thereby requiring additional provisions and could have a material adverse effect on the Bank's ability to make payments under the Notes.

Classification of Advances; Adequacy of Allowance for Advance Losses

In accordance with guidelines set by the HKMA, the Bank divides its classified advances into one of the following three categories corresponding to levels of risk: "Sub-standard", "Doubtful" and "Loss". See "*Selected Statistical and Other Information*". The classification of advances into one of these categories depends on various quantitative and qualitative factors, including the number of months payment is in arrears, the type of advance, the tenor of the advance and the level of collateral coverage. In accordance with HKAS 39, advances are designated as "impaired" when there is objective evidence of impairment as a result of one or more of the loss events that will impact the estimated future cash flows of the loans. Interest will continue to accrue on impaired advances based on the original terms of the loans but will be discounted to arrive at the net present value of the impaired loans. See *"Selected Statistical and Other Information — Asset Quality — Recognition of impaired loans"*.

The laws, regulations and guidelines governing the banking industry in Hong Kong differ from those applicable in certain other countries in certain respects and may result in particular advances 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. While the Bank believes that its credit policies are more prudent than those that 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; Deposit Insurance

Most of the Bank's funding requirements are met through customer deposits, including savings, current, short-term and structured term deposits and, to a much smaller extent, interbank deposits. As at 30 June 2006, 99.8% of the Bank's total customer deposits had remaining maturities of one year or less or were payable on demand. Accordingly, the maturity profile of the Bank's assets and liabilities shows a negative gap in the short term. The negative gap has arisen mainly because the Bank's deposits, which are met through short-term funding sources (primarily in the form of deposits) and other liabilities, are of shorter average maturity than its loans and investments, which have medium-or long-term maturities, thereby creating a potential for funding mismatches. Historically, savings, current and a substantial portion of term deposits which used to roll over upon maturity have been 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 Bank's liquidity position would be adversely affected and the Bank may need to seek alternative sources of short-term or long-term funding to finance its operations, which may be more expensive than existing 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 in the Group.

Deposit insurance is being introduced in Hong Kong. Following the enactment of the Deposit Protection Scheme Ordinance (Cap. 581 of the Laws of Hong Kong) (the "**DPS Ordinance**") in 2004, the Hong Kong Deposit Protection Board (the "**Board**") was formed in July 2004 to oversee the project for establishing the Deposit Protection Scheme (the "**Scheme**"). With the assistance of the HKMA, the Board has developed a detailed project plan to implement the Scheme. Work on the preparatory tasks including the development of a payout system and the specification of a set of rules governing the operation of the Scheme also began in the same year. A Consultative Committee on the Scheme was formed in November 2004 to facilitate the exchange of views between the Board and the banking industry. The HKMA issued a circular in February 2005 requesting all scheme members to complete an annual return for the assessment of contributions under the Scheme. The implementation of the Scheme will likely increase the costs of funding of banks in Hong Kong but its overall impact on the Group's financial results would not be significant.

Implementation of the Bank's Business

Due to the maturity of the Hong Kong banking sector, increasing competition and downward market pressure on profit margins, the Bank intends to expand its range of products and services to diversify its business portfolio in order to maintain its competitive edge. In particular, the Bank intends to target the younger age demographic in its development of new products and services. Expansion of the Bank's business activities exposes the Bank to certain risks and challenges, including the following:

- the Bank may not have sufficient experience or expertise in certain new products and services and may not be compete effectively in these areas;
- the Bank's new products and services may not be accepted by its customers or meet the Bank's expectations for profitability;
- the Bank may need to hire additional qualified personnel which may not be available;
- the Bank may fail to obtain regulatory approval for its new products or services where necessary; and
- the Bank may not be successful in enhancing its risk management capabilities and information technology systems to support a broader range of products and services.

If the Bank is not able to achieve the intended results with respect to the expansion of its business activities, the Group's business, financial condition and results of operations may be adversely affected.

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, the PRC, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand. In addition, the Hong Kong Government has in the past expressed its commitment to maintaining exchange rate stability under the Linked Exchange Rate System, an automatic interest rate adjustment mechanism. However, there can be no assurance 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 revaluation of the Hong Kong dollar.

Exposure to the PRC market

As at the date of this Offering Circular, the Bank had three overseas branches located in Shantou, Macau and San Francisco, and two representative offices located in Guangzhou and Shanghai. As at 30 June 2006, the Bank's loan portfolio in mainland China amounted to approximately HK$307 million (US$40 million), which accounted for 1.2% of the Bank's overall loan portfolio. Currently, the Bank's exposure to the PRC market is limited. However, the Bank has targeted mainland China as a potential market for future development and may decide to expand its business or branch network in mainland China in the future. In addition, the Bank's banking activities in mainland China are conducted mainly with its existing customers based in Hong Kong who are engaged in business in mainland China and the Bank may increase such banking activities to cater to the needs of its customers as they increase the size and scope of their business operations in mainland China. There is no assurance that the Bank's exposure to the PRC market, including the general economic and business conditions, the banking industry, the political and social environment and the legal system of mainland China, will not increase in the future.

Different Corporate Disclosure, Accounting and Regulatory Requirements

The Bank's issued shares are listed on the Hong Kong Stock Exchange and, as such, the Bank is required to publish annual audited and semi-annual unaudited financial information. 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, the Bank prepares its financial statements in accordance with HKFRSs, which are in all material aspects fully converged with IFRS effective for accounting periods beginning on or after January 2005. Thus, the accounting presentation of historical reported earnings of the Bank for accounting periods before 1 January 2005 may differ from those of companies in certain other countries. Certain changes in HKFRSs, which became effective on or from 1 January 2006, have since been adopted by the Bank. See "*Summary of Certain Effects of New and Revised HKFRSs*". This Offering Circular does not include a reconciliation of the Bank's historical financial statements to IFRS and, as applicable, HKFRSs, and there can be no assurance that any such reconciliation would not identify material qualitative or quantitative differences.

Under the Hong Kong Banking Ordinance (Cap. 155 of the Laws of Hong Kong) (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 that which prevails in other countries. See "*Regulation and Supervision*". Since 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. In particular, the HKMA has announced that it intends to adopt the Basel II Accord capital adequacy standards in Hong Kong in the beginning of 2007. It is still uncertain whether the more risk-sensitive capital requirements of Basel II, including in particular the requirement to maintain capital for operational risks, will require the Group to maintain more capital. These changes may result in the incurrence of substantial compliance and monitoring costs and there can be 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.

Change in Accounting Standards

The Bank's financial statements for the year ended 31 December 2005 have been prepared in accordance with all applicable Hong Kong Accounting Standards issued by the Hong Kong Institute of Certified Public Accountants ("**HKICPA**") and accounting principles generally accepted in Hong Kong. The HKICPA has issued a number of new and revised HKFRSs, which are effective for accounting periods beginning on or after 1 January 2006. The effect of the changes brought about by the new HKFRSs are disclosed in Note 2 to the interim financial statements of the Bank for the six months ended 30 June 2006.

Internet Banking Services

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 internet banking 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

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

The Ability of Shareholders and Related Parties to Exercise Influence over Certain of the Bank's Affairs

As at 30 June 2006, Liu Chong Hing Estate Company, Limited ("**Liu Chong Hing Estate**") was the Bank's largest shareholder, holding a 45.78% shareholding interest. In addition, pursuant to an agreement dated 20 May 1994, The Bank of Tokyo-Mitsubishi, UFJ Ltd has granted an option to Liu Chong Hing Estate, which is exercisable at any time during the term of that agreement to purchase 40 million shares of the Bank from The Bank of Tokyo-Mitsubishi, UFJ Ltd in certain circumstances. Liu Chong Hing Estate is a wholly-owned subsidiary of Liu Chong Hing Investment Limited, a public company listed on the HKSE which is, in turn, approximately 45.33% owned by Liu's Holdings Limited. Liu's Holdings Limited is wholly-owned by members of the Liu family, including Messrs. Liu Lit Man, Liu Lit Mo and Liu Lit Chi who are Directors of the Bank. Five out of the nine Executive Directors, together with two out of the seven Non-executive Directors, on the Bank's Board of Directors, also comprise members of the Liu family and five of these individuals also hold shareholding interests in the Bank. See "*Principal Shareholders and Directors' Interests*". Members of the Liu family also serve on the board of directors of Liu Chong Hing Investment Limited. Accordingly, the Liu family has the ability to exert significant influence over the Bank's affairs subject to the HKSE listing rules and the laws of Hong Kong.

The Bank has, from time to time, entered into a number of transactions with members of the Liu family or companies controlled or significantly influenced by them. The transactions include, among others, lending, deposit-taking, loan syndications, provision of cheque clearing services, stockbroking and nominee services, remittances and foreign exchange services, acceptance of property consultancy and property management services, and leasing of office premises. The Bank conducts all transactions with its related parties, including but not limited to members of the Liu family, on an arm's length basis and believes that such transactions were as favourable to it as similar transactions with unrelated third parties would have been. In addition, the Bank has three directors who are independent directors in accordance with the criteria set out in the listing rules of the HKSE and maintains internal policies and procedures to prevent possible conflicts of interest. However, the interests of the Liu family may differ significantly from the interests of the Bank and the Bank's other shareholders and creditors, including the holders of the Notes, and there can be no assurances that the Liu family will exercise influence over the Bank in a manner that is in the best interests of the Bank and the Bank's other shareholders and creditors.

Further Issuance of Securities

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 Bank 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.

Considerations Relating to Hong Kong and Mainland China

Hong Kong Economy

On 1 July 1997, Hong Kong ceased to be a Crown Colony of the United Kingdom and became a Special Administrative Region of the PRC. 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 PRC sovereignty over Hong Kong or that, 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 the PRC and throughout Asia. The global economy has seen marked growth in the last three years. This has in part helped fuel the economic recovery in Hong Kong since the second half of 2003. However there can be no assurance that such economic recovery in Hong Kong will continue. If economic growth slows down in Hong Kong (whether as a result of a global economic slow down or otherwise), the Group's business, financial condition or results of operations may be adversely affected.

Mainland China Economy

Many of the Bank's commercial customers are dependent on varying degrees on trade with mainland China. The value of the Bank's advances in mainland China, as well as its advances to companies that have business interests in mainland China, may be influenced by the general state of the PRC 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, exchange controls and the exchange rate and the impact on the economy of the PRC's accession to the WTO). There can be no assurance that the economic and political environment in mainland China will remain favourable to the Bank's business in mainland China in the future irrespective of the likelihood of whether the PRC Government would reverse its open-door economic policy which has been adopted for more than two decades and which contributed to the country's economic well being over the years.

Global Economy

There has been strong growth in the global economy in the last three years. This has in part helped fuel the economic recovery in Hong Kong since the second half of 2003. However there can be no assurance that such economic recovery in Hong Kong will continue. If economic growth slows down in Hong Kong (whether as a result of a global economic slow down or otherwise), there could be a material adverse effect on the Group's retail and corporate customers. Declining customer demand for the Group's products and services would lead to excess capacity in the Group's operations, which could have a material adverse impact on the Group's business, financial condition and results of operations.

Recurrence of SARS, Avian Influenza or Other Highly Contagious Diseases in Asia and Elsewhere

In 2003, there was an outbreak of Severe Acute Respiratory Syndrome ("**SARS**") in the PRC, Singapore, Hong Kong, other Asian Countries and Canada. The SARS outbreak had a significant adverse impact on the economies of the affected countries. Since the latter half of 2005, there have been media reports regarding the spread of the H5N1 virus or "Avian Influenza A" among birds, poultry and in some isolated cases, transmission of Avian Influenza virus from animals to human beings. There can be no assurance that there will not be another significant global outbreak of a highly contagious disease. If such an outbreak were to occur, it may have a material adverse impact on the Group's results of operations.

Considerations Relating to the Notes

Subordination of the Notes

The Notes will constitute direct, unsecured and subordinated obligations of the Bank, ranking pari passu without any preference among themselves. In the event of a winding-up of the Bank, the claims of the holders of the Notes will be subordinated in right of payment to the claims of all unsubordinated creditors of the Bank, and will rank *pari passu* in right of payment with all other subordinated indebtedness present and future of the Bank, except that claims in respect of the Notes will rank in priority to the rights and claims of holders of subordinated liabilities which by their terms rank in right of payment junior to the Notes and all classes of equity securities of the issuer, including holders of preference shares, if any. See "*Terms and Conditions of the Notes — Status*".

As a consequence of these subordination provisions, in the event of a liquidation, winding-up or other similar proceeding of the Bank (each, a "**Winding-up Proceeding**"), the holders of the Notes may recover less rateably than the holders of deposit liabilities and/or the holders of other unsubordinated liabilities of the Bank. The rights of the holders of the Notes will also be effectively subordinated to the rights of holders of all liabilities, including deposit liabilities, of the Bank's subsidiaries. The Notes and the Trust Deed do not limit the amount of the liabilities ranking senior to the Notes that may be hereafter incurred or assumed by the Bank.

It is intended that the Notes should constitute Category II Supplementary Capital of the Bank and, accordingly, under statutory requirements prevailing at the date of this Offering Circular relating to Category II Supplementary Capital, and by virtue of the above provisions, any redemption of such Notes prior to the stated maturity is subject to the prior approval of the HKMA at the relevant time.

Certain Considerations 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, the Trustee and such holders of the Notes might not be entitled in such proceedings to a recovery in U.S. dollars and might be entitled only to a recovery in Hong Kong dollars.

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

Credit Ratings of the Notes

The Notes have been rated "Baa3" by Moody's and "BBB" by Fitch. These ratings reflect the Bank's ability to make timely payments of principal and interest on the Notes. A rating is not a recommendation to buy, sell or hold any security, does not address the likelihood or timing of payment of the Notes and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation. There is no assurance that the ratings assigned to the Notes will remain in effect for any given period or that the ratings will not be revised by the assigning rating organisation in the future if, in its judgment, circumstances so warrant. A downgrade in ratings may affect the market price of the Notes.

Liquidity of the Notes

There can be no assurance as to the liquidity of the Notes or that an active trading market will develop. If such a market were to develop, the Notes could trade at prices that may be higher or lower than the initial issue price depending on many factors, including prevailing interest rates, the Bank's operations and the market for similar securities. The Managers are not obliged to make a market in the Notes and any such market-making, if commenced, may be discontinued at any time at the sole discretion of the Managers, acting together. No assurance can be given as to the liquidity of, or trading market for, the Notes upon their listing on the HKSE.

USE OF PROCEEDS

The Notes will represent Tier II capital which will help strengthen the Bank's capital base for future growth. The net proceeds from the issue of the Notes will be approximately US$124,300,000, after deducting the commissions and expenses incurred in connection with the issue of the Notes, and will be used for the general funding purposes of the Bank.

CAPITALISATION AND INDEBTEDNESS

Capitalisation and Indebtedness of the Group

As at the date of this Offering Circular, the Bank had an authorised share capital of HK$300,000,000 consisting of 600,000,000 ordinary shares of HK$0.50 each, and issued and fully paid up share capital of HK$217,500,000 consisting of 435,000,000 ordinary shares of HK$0.50 each.

The following table sets forth the Bank's consolidated capitalisation and indebtedness as at 30 June 2006 and as adjusted for the issue of the Notes.

	As at 30 June 2006	
	Actual	**As adjusted**
	(HK$ thousands)	
Short-term borrowings		
Deposits from customers	47,630,372	47,630,372
Cash and balances with banks and other financial institutions	736,177	736,177
Total short-term borrowings	48,366,549	48,366,549
Medium-term borrowings		
Deposits from customers	97,392	97,392
Cash and balances with banks and other financial institutions	—	—
Total medium-term borrowings	97,392	97,392
Long-term borrowings		
Deposits from customers	—	—
Cash and balances with banks and other financial institutions	—	—
Notes to be issued	—	970,938
Total long-term borrowings	—	970,938
Capital resources		
Share capital	217,500	217,500
Reserves	5,706,447	5,706,447
Total capital resources	5,923,947	5,923,947
Total capitalisation	54,387,888	55,358,826

There has been no material change in the Bank's total consolidated capitalisation or indebtedness since 30 June 2006.

BUSINESS OF THE BANK

Introduction

The Bank is a full service bank which operates primarily in Hong Kong. As at the date of this Offering Circular, the Bank had an established network comprising a head office and a total of 44 branches, including 41 branches in Hong Kong, three overseas branches located in Shantou, Macau and San Francisco, and two representative offices located in Guangzhou and Shanghai.

The Bank provides a wide range of corporate and retail banking services and other related financial services. Corporate and retail banking services provided by the Bank include lending and trade finance facilities, consumer financing, overdraft facilities, mandatory provident fund services, provision of fixed deposits, current and savings accounts, credit card services and personal wealth management services. Other related financial services offered by the Bank include remittance and money exchange, safe deposit boxes, auto pay and direct debit services. The Bank is also engaged in treasury activities, which include inter-bank placement and deposit transactions, the management of overall interest rate risk and liquidity of the Bank and centralised cash management as well as other business activities such as investment holding and property investment. The Bank also offers futures and securities trading and insurance services through certain of its wholly-owned subsidiaries.

Since its inception in 1948, the Bank has expanded steadily and believes that it has successfully established itself as a reliable and prudent bank in Hong Kong as well as the other jurisdictions in which it operates. Despite its relatively small size, the Bank enjoys long-standing relationships with many of its key customers and believes that it possesses a strong and stable deposit base. As at 30 June 2006, the Bank's total assets, shareholders' funds, advances to customers and customer deposits amounted to HK$54,927 million (US$7,071 million), HK$5,924 million (US$763 million), HK$25,448 million (US$3,276 million) and HK$47,728 million (US$6,145 million), respectively.

For the year ended 31 December 2005 and the six months ended 30 June 2006, the Bank recorded a net profit of HK$398 million (US$51 million) and HK$249 million (US$32 million), respectively. As at 30 June 2006, the Bank's capital adequacy ratio, loan-to-deposit ratio and average liquidity ratio were 14.79%, 47.98% and 55.39%, respectively. For the six months ended 30 June 2006, the Bank achieved a return on average assets of 0.95% and a return on average shareholders' funds of 8.47%. See "*Summary Financial and Other Information — Other Selected Financial Data*".

The Bank maintains correspondent banking relationships with approximately 300 foreign banks and provides services such as Hong Kong dollar clearing services for foreign banks that maintain Hong Kong dollar and/or US dollar accounts with the Bank, negotiation and advisory services in relation to letters of credit as well as trade enquiries, transfers and remittances.

The Bank has been listed on the HKSE since July 1994. As at 30 June 2006, the authorised share capital of the Bank was 600 million ordinary shares of HK$0.50 each, of which 435 million ordinary shares have been issued and are outstanding and fully paid. Based on the closing price of its shares on the HKSE on 16 November 2006, the Bank had a market capitalisation of approximately HK$7,178 million.

The Bank intends to change its name from "Liu Chong Hing Bank Limited" to "Chong Hing Bank Limited". Shareholders' approval for the proposed change of name was obtained at an extraordinary general meeting of shareholders held on 29 November 2006. It is expected that the change of name will take effect by the end of the year.

History

The Bank was founded in 1948 in Hong Kong under the name "Liu Chong Hing Savings Bank" with the objectives of promoting savings, assisting industry and commerce and providing banking services to the public. In 1955, it was granted a banking licence by the HKMA and in the same year, it was formally incorporated under its present name, Liu Chong Hing Bank Limited.

In 1973, The Bank of Tokyo-Mitsubishi UFJ, Ltd (formerly known as "The Mitsubishi Bank, Limited" and "The Bank of Tokyo-Mitsubishi, Ltd") acquired a 25% interest in the Bank. Through this affiliation, the Bank enjoyed an increase in Japanese and correspondent banking services. In the same year, Liu Chong Hing Investment Limited acquired a majority interest of 57.67%, through its wholly-owned subsidiary, Liu Chong Hing Estate, in the Bank. Liu Chong Hing Investment Limited is a public company which has been listed on the HKSE since 1972 and is principally engaged in property development, investment and insurance activities. As at 30 June 2006, it held a 45.78% indirect interest in the Bank.

In 1975, the Bank introduced online computerised services for all of its deposit accounts, which were subsequently upgraded in 1980 and 1987. The Bank believes that it is one of the first locally incorporated banks to provide such services.

In 1977, the Bank established a depositary agency in San Francisco to provide services to its existing customers who were engaged in business in San Francisco as well as to foster the Bank's trade finance business between Hong Kong and the United States. In September 1995, the Bank was granted a full wholesale banking branch licence in the United States, which allowed it to accept deposits from US residents, subject to certain conditions.

In June 1982, the Bank introduced through-the-wall automated teller machines ("**ATMs**") to its operations and in January 1986, the Bank's ATM network was linked to the Joint Electronic Teller Services Limited ("**JETCO**") network comprising a central data processing system connected to ATMs belonging to 44 banks in Hong Kong, which enabled the Bank to use ATM machines of other banks in the system. In October 1984, the Bank became a founding member of the Easy Pay System, an electronic retail point of sale payment system.

As part of its continuing drive to capitalise on opportunities created by the further liberalisation of the financial markets in mainland China and the increased business activity between the PRC and Hong Kong, the Bank set up a representative office in Shanghai in 1988. In April 1993, the Bank established a full service foreign bank branch in Shantou in the Guangdong province of the PRC.

In October 1993, the Bank introduced fully automated telephone banking services for its retail customers.

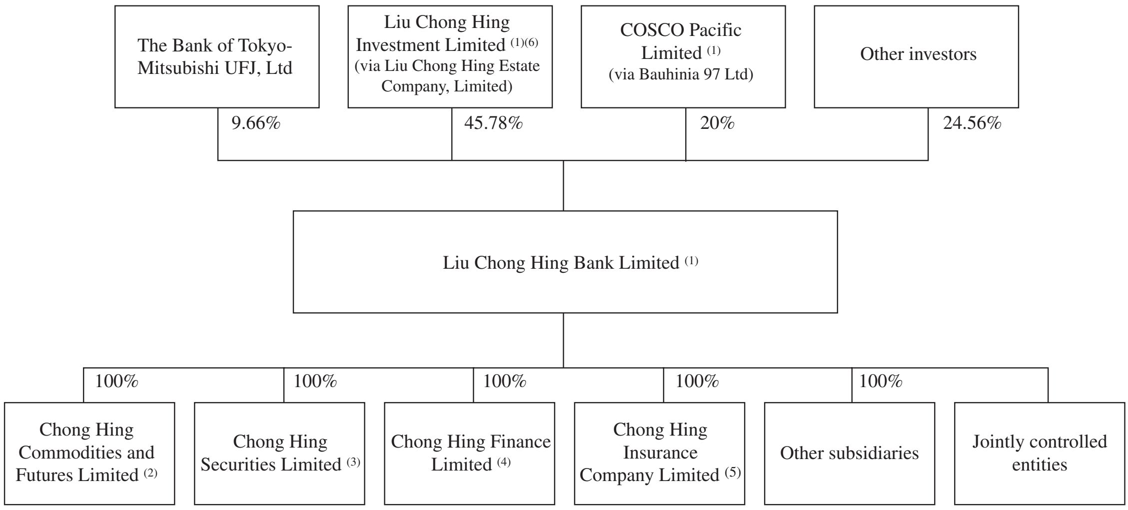
In 1994, Liu Chong Hing Estate and The Bank of Tokyo-Mitsubishi UFJ, Ltd entered into a shareholders' agreement, which enabled the Bank to gain access to updated technology, expertise in international banking, management know-how, market development and a firm foundation for future growth, through mutual co-operation with and support from The Bank of Tokyo-Mitsubishi UFJ, Ltd. On 11 July 1994, the Bank was publicly listed on The Stock Exchange of Hong Kong Limited. Its listed shares were selected to be a constituent stock of the Hang Seng MidCap 50 Index in 1996 and, subsequently, a constituent stock of the Hang Seng Composite Index.

In 1997, the Bank established a branch in Macau.

In 1999, the Bank formed the Bank Consortium Holding Limited (the "**Bank Consortium**") with nine other local banks in Hong Kong with the objective of providing quality Mandatory Provident Fund ("**MPF**") services (with both the Master Trust Scheme and the Industry Scheme) through the Bank Consortium Trust Company Limited, a wholly-owned subsidiary of the Bank Consortium. In the same year, the Bank established a representative office in Guangzhou, PRC.

Corporate Structure

The chart below illustrates the corporate structure of the Bank:



(1) Listed on the HKSE.

(2) Registered with The Hong Kong Futures Exchange Limited as a participant.

(3) Registered with The Stock Exchange of Hong Kong Limited as a participant.

(4) Licensed under the Banking Ordinance (Cap. 155 of the Laws of Hong Kong) as a deposit-taking institution.

(5) Licensed under the Insurance Companies Ordinance (Cap. 41 of the Laws of Hong Kong) as an insurance company.

(6) Liu Chong Hing Investment Limited is approximately 45.33% owned by Liu's Holdings Limited, which is, in turn, owned by members of the Liu family.

The Bank is the holding company and the principal operating company of the Group. Through its shareholding relationships and mutual co-operation with Liu Chong Hing Investment Limited, COSCO Pacific Limited and The Bank of Tokyo-Mitsubishi UFJ, Ltd, the Bank benefits from cross-referrals, both locally and internationally, business promotion and market development of financial products and services as well as access to management know-how and updated technology.

The Bank's key subsidiaries are Chong Hing Commodities and Futures Limited, Chong Hing Securities Limited, Chong Hing Finance Limited and Chong Hing Insurance Company Limited. The Bank offers futures and securities trading and insurance services through its wholly-owned subsidiaries, Chong Hing Commodities and Futures Limited, Chong Hing Securities Limited and Chong Hing Insurance Company Limited whereas Chong Hing Finance Limited is principally engaged in deposit-taking and specialised lending activities such as equipment leasing. In addition, the Bank has a number of other wholly-owned subsidiaries whose business activities include property investment and management, credit card management, general merchant banking, and the provision of nominee services and electronic data processing services.

The Bank also holds strategic investments in a number of jointly controlled entities which include the Bank Consortium, BC Reinsurance Limited and Hong Kong Life Insurance Limited. The Bank Consortium, a 13.3% jointly controlled entity, offers a wide range of services for retirement schemes, which facilitates the Bank to offer MPF services. BC Reinsurance Limited and Hong Kong Life Insurance Limited, a 21.0% and 16.7% jointly controlled entity, respectively, offer reinsurance and life insurance underwriting services, which enhance the insurance services offered by the Bank. Net Alliance Co, Limited, a 17.6% jointly controlled entity, provides a wide range of internet services. The Bank intends to seek more suitable strategic investments in the future so as to provide better financial products and services to the public.

Strategy

The Bank's long-term strategy is to continue to strengthen its foundation, enhance its overall competitiveness, expand its operations both locally and overseas and provide its customers with quality financial and banking products and services. The Bank has formulated a strategic plan for the years 2005 to 2009 governing the direction and strategies for the Bank's future business development and growth.

The major components of the strategic plan are as follows:

Increase the Bank's coverage geographically by strategically expanding its established branch network

The Bank currently operates a network of a head office and 41 branches in Hong Kong, five of which were opened in the first nine months of 2006. The Bank plans to widen its customer coverage by increasing the number of branches in Hong Kong up to 50 by 2009. The Bank expects to establish these branches in strategic locations across Hong Kong where the Bank currently does not have presence so as to tap into new customer bases. In particular, the Bank intends to focus on its coverage of housing estates located mainly in the New Territories where there are a higher proportion of younger residents so as to diversify its customer base demographically. In addition, the Bank believes that it is able to operate on a cost-effective basis in such housing estates where the target customer base is much larger. To minimise the capital requirements for bank premises for these new branches, the Bank plans to establish the new branches mainly under long-term operating leases. The Bank also plans to expand its existing ATM branch network by setting up more ATMs in various locations of Hong Kong. The Bank currently operates a network of 41 ATMs, each of which is situated at its branches in Hong Kong.

Expand the Bank's deposits base by introducing new deposit products and enhancing its services

The Bank derives a large proportion of its funding from customer deposits. In addition to expanding its branch network to increase its customer base, the Bank intends to grow its deposit base steadily through, and is already in the process of implementing, the following initiatives:

- renovating its existing branches to uplift its image and increase its appeal to a larger pool of customers;
- developing more structured deposit products, such as equity-linked deposits and currency-linked deposits, to cater to the changing needs of customers, in particular, targeting a younger age demographic;
- offering attractive deposit rates to value-added customers;
- enhancing internet banking and telephone banking services, which will enable its customers to perform more off-counter transactions;
- installing automatic banking facilities (such as automatic passbook printing and cheque deposit machines) at its branches to upgrade and enhance banking services;
- increasing the number of promotional and marketing activities to attract new deposit customers;
- enhancing customer services by fostering a courtesy culture among its customer service staff; and
- providing value-added services to its existing customers in order to cultivate their loyalty and retain their business.

Partly as a result of the Bank's increased promotional activities and marketing campaigns conducted in relation to its new deposit products, the Bank has recorded increased growth in its customer deposits. As at 30 June 2006, the Bank's customer deposits amounted to HK$47,728 million (US$6,145 million), which represented a 26.5% increase from HK$37,718 million as at 30 June 2005. The Bank believes that its expanded and upgraded coverage network, coupled with a wider variety of deposit products offered to customers, will enable it to maintain its existing business as well as increase its customer base by attracting new customers.

Improve and diversify the Bank's customer mix and income sources

To compensate for the effects of decreasing interest rate margins and increased competition, the Bank intends to focus on diversifying its sources of income. In addition to introducing more tailored deposit products, the Bank is also in the process of (i) developing new financial products to cater to existing and potential customers, (ii) expanding its private banking business by providing premier wealth management services to high net-worth customers to satisfy the increasingly sophisticated investment needs of its customers, (iii) expanding its credit card business, (iv) increasing efforts to enhance cross-selling services offered at its branches, (v) expanding its securities business by enhancing and improving its personal brokerage services, (vi) extending its existing share financing business to its retail customers and (vii) increasing efforts to derive higher profit margins from its investment activities. The Bank believes that these initiatives, together with the expansion of its branch network, will not only diversify its income portfolio, but will also enlarge its income base as well as reduce the Bank's reliance on any one source of income.

Prudently grow and actively enhance the Bank's credit portfolios through the offering of new products and services, targeted marketing and enhanced customer service

The Bank aims to achieve steady growth in its corporate loan and retail loan portfolio. In addition to diversifying its overall income sources, the Bank believes that the development of additional loan products and services and the expansion of its overall loan portfolio will enable it to capitalise on growing opportunities in Hong Kong. As at 30 June 2006, local corporate loans represented 65.0% of the Bank's total loan portfolio, local retail loans represented 22.0% and loans advanced for overseas uses represented 13.0%.

Corporate loan portfolio

Corporate lending represents a major portion of the Bank's credit activities and the Bank intends to continue to strengthen its corporate credit portfolio and improve its risk-adjusted return by actively managing the sector, geographical, customer and product composition of its corporate credit portfolio. The intended growth and expansion in the Bank's corporate loan portfolio will be focused on certain key areas such as:

- lending to mid-sized corporates and listed companies in Hong Kong;
- trade finance and services to import and export companies;
- supporting small- and medium-sized enterprises ("**SMEs**"), major industries in Hong Kong and PRC companies engaged in business in Hong Kong;
- lending to the hotel industry and other infrastructure development;
- lending to high net-worth individuals;
- share financing to medium- to large-sized customers;
- placing more focus on cash flow lending in addition to secured lending for increased flexibility and to better cater to the changing needs of customers;
- participating in syndicated loans; and

- granting credit facilities to large corporations.

The Bank plans to or is already in the process of (i) establishing corporate and commercial banking centres in both Hong Kong Island and Kowloon, (ii) strengthening marketing efforts to solicit business from large corporations and high net-worth individuals, (iii) increasing flexibility in its facility structuring and service offerings, (iv) synchronising the Bank's internal risk assessment and credit policy with the Bank's target market positioning, (v) enhancing tailor-made services and products to corporate customers and (vi) reducing credit turnaround time to enhance speed and time to market. With these initiatives, the Bank aims to establish a boutique "Community Bank" image in the market as a relationship-oriented bank and to become the preferred banking partner and operating bank for corporate customers, particularly mid-sized corporates.

Retail loan portfolio

Currently, the majority of the Bank's deposit customers comprise retail customers, out of which a large portion comprises middle-aged established individuals above 40 years of age. The Bank intends to leverage on its existing network of retail deposit customers to grow its retail credit portfolio in a prudent manner. In addition to improving its customer services at branches by upgrading and enhancing information technology systems and services as well as operation support systems to increase efficiency, reduce costs and turnaround time, the Bank intends to focus on growing certain components of its retail banking business, especially in high margin business such as consumer financing.

Specifically, the Bank plans to build its residential mortgage loans business by increasing cross-selling of mortgage services as well as other retail banking products, offering competitive pricing and terms and conditions for its mortgages, soliciting co-operation with developers or property agencies to capitalise on business opportunities and offering its mortgage loan plans at more of its branches so as to shorten its credit turnaround time. As at 30 June 2006, residential mortgages comprised approximately 16.4% of the Bank's total loan portfolio, which the Bank estimates to be low compared to the proportion of most other locally incorporated banks and, accordingly, the Bank is of the view that there is still potential for growth in this business segment. The Bank is also in the process of developing more personal loan products such as cash cards and unsecured overdrafts to attract young professionals. In addition, the Bank intends to focus on growing its share financing business on a retail level by offering share financing to its retail customers, which is currently offered mainly to corporate and institutional customers.

Continue to seek strategic investments in the form of jointly controlled entities

In addition to its existing strategic investments in its jointly controlled entities, the Bank will continue to seek suitable opportunities to undertake similar strategic investments. The Bank believes that such strategic investments are a cost-effective method of expanding its business, particularly in areas where it lacks the scale required to compete successfully on its own. The Bank has always made investments in a prudent manner and will continue to do so. Before making such investments, the Bank will duly consider factors including (i) the expected risk and return of the investment; (ii) the impact of the investment on both the capital and liquidity of the Bank; (iii) the potential benefits for the investment such as cross-selling opportunities and enhancement to the Bank's existing financial products and services and (iv) other business opportunities or sharing of expertise associated with the other partners of the jointly controlled entity.

Business Overview

The principal business segments of the Bank are corporate banking and retail banking. Other business activities include treasury activities, insurance, MPF services and other asset management and trustee services. The following table sets forth the contribution of each segment to the Bank's total operating income for the periods indicated.

	For the six months ended 30 June			
	2005		2006	
	(HK$ thousands)	*(percentage)*	*(HK$ thousands)*	*(percentage)*
Corporate banking:				
Commercial advances	130,068	28.5	218,579	37.8
Syndicated lending	30,357	6.6	37,650	6.5
Sub-total	160,425	35.1	256,229	44.3
Retail banking:				
Residential mortgages	52,244	11.4	67,204	11.6
Consumer financing	29,593	6.5	35,363	6.1
Sub-total	81,837	17.9	102,567	17.7
Treasury activities	171,776	37.6	152,960	26.4
Other	43,137	9.4	66,768	11.6
Total operating income	457,175	100.0	578,524	100.0

Corporate banking

The corporate banking business of the Bank comprises mainly lending activities to large corporate and institutional customers both in Hong Kong and mainland China, which include the financing and refinancing of property developments, property investments and infrastructure projects, trade financing, commercial mortgages for purposes of purchasing retail, office and industrial space, and funding for general corporate requirements. The Bank also offers financial services such as remittance and money exchange services, safe deposit boxes, autopay and direct debit services on a corporate level.

The majority of the Bank's borrowers are Hong Kong companies that typically use the funds for projects and investments in Hong Kong and, to a lesser degree, in Macau and mainland China. The Bank's lending activities in mainland China are conducted mainly with its existing customers based in Hong Kong or referrals arising from its existing customer relationships who are engaged in business in mainland China.

Commercial advances

As at 30 June 2006, the amount of outstanding corporate advances amounted to HK$15,768 million (US$2,030 million), which represented 62.0% of the Bank's total outstanding advances. For the six months ended 30 June 2006 and 30 June 2005, on a consolidated basis, corporate banking activities contributed 37.8% and 28.5% of the Bank's total operating income, respectively.

Substantially all of the Bank's corporate advances are extended on a recourse basis and/or are secured by the underlying projects. In the case of property financing, all advances are secured by a first legal charge over the underlying property and in most cases, together with a charge over all the sale and rental proceeds derived from the property. In some circumstances, the Bank may require additional collateral such as time deposits, listed securities and other financial instruments that the Bank deems acceptable. All overdrafts and term loans are renewed on an annual basis. The Bank's corporate advances range from relatively small amounts to that of several hundred million Hong Kong dollars and the average original maturity for instalment loans is approximately 18 years. Loan-to-value ratios for project financing are determined on a case-by-case basis. The maximum loan-to-value ratios for construction projects and commercial mortgages are approximately 100% and 70% of the total estimated completion value of the project and the prevailing market value of the commercial properties, respectively.

Trade finance

Trade finance comprises advances to companies through overdraft facilities, short-term advances, letters of credit, trust receipts, export credit and packing credit advances mainly for purposes of accommodating working capital requirements. The Bank also provides other trade finance related services to its customers, including advice on export documentary credits to be received by the customer, negotiation of bills under documentary credits and collection of bills. The majority of trade finance advances are secured by a mortgage of property or cash collateral, although advances may be made on a partially secured or on an unsecured basis. Trade finance advances typically have a relatively shorter maturity and most of the Bank's trade advances have a maturity period ranging from 60 to 120 days.

The Bank's trade finance customers comprise mainly manufacturing companies, large trading companies and multinational corporations. The Bank intends to continue to increase income contribution from trade finance as its existing customers increase the size and scope of their operations and by providing its customers with personalised service through its experienced trade finance staff. The trade finance sector in Hong Kong is well developed and, consequently, the Bank is also seeking to capitalise on its overall reputation and existing network in the PRC to deliver trade finance services to its increasing number of customers with operations in the PRC. The Bank also intends to increase trade financing provided to import and export companies.

Syndicated Lending

The Bank is also engaged in the Hong Kong syndicated lending market. The majority of the Bank's syndicated advances is extended to local companies engaging in property development or investment in completed developments, large local conglomerates and large mainland China private or state-owned enterprises. The Bank's typical commitment per advance is between HK$10 million and HK$380 million.

In the first six months of 2006, the syndicated corporate lending market remained active as both large and medium-sized enterprises took advantage of the high level of bank liquidity in Hong Kong to finance their expansion projects and/or refinance their existing debt. In addition, large PRC corporations continued to tap the local syndicated lending market to finance their overseas acquisitions. Despite this increase in activity, interest margins on syndicated loan transactions continued to decline due to keen competition. In order to improve its yield return and broaden its customer base, the Bank intends to continue to focus on increasing its lending activities to high quality companies in the middle market as the margins associated with borrowers from this sector are typically more attractive than margins on unsecured syndicated advances to the larger property developers in the market.

For the six months ended 30 June 2006 and 30 June 2005, on a consolidated basis, syndicated lending activities accounted for 6.5% and 6.6% of the Bank's total operating income, respectively.

Retail banking

Retail banking comprises personal banking (including deposits, residential mortgage financing and other consumer financing) and wealth management services (including insurance and investment) to individual customers. The Bank also offers financial services such as remittance and money exchange services, safe deposit boxes, autopay and direct debit services on a retail level and provides fully automated telephone and internet banking services to its customers.

Residential mortgages

Residential mortgages represent the largest segment of the Bank's total advances to retail customers, accounting for 74.8% of the Bank's total retail loan portfolio and 16.4% of the Bank's total loan portfolio as at 30 June 2006, and include advances guaranteed by the Hong Kong Government under GHOS, Private Sector Participation Scheme ("**PSPS**") and Tenants Purchase Scheme ("**TPS**") to assist lower income families in purchasing homes. Advances under GHOS, PSPS and TPS accounted for an aggregate of HK$739 million (US$95 million), which represented 2.9% of the Bank's total loan portfolio as at 30 June 2006. The Bank maintains close relationships with most property developers in Hong Kong and this has enabled the Bank to source a significant amount of home mortgage and commercial mortgage advance business. The majority of the Bank's home mortgage customers comprises buyers of housing units in Hong Kong who intend to occupy the premises. Other home mortgages are extended to individuals purchasing residential units for investment purposes.

All home mortgage advances are secured by a first legal charge on the property and, in certain circumstances, the Bank may also require personal guarantees as additional security. Home mortgages typically include floating interest rates and are repayable by instalments. The average original advance maturity is approximately 20 years for home mortgages and the average original principal amount of a home mortgage advance (excluding advances under GHOS, PSPS and TPS) is approximately HK$1.34 million. The maximum loan-to-value ratio for home mortgages is 70% of the prevailing market value of the property.

For the six months ended 30 June 2006 and 30 June 2005, on a consolidated basis, residential mortgages accounted for 11.6% and 11.4% of the Bank's total operating income, respectively.

Consumer financing

Consumer advances include overdrafts, secured and unsecured advances to individuals for a variety of purposes including funding for education, weddings, travel and home improvement and renovation.

Applications for consumer advances are processed by the Bank's Retail Banking Business Division and all applications up to the respective stipulated threshold limits must be submitted to the Loans Committee for approval.

As at 30 June 2006, the Bank's total outstanding consumer advances amounted to HK$1,320 million (US$170 million), which represented 23.6% of the Bank's retail loan portfolio and 5.2% of the Bank's total loan portfolio.

Since the beginning of 2006, the Bank has launched a series of lending programmes with innovative product features, which include a personalised interest rate based on the relevant customer's credit standing, payment holidays, and attractive tax advance packages. The Bank believes that the market response to these new programmes has been encouraging and intends to continue to focus on diversifying its retail loan portfolio both in terms of product variety and income source. In addition, the Bank intends to focus on growing its share financing business on a retail level by offering share financing to its retail customers, which is currently offered mainly to corporate and institutional customers.

Wealth management

The Bank's Wealth Management Operation Department was established in 2004 with a view to providing customers with superior financial planning services and is primarily responsible for the Bank's wealth management business. The Bank's wealth management business comprises mainly provision of financial advisory services, which include investment advice, as well as financial investment products to mainly customers who are looking for alternative secure investment options to bank deposits. As such, the Bank provides low-risk investment products, which include principal guaranteed structured deposits that are linked to a variety of asset classes, security instruments, retail bonds, unit trusts and retail structured notes.

As part of its strategy to increase and diversify its fee-based income sources, the Bank has recently introduced new equity-related structured products in 2006 to complement its existing range of equity-linked deposit and currency linked deposit products, and intends to continue developing new investment products to cater to the increasingly sophisticated needs of its customers.

Credit cards

The Bank became a principal member of VISA in 1988 and a principal member of MasterCard International in 2000. In 2002, the Bank commenced operations of its own credit card business. As at 30 June 2006, the Bank had approximately 70,000 credit cards in issue, including more than 15 types of core, affinity and co-branded cards that the Bank has issued in association with two educational institutions, four professional and business associations, three welfare institutions and four commercial entities in Hong Kong. As at 30 June 2006, the Bank's total outstanding credit card advances amounted to HK$90 million (US$12 million), which represented 1.6% of the Bank's retail loan portfolio.

The Bank intends to continue developing and strengthening its credit card business. In line with its objective, the Bank recently launched its VISA Corporate Gold and Platinum cards in February 2005, which cater specifically to its corporate customers and in the same month and subsequently in June 2006, the Bank introduced its MAN credit cards and its MSN credit cards, respectively, both of which were targeted at customers from affluent high-end market segment. In particular, the Bank also intends to grow and develop its credit card business with the aim of attracting younger consumers as well as enhance its value-added services in order to develop customer loyalty. The Bank is currently in the process of developing and introducing new co-branded card programmes as well as increasing cross-selling of its credit card services so as to enlarge its credit card customer base. As a brand-building strategy, the number of cardholder privileges will also be increased to encourage usage of the Bank's credit cards.

The main sources of earnings from the Bank's credit card business are interest income and commission income. Part of the commission income derived from the Bank's affinity credit cards is rebated to the relevant affiliated institution.

Treasury activities

The Bank's treasury activities primarily consist of money market transactions, investment portfolio management and proprietary and other interbank and capital market activities conducted on behalf of the Bank. Securities dealing activities are also conducted by the Bank through its wholly-owned subsidiary, Chong Hing Securities Limited. Treasury operations are also responsible for managing the funding and liquidity positions of the Bank and other market risk positions arising from banking activities.

The Bank is also engaged in foreign exchange trading activities as well as equity and futures stock broking on behalf of its customers. Income derived from foreign exchange activities is generated mainly from services provided to customers in the form of foreign exchange trading and forward contracts. Stock broking activities and dealings in Hang Seng Index futures, options and other derivative products are also conducted by the Bank through its own banking network as well as its wholly-owned subsidiaries, Chong Hing Securities Limited and Chong Hing Commodities and Futures Limited, on an agency basis.

As a matter of policy, the Bank generally discourages aggressive trading activities and foreign exchange trading activities are typically engaged on behalf of its customers as part of the Bank's overall banking business. Historically, treasury activities constitute a minor proportion of the Bank's business activities. However, in conjunction with the establishment of a new headquarters office and in order to increase the rate of return derived from its total asset portfolio, the Bank intends to expand its treasury operations and is currently in the process of establishing a specialised corporate dealing desk to improve its services. The Bank is also hiring more personnel, such as dealers to manage surplus funds and arbitrage opportunities and professionals to develop new structure products.

Others

Insurance

The Bank conducts its main insurance business through its wholly-owned subsidiary, Chong Hing Insurance Company Limited, which was acquired in June 2005 to serve as a division for the Bank's insurance business. Chong Hing Insurance Company Limited provides a diversified range of insurance services, including fire insurance, marine insurance, motor vehicle insurance, employee's compensation insurance, public liability insurance and property insurance. Insurance products offered by Chong Hing Insurance Company Limited are distributed through the Bank's branch network, insurance agents, brokers, allied partners and internet websites of both the Bank and Chong Hing Insurance Company Limited.

The Bank also offers a comprehensive range of both individual and group life and medical insurance, general and travel insurance through its 16.7% owned jointly-controlled entity, Hong Kong Life Insurance Limited.

For the year ended 31 December 2005, Chong Hing Insurance Company Limited's premium income derived from its insurance business amounted to HK$42 million (US$5 million), which represented an increase of 12% for the year ended 31 December 2004. For the six months ended 30 June 2006, Chong Hing Insurance Company Limited's premium income was HK$17 million (US$2 million), which represented an increase of 2% as compared to the six months ended 30 June 2005.

MPF services and other asset management and trustee services

The Bank offers a comprehensive range of MPF services, including trustee, scheme administration, investment management and custody services to employers, employees and the self-employed through its 13.3% owned jointly-controlled entity, the Bank Consortium. The Bank Consortium is currently collectively owned by the Bank, Asia Financial Group, Dah Sing Bank, Shanghai Commercial Bank, Wing Hang Bank, Wing Lung Bank, Fubon Bank, and Industrial and Commercial Bank of China (Asia). The Bank Consortium also offers a full range of pension products which include the Bank Consortium MPF Plan (a master trust scheme), the Bank Consortium Industry Plan (an industry scheme), BCT Premier Pooled ORSO Retirement Plan (an ORSO scheme) for Employer Sponsored Scheme and scheme administration for other registered MPF schemes. Through the Bank Consortium, the Bank also offers a wide range of trustee services, including acting as executor or trustee of wills, trustee of family trusts, investment funds, unit trusts, charities and public funds.

Internet Banking Services

As part of its general banking business, the Bank offers internet banking services to its customers which allow them to manage their accounts on the internet, by fixed-line telephones and at designated kiosks. The Bank's internet banking services comprise a wide variety of banking functions, including balance enquiries, rate enquiries, funds transfers, renewals of time deposit, bill payment, credit card transactions, redemptions of bonus points for gifts and MPF account enquiries and contributions.

As at 30 June 2006, the Bank had over 7,040 registered internet banking users, which represented an increase of 220% as compared to as at 30 June 2005, and the average daily transaction volume for the six months ended 30 June 2006 exceeded 115 transactions.

The Bank also offers internet-based brokerage service (including real-time internet stock price quote service) through its wholly-owned subsidiary, Chong Hing Securities Limited, which allows customers to trade securities on the internet. Chong Hing Securities Limited was admitted as part of the first batch of brokers adopting the Broker Supplied System under the AMS/3 system, which allowed its dealing operations to run under a fully automated straight-through processing environment. Over the past few years, Chong Hing Securities Limited has instituted various incentive schemes to encourage clients to execute trades via its user-friendly electronic trading platform and the Bank believes that these schemes have been well-received by its customers. As at 31 December 2005, Chong Hing Securities Limited registered an increase of approximately 28% in the number of internet-based securities client accounts as compared to the number as at 31 December 2004. As at 30 June 2006, Chong Hing Securities Limited registered an increase of approximately 64% in the number of internet-based securities client accounts as compared to as at 30 June 2005. As at 30 June 2006, more than 11% of Chong Hing Securities Limited's trading customers had registered internet-based securities client accounts with its internet-based brokerage service, and the volume of transactions executed via the internet-based brokerage system accounted for approximately 8% of the total number of trades and approximately 5% of Chong Hing Securities Limited's total turnover.

International Operations

The Bank's international operations were commenced to meet the requirements of its existing core customers as their interests expand overseas from Hong Kong. The table below sets forth the Bank's branches and representative offices outside Hong Kong.

Operations	**Country**	**Year of Establishment**
Representative office in Guangzhou	PRC	1999
Branch in Macau	PRC	1997
Branch in San Francisco	USA	1977
Representative office in Shanghai	PRC	1988
Branch in Shantou	PRC	1993

Group Structure

As at the date of this Offering Circular, the Bank had a total of 11 subsidiaries and four jointly controlled entities. The Bank is the holding company and the principal operating company of the Group. The Bank has a number of significant subsidiaries through which the Group conducts various operations such as stock broking, property investment and certain fee-based activities. As at the date of this Offering Circular, save for Chong Hing Securities Limited, none of the Bank's subsidiaries account for 10% or more of the consolidated net profit and loss of the Group or has a book value of 10% or more of the Group's consolidated total assets.

The table below sets forth a summary of the Bank's principal subsidiaries as at the date of this Offering Circular:

Name of subsidiary	Place of incorporation and operation	Issued and fully paid ordinary share capital	% Held by the Bank	Nature of business
Chong Hing Finance Limited	Hong Kong	HK$25,000,000	100%	Deposit-taking and lending
Chong Hing Securities Limited	Hong Kong	HK$10,000,000	100%	Securities trading and nominee services
Chong Hing Commodities and Futures Limited	Hong Kong	HK$5,000,000	100%	Investment holding and commodities and futures brokerage and agency
Chong Hing Insurance Company Limited	Hong Kong	HK$50,000,000	100%	Insurance services

The table below sets forth a summary of the Bank's jointly controlled entities as at the date of this Offering Circular:

Name of jointly controlled entity	Place of incorporation and operation	Class of shares held	Ownership interest	Nature of business
Bank Consortium Holding Limited	Hong Kong	Ordinary	13.3%	Investment holding and provision of trustee, administration and custodian services for retirement schemes
BC Reinsurance Limited	Hong Kong	Ordinary	21.0%	Reinsurance
Hong Kong Life Insurance Limited	Hong Kong	Ordinary	16.7%	Life insurance underwriting
Net Alliance Co, Limited	Hong Kong	Ordinary	17.6%	Provision of internet services

Properties

The Bank currently owns properties with an aggregate floor area of approximately 270,000 square feet in Hong Kong. Most of the Bank's properties are used as banking offices, as branches or for back office operations. The remainder are currently leased to third parties. In addition, the Bank also leases properties with an aggregate floor area of approximately 75,000 square feet in Hong Kong. These leased properties are used as banking offices, as branches and for back office operations.

The Bank intends to obtain office space held on long-term operating leases for all of its new branches which it expects to set up in the next three years. In addition, the Bank is currently in the process of relocating its head office to a newly redeveloped headquarters building and the relocation is expected to be completed by the end of 2006.

Intellectual Property

The Group relies on domain name registrations to establish and protect its internet domain names. The Group has registered a number of internet domain names, including "www.lchbank.com" and "www.lchbank.com.hk".

As at 30 June 2006, Liu Chong Hing Investment Limited, a company holding a 45.78% shareholding interest in the Bank has registered “” as a trade mark with the Trade Marks Registry, Intellectual Property Department of the Government of the Hong Kong Special Administrative Region and that trade mark has been licensed to the Bank as a registered user.

Insurance

The Bank maintains various types of insurance coverage, including property insurance to cover the loss of or damage to building structure and content, electronic equipment and motor vehicles; insurance to cover loss of property due to bulgary, theft and robbery; public liability insurance to cover legal liability as a result of physical bodily injury and/or property damage caused to third parties; bankers blanket bonds insurance to cover the loss resulting from fraudulent acts (including computer-related crimes) by employees, loss of money on premises and in transit and forgery of bank instruments; directors' and officers' liability insurance to cover the personal liability of the Bank's officers against any claims resulting from any wrongful act committed in connection with carrying out their duties as officers of the Bank; employees' liability insurance as required by the Employees' Compensation Ordinance (Cap. 282 of the Laws of Hong Kong); and group medical insurance for its workforce. The Group also requires borrowers to obtain appropriate insurance coverage for security provided by them.

Following the enactment of the Deposit Protection Scheme Ordinance (Cap. 581 of the Laws of Hong Kong) in 2004, the Hong Kong Deposit Protection Board was formed to oversee the project for establishing the Deposit Protection Scheme (the “**DPS**”). The Scheme will require the Bank to obtain insurance coverage for all bank deposits. Under the Scheme, the Bank is required to pay a premium based on a supervisory rating to be determined by the HKMA and modify the systems, procedures and customer communications in order to comprehend the respective rules of the DPS. The Bank has formed a project team to prepare for and oversee the implementation of the DPS. See “*Investment Considerations – Liquidity; Short-Term Funding; Deposit Insurance*”.

Competition

The Hong Kong banking industry is mature and the Bank faces intense competition from a number of Hong Kong incorporated banks and branches of international banks, particularly in the home mortgage lending sector and deposit-taking business. In addition, the Bank faces keen competition from local finance companies in certain areas of its business, such as credit cards and hire purchase.

Given the increasing competition among the local banks in Hong Kong, the Bank has decided to focus on diversifying its revenue sources and increasing its fee based income, particularly from its wealth management and retail investment businesses. In addition, like many of the local banks in Hong Kong, the Bank is now focusing on expanding its presence in mainland China, as evidenced by the establishment of representative offices in major cities in mainland China. However, in view of the fact that banking business in mainland China will be opened fully to foreign banks by 2007, the Bank expects competition to continue to increase in the region.

For a further discussion of the risks of competition faced by the Bank in Hong Kong, see “*Investment Considerations*”.

Litigation

Save as otherwise disclosed in this Offering Circular, neither the Bank nor any of its subsidiaries is currently involved in any litigation, arbitration or similar proceedings, and the Bank is not aware of any such proceedings pending or threatened against it or any of its subsidiaries, which are or might be material in the context of the issue of the Notes.

Employees

As at the date of this Offering Circular, the Group had a total of 1,316 employees as set forth in the following table:

	No. of employees
Head office	1,119
Overseas (including mainland China)	51
Subsidiaries	146
Total	1,316

Approximately 17.0% of the Bank's employees as at 30 June 2006 performed managerial and management functions.

The Bank views its employees as an asset and believes that investment in human resources is critical to its growth. The Bank has training programmes, both internal and external, aimed at management development and team building. The Bank's training curriculum includes courses on banking operations, product knowledge, marketing, management skills and customer service.

The Bank believes that it enjoys a good relationship with its employees. None of the Bank's employees are members of a trade union. The Bank provides subsidised mortgage, low-interest housing advances, life and medical insurance benefits and maintains a pension fund scheme for its employees. The Bank also operates employee share option schemes under which options to purchase shares in the Bank can be granted to eligible employees and Executive Directors. As at the date of this Offering Circular, no options to purchase shares under any of its employee share option schemes had been granted by the Bank.

SELECTED STATISTICAL AND OTHER INFORMATION

The selected statistical and other information set forth below relates only to the Group and has, except where otherwise indicated, been compiled as at and for each of the three years ended 31 December 2003, 2004 and 2005 and each of the six month periods ended 30 June 2005 and 2006, respectively, and should be read in conjunction with the information contained elsewhere in this Offering Circular, including *"Business of the Bank"*.

Advance Portfolio

Overview

As at 30 June 2006, the Group's total outstanding advances to customers were HK$25,448 million (US$3,276 million), which represented 46.3% of its total assets. The majority of the Group's advances are in respect of home mortgages and advances for property investment and development, which together represented 42.2% (excluding advances under GHOS, PSPS and TPS) of the Group's total advances to customers as at 30 June 2006.

The table below sets forth a summary of the Group's gross advances by sector as the dates indicated.

	As at 31 December						As at 30 June	
	2003	**Percentage of total**	**2004**	**Percentage of total**	**2005**	**Percentage of total**	**2006**	**Percentage of total**
	(HK$ millions, except percentages)							
Loans for use in Hong Kong								
Industrial, commercial and financial								
— Property development	1,612	8.0%	1,909	9.4%	1,609	6.6%	1,757	6.9%
— Property investment	3,898	19.3%	4,535	22.4%	5,853	24.1%	5,551	21.8%
— Financial concerns	1,598	7.9%	1,710	8.4%	1,230	5.1%	1,565	6.1%
— Stockbrokers	339	1.7%	332	1.6%	322	1.3%	324	1.3%
— Wholesale and retail trade	640	3.2%	703	3.5%	569	2.3%	653	2.6%
— Manufacturing	931	4.6%	1,029	5.1%	840	3.5%	1,019	4.0%
— Transport and transport equipment	388	1.9%	188	0.9%	211	0.9%	319	1.3%
— Others(1)	3,302	16.4%	2,902	14.3%	4,462	18.3%	4,580	18.0%
— Sub-total	12,708	63.0%	13,308	65.6%	15,096	62.1%	15,768	62.0%
Individuals								
— Loans for the purchase of flats under the Home Ownership Scheme and the Private Sector Participation Scheme	1,034	5.1%	902	4.4%	791	3.3%	739	2.9%
— Loans for the purchase of other residential properties	2,849	14.1%	2,547	12.6%	3,404	14.0%	3,448	13.5%
— Credit card advances	83	0.4%	76	0.4%	125	0.5%	90	0.4%
— Others(2)	1,028	5.1%	1,040	5.1%	1,222	5.0%	1,320	5.2%
— Sub-total	4,994	24.7%	4,565	22.5%	5,542	22.8%	5,597	22.0%
Total loans for use in Hong Kong	17,702	87.7%	17,873	88.1%	20,638	84.9%	21,365	84.0%
Trade finance	702	3.5%	522	2.6%	654	2.7%	778	3.0%
Loans for use outside Hong Kong(3)	1,781	8.8%	1,895	9.3%	3,005	12.4%	3,305	13.0%
Total advances to customers	20,185	100.0%	20,290	100.0%	24,297	100.0%	25,448	100.0%

Notes:

(1) "Others" includes the civil engineering, utilities, telecommunications and hotel industries.

(2) "Others" includes professional and private individuals for other private purposes.

(3) This refers to loans to customers the proceeds of which are not used in Hong Kong.

Geographical Concentration

The table below sets forth a summary of the Group's gross advances to customers by geographical location as at the dates indicated.[1]

	As at 31 December						As at 30 June	
	2003	Percentage of total	2004	Percentage of total	2005	Percentage of total	2006	Percentage of total
	(HK$ millions, except percentage)							
Hong Kong	18,645	92.4%	18,771	92.5%	21,713	89.4%	22,700	89.2%
PRC	359	1.8%	299	1.5%	347	1.4%	307	1.2%
Macau	242	1.2%	256	1.3%	1,131	4.6%	1,242	4.9%
United States of America	305	1.5%	470	2.3%	555	2.3%	345	1.4%
Others[2]	634	3.1%	494	2.4%	551	2.3%	854	3.3%
Total	20,185	100.0%	20,290	100.0%	24,297	100.0%	25,448	100.0%

Notes:

(1) The above geographical analysis has been classified by the location of the counterparties, after taking into account any transfer of risk.

(2) This includes Thailand, Singapore, Panama, Bermuda, the British Virgin Islands and the Cayman Islands.

Customer Advance Concentrations

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 Banks — Financial Exposure to Any One Customer"*. As at 30 June 2006, the Group's 20 largest borrowers (including groups of individuals and companies) accounted for approximately HK$12 billion (US$2 billion), or 45.2% of the Group's gross advances, with the largest accounting for HK$1 billion (US$129 million), or 3.9% of the Group's gross advances.

Advance Analysis

Approximately 24.8% of advances had a remaining maturity of more than five years as at 30 June 2006. The following table sets forth a summary of the Group's gross advances by remaining maturity as at the dates indicated.

	As at 31 December						As at 30 June	
	2003	Percentage of total	2004	Percentage of total	2005	Percentage of total	2006	Percentage of total
	(HK$ millions, except percentages)							
Repayable on demand[1]	1,989	9.9%	1,402	6.9%	1,616	6.6%	1,597	6.3%
3 months or less	2,993	14.8%	3,450	17.0%	4,635	19.1%	4,109	16.1%
1 year or less but over 3 months	2,920	14.5%	3,164	15.6%	3,254	13.4%	3,750	14.7%
5 years or less but over 1 year	6,891	34.1%	7,027	34.6%	8,116	33.4%	9,076	35.7%
After 5 years	4,509	22.3%	4,789	23.6%	6,088	25.1%	6,306	24.8%
Undated	883	4.4%	458	2.3%	588	2.4%	610	2.4%
Gross advances to customers	20,185	100.0%	20,290	100.0%	24,297	100.0%	25,448	100.0%

Note:

(1) Includes overdrafts.

As at 30 June 2006, approximately 99.6% of advances made by the Group were at floating rates of interest (see *"— Asset and Liability Management*"), with the balance being made at fixed interest rates. The rates for home mortgage advances and commercial mortgage advances in Hong Kong typically range from 2.6% below the prime rate to the prime rate. The interest rate for Hong Kong dollar consumer finance advances (other than overdrafts) is typically calculated on the initial principal amounts of such advances and typically ranges from 6.8% to 9.4% per month. The interest rate for Hong Kong dollar trade finance advances made by the Group is typically a margin over the prime rate. The interest rate for project finance lending and syndicated lending is typically a margin over the Hong Kong interbank offer rate ("**HIBOR**"). As at 30 June 2006, 93.2% of advances made by the Group were denominated in Hong Kong dollars and 5.8% were denominated in US dollars. Rates which are lower than the above rates may be offered by the Group under appropriate circumstances.

Home mortgages are secured by a first legal charge over the underlying property. Working capital advances for businesses are typically secured by fixed and floating charges over land, buildings, machinery, inventory and receivables. Term advances for specific projects or developments are typically secured against the underlying project's assets and its receivables, while additional guarantees are typically provided by the sponsors or shareholders. The Group also receives guarantees in relation to certain of its other advances to cover, in the case of trade finance, any shortfall in security or, in the case of consumer advances to younger or less financially secure customers, to provide security on what are normally unsecured advances.

All forms of security taken as collateral against credit facilities are monitored by the respective departments which extend the advances. In general, the collateral is periodically valued by an independent valuer to determine whether any additional collateral is required.

Credit Policies and Approval Procedures

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

The Group's primary credit approval bodies are the Loans Committee, which comprises senior staff members of the Bank, and the Executive Loans Committee, which comprises all the Executive Directors of the Bank. The Executive Loans Committee has overall responsibility for the Group's credit policies and oversees the credit quality of the Group's advance portfolio. Under the oversight of the Executive Loans Committee, officers of the Group are authorised to approve credit based on the size of the advance, the collateral provided, the credit standing of the applicant and other prescribed credit guidelines.

The Credit Review Department is responsible for reviewing all credit applications. When a customer fills out an advance application or requests a credit line, the branch or lending department account officer collects information through customer interviews, documentation requests and feasibility studies as well as other sources. The account officer then prepares and submits a credit proposal based on the information gathered for the review of the Credit Review Officers. Credit Review Officers are required to check the accuracy of the information submitted and that the credit proposal meets the underwriting standard required, and are required to provide an independent credit evaluation in support of a recommendation for granting or rejecting the advance and subsequent renewal applications.

Credit approval is performed by the Loans Committee in accordance with the delegated lending authority from the Lending Policy of the Bank with reference to a customer's objective of borrowing, financial strength, repayment ability, past account performance and collateral being offered as security, as appropriate. Approval from the Executive Loans Committee is required as and when the requested amount of the advance exceeds the delegated authority of the Loans Committee.

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are typically monitored on a revolving basis and are subject to periodic reviews. Limits on the level of credit risk by product, industry sector and by country are approved annually by the Board.

The exposure to any one borrower including banks and brokers is further restricted by sub-limits covering on and off-balance sheet exposures, and daily delivery risk limits in relation to trading items such as forward foreign exchange contracts. Actual exposures against limits are monitored daily.

Exposure to credit risk is managed through regular reviews of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees.

Asset Quality

Overview

The performance of the Hong Kong economy is heavily dependent on the property sector, and property lending (excluding advances under GHOS, PSTS and TPS) accounted for 42.2% of the Group's total advances to customers as at 30 June 2006. As a result, the Bank's asset quality is vulnerable to a decline in property prices. The ability of borrowers, including homeowners, to make timely repayment of their advances may be adversely affected by rising interest rates or a slowdown in economic recovery. As at 30 June 2006, home mortgage advances (including advances under GHOS, PSPS and TPS) accounted for HK$4,187 million (US$539 million) or 16.4% of the Bank's total advances to customers and accounted for one of the largest segments of the Bank's total advances to customers. See *"Investment Considerations — Considerations Relating to the Group — Advance Concentration; Exposure to the Hong Kong Property Market"*.

Prior to 1 January 2005, when an advance had a past-due record of 30 days or more, it would be downgraded to "special mention" although the Group would continue to accrue interest on such advance in its profit and loss account. The prospect of recovery of the market value of the underlying security was evaluated in assessing whether specific provisions should be made.

Since 1 January 2005, following the coming into effect of HKAS 39, classified advances are also referred to as impaired loans. Furthermore, interest suspension is no longer permitted. See "— *Provision for bad and doubtful debts*" for details of provisioning of advances.

The Bank believes that its advance classification policy is in compliance with the Banking Ordinance and the applicable guidelines of the HKMA.

Recognition of Impaired Loans

The Group's impaired loans are sub-divided into three categories: sub-standard, doubtful and loss. When the repayment of an advance is uncertain (for example, there is a past-due record of 90 days or more and there would be a loss of an amount of principal or interest after taking into consideration the net realisable value of any collateral), the Group downgrades the advance to sub-standard. If full recovery of the advance is in doubt and the Group expects to sustain a loss of principal or interest, taking into account the net realisable value of any security available, the Group classifies the advance as doubtful. Loss advances are those which are considered non-collectible after exhausting all collection efforts, such as the realisation of collateral and the institution of legal proceedings, and the liquidator or official receiver has ascertained the relevant recovery ratio.

Accrual of Interest

Prior to 1 January 2005, the Group followed the HKMA guidelines on "Recognition of Interest", under which interest accrual was suspended if there was a reasonable doubt on the ultimate collectibility of the advances, taking into consideration both qualitative and quantitative factors. In particular, if the advances were overdue for over 3 months and the net realisable value of the security was insufficient to cover the principal and accrued interest, then interest accrual would have been suspended.

However, since 1 January 2005, following the coming into effect of HKAS 39, interest suspension is no longer permitted. Impairment loan interest, which is calculated at the interest rate prevailing at the time the account was first impaired, is accrued monthly and is capitalised to the impaired advance account.

Provisions for Bad and Doubtful Debts

Prior to 1 January 2005, with respect to bad and doubtful debts, specific provisions were made according to the prospects for recovery, ranging from 25% to 100%. A specific provision is written off against the balance of the loan once the portion to be written off is ascertained to be unrecoverable. The Credit Risk Management Department prepares a monthly report, which is submitted to the Credit Review Department to enable the Loans Committee to assess whether any adjustment of specific provisions was necessary. With respect to bad and doubtful personal advances, the Group's policy was to make full specific provisions for all unsecured amounts outstanding.

However, since 1 January 2005, following the coming into effect of HKAS 39, specific provisions have become impairment loss allowances, which are ascertained by an individual assessment of the impaired/non-performing loan, based on a discounted cash flow method. Impairment loss is assessed on principal plus amortised cost and impairment loan interest, which is calculated at the interest rate prevailing at the time the account was first impaired, is accrued monthly and is capitalised to the impaired advance account. Impairment loss allowances are made for accrued interest if necessary.

Prior to 1 January 2005, the Bank would set aside a general provision (not less than 1% of the total advances to customers), to allow for any unidentified, unexpected or unforeseeable losses that may have arisen in connection with its advance portfolio. In the case of "special mention" advances, a 2% general provision was required under the Bank's internal credit policy. In addition to general provisions, specific provisions were made for advances which were identified according to their foreseeable recovery status, see "— *Provisions for bad and doubtful debts*".

Since 1 January 2005, following the coming into effect of HKAS 39, general provisions have become portfolio provisions, which are calculated monthly by collective assessment at a rate determined according to historical loss experience on a regular basis. The assessable advance portfolio excludes those impaired loans under individual assessment for impairment loss.

The Bank believes that its provisioning policies are in compliance with the Banking Ordinance and the applicable guidelines of the HKMA.

The table below summarises the changes in the Group's provisions for bad and doubtful debts/impairment allowance for the periods indicated.

	Years ended 31 December			Six months ended 30 June	
	2003	2004	2005	2005	2006
	(HK$ millions, except percentages)				
Provisions for bad and doubtful debts/impairment allowance:					
Beginning balance	475	431	303	303	187
Opening balance adjusted after the adoption of HKAS 39	–	–	(63)	(63)	–
Provision during the period	129	105	110	32	69
Bad debts charges recovered	(66)	(54)	(42)	(18)	(31)
Loans written-off	(107)	(179)	(121)	(89)	(91)
Closing balance	431	303	187	165	134
Provisions for bad and doubtful debts/impairment allowance as a percentage of:					
Total loans at period end	2.1%	1.5%	0.8%	0.7%	0.5%
Total non-performing loans/impaired loans at period end	44.3%	38.3%	29.0%	25.3%	23.9%
Write-offs as a percentage of:					
Average total loans during period	0.5%	0.9%	0.5%	0.4%	0.4%
Total loans at period-end	0.5%	0.9%	0.5%	0.4%	0.4%
Total non-performing loans/impaired loans at period end	11.0%	22.6%	18.9%	13.7%	16.3%

Top Ten Impaired Loans

As at 30 June 2006, the Bank's ten largest impaired loans accounted for 1.9% of its total advances. Approximately 79% of the value of the Bank's ten largest impaired loans is attributed to two legacy loans advanced by the Bank to separate customers in the PRC prior to 2003. The majority of the borrowers of such ten largest impaired loans were engaged in property development and property investment. As at 30 June 2006, the Bank's exposure under its ten largest impaired loans ranged from approximately HK$4 million (US$500,000) to approximately HK$243 million (US$31 million), and amounted to approximately HK$490 million (US$63 million) in the aggregate.

Impaired Loans Which Have Been Restructured

The Group's impaired loans are restructured on a case-by-case basis, subject to the approval of the appropriate lending parties for both the restructured limits and recovery measures. The Group maintains a prudent reclassification policy. For example, if payments under an advance are rescheduled, that advance will not be reclassified and will remain under adverse classification (either as a sub-standard or doubtful advance) and may only be upgraded to a pass advance if the revised payment terms are honoured for a period of 6 months, in the case of monthly payments, and 12 months, in the case of quarterly or semi-annual repayments.

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

	As at 31 December			As at 30 June
	2003	2004	2005	2006
	(HK$ millions, except percentages)			
Gross non-performing loans/impaired loans	973	791	643	560
Aggregate specific provision/impairment loss allowance	(203)	(95)	(55)	(24)
Net non-performing loans/impaired loans	770	696	588	536
Gross non-performing loans/impaired loans as a percentage of total loan portfolio	4.8%	3.9%	2.7%	2.2%
Net non-performing loans/impaired loans as a percentage of total loan portfolio	3.8%	3.4%	2.4%	2.1%

Held-to-maturity Debt Securities

The Group's held-to-maturity debt securities included listed and unlisted debt securities. As at 30 June 2006, the book value of these securities was HK$13,002 million (US$1,674 million), which represented 90.0% of the Group's total investments in securities. These debt securities included both Hong Kong dollar and US dollar denominated bonds and notes. See "*Asset and Liability Management*" below.

The following table sets forth, as at the dates indicated, carrying values of the Group's held-to-maturity debt securities, categorised by the types of issuers:

	As at 31 December				As at 30 June	
	2004		2005		2006	
	Amount	Percentage	Amount	Percentage	Amount	Percentage
	(HK$ millions, except percentages)					
Held-to-maturity securities issued by:						
Central governments and central banks	50	1.5%	95	1.0%	290	2.2%
Public sector entities.	30	0.9%	25	0.3%	21	0.2%
Banks and other financial institutions	1,915	56.5%	7,130	77.6%	10,849	83.4%
Corporate entities	1,393	41.1%	1,943	21.1%	1,842	14.2%
Total	3,388	100.0%	9,193	100.0%	13,002	100.0%

Asset and Liability Management

The Group's asset and liability management is steered by the Group's Asset and Liability Management Committee ("**ALCO**"). The ALCO establishes policies and guidelines in respect of the maturity, pricing and volume of non-capital funding such that the Group obtains funds in the most efficient and effective manner. Capital planning also comes under the supervision and review of the ALCO. The deployment of funds into various classes of asset is reviewed regularly by the ALCO, having regard to the policies laid down for the management of the credit risk, the liquidity risk, the interest rate risk and the market risk. The ALCO consists of the senior staff members representing major divisions of the Bank.

Two key aspects of the Group's asset and liability policy are liquidity risk management and interest rate risk management.

Liquidity Risk Management

Liquidity risk is the risk that the Group cannot meet its current obligations. The ALCO is responsible for monitoring the Bank's liquidity position, and does so through the periodic review of the statutory liquidity ratio, the maturity profile of assets and liabilities, loan-to-deposit ratio and inter-bank transactions. Liquidity policy is monitored by the ALCO and reviewed regularly by the Board of Directors of the Bank. The Bank's policy is to maintain a conservative level of liquid funds on a daily basis so that the Bank is prepared to meet its obligations when they fall due in the normal course of business and to satisfy statutory liquidity ratio requirements, and also to deal with any funding crises that may arise. Limits are set on the minimum proportion of maturing funds available to meet all the calls on cash resources such as overnight deposits, current accounts, maturing deposits, loan draw-downs and guarantees, and from margin and other calls on cash-settled derivatives and on the minimum level of inter-bank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

The Bank's average consolidated liquidity ratio and consolidated loan-to-deposit ratio were 55.39% (which was above the statutory minimum of 25%) and 47.98%, respectively, as at 30 June 2006.

The Bank's Risk Management and Compliance Committee (the "**RMCC**") recommends internal target levels in respect of the monthly average liquidity ratio, monthly average Tier 1 liquidity ratio, and lowest daily liquidity ratio, and the weekly computation of liquidity ratio and Tier 1 liquidity ratio. The Bank's Chief Accountant is responsible for monitoring these ratios and, where a tight liquidity position remains for a prolonged period, the Chief Accountants reports his findings to the ALCO and RMCC who, after consultation with members of the Executive Committee decide the appropriate corrective actions to be taken. The liquidity positions of the Bank's overseas branches in Shantou, San Francisco and Macau are monitored through the submission of monthly management accounts and daily cash flow positions to the Bank's head office.

In managing liquidity risk the Bank measures, monitors and controls cash flow and maturity mismatch positions under different operating conditions. Under this cash flow approach the Bank believes that it has in place appropriate systems for:

- monitoring on a daily basis net funding requirements under normal business conditions;
- conducting regular cash flow analyses based on stress scenarios; and
- developing reasonable assumptions for making the above cash flow projections.

The Bank constructs a maturity profile that projects future cash flows arising from assets, liabilities and off-balance sheet transactions. All cash flows are allocated into a series of time bands according to their expected maturity dates for which the Bank is able to estimate the prospective net funding requirement. The profile enables the Bank to monitor short-term liquidity requirements as a priority and to review mismatch positions for medium– to longer-term bands. Time bands within one month are monitored daily whilst longer bands are reviewed on a monthly basis. In calculating maturity mismatches, the Bank analyses historical experience and observations to determine cash flow patterns and derive behavioural assumptions applicable to the cash flows and takes into account not only contractual maturities but also adopts realistic assumptions underlying the behaviour of assets, liabilities and off-balance sheet activities. The Chief Accountant is responsible for analysing the magnitude of the mismatches and discuss his findings with the ALCO, RMCC and Executive Committee as appropriate.

The Bank conducts a programme of stress testing to assess the Bank's ability to meet obligations under institution-specific or general market funding crises and submits the results of such testing to the ALCO and RMCC for review on a regular basis. These systems and procedures are designed to enable the Bank to ensure that either a positive cash flow position is maintained or otherwise sufficient cash can be generated to satisfy the funding requirements on a daily basis.

The Bank's liabilities in foreign currencies other than US dollars are incurred virtually exclusively from customer deposits, the majority of which is placed on deposits with other authorised institutions, and therefore the Bank's policy in respect of such currencies is to monitor liquidity on a matched basis. The Bank has a policy of taking deposits and holding assets denominated in only those hard currencies tradable in the interbank money market or currency forward market.

Although the Bank has generally been a net inter-bank lender in the market, it regards the ability to obtain funds in the inter-bank market as an important source of liquidity in both normal and crisis situations, and therefore regularly borrows in the inter-bank market as a means of testing the availability of credit lines. The Bank's borrowing capacity, however, is restricted by statutory limits, the Bank's ability to pledge collateral acceptable to prospective lenders, the general liquidity position in the market, the price of such borrowings and the circumstances leading to the Bank's need to borrow rather rely on deposits.

As the Bank considers a stable deposit base as critical to its liquidity position, it conducts statistical and behavioural analyses of its deposit base with the objective of accumulating funding sources which are likely to remain with the Bank on a longer-term basis. The Bank is focused on building its relationships with depositors to achieve this objective.

Interest Rate Risk Management

Interest rate risk is the risk that arises when the movement of interest rates affects adversely the net interest margin of the Group and thus its operating results. Net interest margin is defined as the net interest income (total interest income less total interest expenses) expressed as a percentage of total assets or total liabilities plus shareholders' funds. The Bank does not carry interest rate positions on its trading book. Interest rate risk arises primarily from several sources, including the timing differences in the re-pricing of, and the different bases of pricing, interest-bearing assets, liabilities and commitments (otherwise known as re-pricing risk and basis risk, respectively) and positions of non-interest bearing balances and in particular free capital generated by shareholders' funds (otherwise known as structural risk). As a matter of policy, the Bank does not carry financial instruments or offer products to customers that expose the Bank to significant yield curve and option risks. As a result such exposures are insignificant for the Bank. The Bank monitors re-pricing risk by regular sensitivity analyses of the net re-pricing gap of assets and liabilities with reference to their next re-pricing date. Basis risk is monitored by regular sensitivity analysis of the net long/short position of prime/HIBOR/US prime/LIBOR based assets and liabilities with reference to their next re-pricing date. The Bank performs monthly sensitivity and gapping analyses in Hong Kong dollars and other major currencies to which it has significant exposure. The Bank implements certain measures to mitigate its interest rate risk, including but not limited to the avoidance of trading in interest rate derivatives, entry into inter-bank and longer-term debt securities transactions in order to square as much as possible net re-pricing gaps, and adhering to gapping limits.

The Bank measures the exposure of its assets and liabilities to fluctuations in interest rates primarily by way of gap analysis which provides the Bank with a static view of the maturity and re-pricing characteristics of balance sheet positions. An interest rate gap report is prepared by classifying all assets and liabilities into various time period categories according to contracted maturities or anticipated re-pricing dates whichever is earlier. The difference in the amount of assets and liabilities maturing or being re-priced in any time period category would then give the Bank an indication of the extent to which the Bank is exposed to the risk of potential changes in the net interest income.

The following table sets forth the combined currency asset-liability gap position for the Bank's local operations (head office and all local branches) as at 31 December 2005.

	Up to 3 months	**3 to 12 months**	**1 to 5 years**	**Over 5 years**	**Non-interest bearing**	**Total**
			(HK$ thousands)			
Assets:						
Cash and short-term funds	10,769,415	99,501	228,835	10,000	690,728	11,798,479
Placements with banks and other financial institutions	2,029,416	–	–	–	–	2,029,416
Financial assets at fair value through profit or loss	565,737	–	203,047	–	85,983	854,767
Available-for-sale securities	–	278,397	–	–	523,372	801,769
Held-to-maturity securities	5,947,792	1,124,606	2,118,410	98	2,000	9,192,906
Advances to customers	24,001,286	267,240	24,981	3,137	–	24,296,644
Other assets	–	–	–	–	999,771	999,771
Total assets	43,313,646	1,769,744	2,575,273	13,235	2,301,854	49,973,752
Liabilities:						
Deposits and balances of banks and other financial institutions	2,256,977	–	–	–	6,527	2,263,504
Deposits from customers	37,413,235	1,676,101	267,837	–	2,149,119	41,506,292
Other liabilities	–	–	–	–	370,820	370,820
Total liabilities	39,670,212	1,676,101	267,837	–	2,526,466	44,140,616
Total interest sensitivity gap	3,643,434	93,643	2,307,436	13,235	(224,612)	5,833,136

The following table sets forth, for the period indicated, the impact of changes in Hong Kong dollar and US dollar interest rates on annualised net interest income for the Bank's local operations.

	As at 30 June 2006			
	Change in interest rates (in basis points)			
	(100)	**(50)**	**50**	**100**
	(HK$ millions, except percentages)			
Change on annualised net interest income	-14.3	-7.2	+7.2	+14.3
As a percentage of the Group's net interest income for the year 2005	-1.9%	-1.0%	+1.0%	+1.9%

Given the re-pricing position of the assets and liabilities for the Bank's operations as at 30 June 2006, if interest rates decreased by 100 basis points (a basis point being a unit that is equal to one hundredth of 1%), the Bank would expect that annualised net interest income would fall by HK$14.3 million, representing 1.9% of the Group's net interest income for the year ended 31 December 2005. If interest rates increased by 100 basis points, the annualised net interest income would rise by HK$14.3 million, representing 1.9% of the Group's net interest income for the year ended 31 December 2005. This sensitivity analysis is for risk management purposes and assumes no other changes in the re-pricing structure. Actual changes in net interest income will vary from the model.

The table below sets out the Group's average balances of interest-earning assets and interest-bearing liabilities, interest and related average interest rates for the years ended 31 December 2003, 2004 and 2005. Average balances of interest-earning assets and interest-bearing liabilities for the years ended 31 December 2003, 2004 and 2005 are based on the arithmetic mean of the respective balances at the beginning and the end of such periods.

	Years ended 31 December								
	2003			**2004**			**2005**		
	Average balance	**Interest**	**Average rate (%)**	**Average balance**	**Interest**	**Average rate (%)**	**Average balance**	**Interest**	**Average rate (%)**
	(HK$ millions, except percentages)								
ASSETS									
Interest-earning assets									
Customer loans and credit									
Advances to customers	19,856			20,158			22,183		
Trade bills	62			79			110		
Total	19,918	669	3.4%	20,237	631	3.1%	22,293	998	4.5%
Interbank placements and loans									
Cash and short-term funds	12,195			12,804			12,703		
Placements with banks and other financial institutions	1,734			1,394			1,787		
Advances to banks	59			58			58		
Total	13,988	260	1.9%	14,256	243	1.7%	14,548	477	3.3%
Securities									
Certificates of deposit	1,315			1,301			1,635		
Debt securities	2,534			3,474			5,994		
Total	3,849	105	2.7%	4,775	116	2.4%	7,629	245	3.2%
Total interest-earning assets	37,755	1,034	2.7%	39,268	990	2.5%	44,470	1,720	3.9%
Provisions for bad and doubtful debts/impairment allowances	(453)			(367)			(245)		
Non-interest earning assets	2,263			1,748			1,442		
Total assets	39,565			40,649			45,667		
LIABILITIES									
Interest-bearing liabilities									
Deposits									
Deposits from customers	32,542	358	1.1%	33,272	334	1.0%	37,729	915	2.4%
Deposits and balances of banks and other financial institutions	728	6	0.8%	1,298	7	0.5%	1,912	52	2.7%
Total deposits	33,270	364	1.1%	34,570	341	1.0%	39,641	967	2.4%
Total interest-bearing liabilities	33,270	364	1.1%	34,570	341	1.0%	39,641	967	2.4%
Non interest-bearing liabilities	424			383			384		
Total liabilities	33,694			34,953			40,025		
NET INTEREST INCOME		670			649			753	
NET INTEREST SPREAD[1]			1.6%			1.5%			1.5%

Note:

(1) Net interest spread represents the average rate on total interest-earning assets less the average rate on total interest-bearing liabilities.

The table below sets out the Group's average balances of interest-earning assets and interest-bearing liabilities, interest and related average interest rates for the six months ended 30 June 2005 and 2006. Average balances of interest-earning assets and interest-bearing liabilities for the six months ended 30 June 2005 and 2006 are based on the arithmetic mean of the respective balances at the beginning and the end of such periods.

	Six months ended 30 June					
	2005			2006		
	Average balance	Interest	Average rate (%)	Average balance	Interest	Average rate (%)
	(HK$ millions, except percentages)					
ASSETS						
Interest-earning assets						
Customer loans and credit						
Advances to customers	21,072			24,738		
Trade bills	102			135		
Total	21,174	384	1.8%	24,873	752	3.0%
Interbank placements and loans						
Cash and short-term funds	12,824			10,718		
Placements with banks and other financial institutions	1,935			3,120		
Advances to banks	58			57		
Total	14,817	197	1.3%	13,895	369	2.7%
Securities						
Certificates of deposit	1,269			1,831		
Debt securities	4,888			10,261		
Total	6,157	87	1.4%	12,092	215	1.8%
Total interest-earning assets	42,148	668	1.6%	50,860	1,336	2.6%
Impairment allowances	(234)			(160)		
Non-interest earning assets	1,725			1,750		
Total assets	43,639			52,450		
LIABILITIES						
Interest-bearing liabilities						
Deposits						
Deposits from customers	35,835	299	0.8%	44,617	858	1.9%
Deposits and balances of banks and other financial institutions	1,377	15	1.1%	1,500	37	2.5%
Total deposits	37,212	314	0.8%	46,117	895	1.9%
Total interest-bearing liabilities	37,212	314	0.8%	46,117	895	1.9%
Non interest-bearing liabilities	536			455		
Total liabilities	37,748			46,572		
NET INTEREST INCOME		354			441	
NET INTEREST SPREAD[(1)]			0.8%			0.7%

Note:

(1) Net interest spread represents the average rate on total interest-earning assets less the average rate on total interest-bearing liabilities.

Internal Auditing

The Internal Audit Department has responsibility for auditing the Group's operations. Through regular audits of all of the departments, subsidiaries and branches of the Bank, the Internal Audit Department reviews and evaluates the adequacy and effectiveness of internal controls, safeguards the Group's assets, reviews operations in terms of efficiency and effectiveness, secures the accuracy and reliability of information and reviews compliance with established policies, procedures and relevant statutory requirements. The results of an internal audit are reported to the head of the audited department, subsidiary or branch, and any internal audit recommendations are generally expected to be implemented shortly after the issuance of the internal audit report. Significant findings arising from an internal audit are summarised by the Chief Group Auditor in bi-monthly reports to the Chairman of the Audit Committee and senior management, and in semi-annual reports submitted to the full Audit Committee and senior management. The Internal Audit Department also shares its findings with the HKMA and Deloitte Touche Tohmatsu, the Bank's external auditors, on a regular basis.

MANAGEMENT AND EMPLOYEES

The Bank is managed by its Board of Directors, which is responsible for the direction and management of the Bank. The Articles of Association of the Bank require that there be not less than seven Directors, unless and until otherwise determined by an ordinary resolution of the shareholders of the Bank. Directors are appointed either by the shareholders at a general meeting of shareholders or by the Board of Directors at any time.

Board of Directors

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

Name	Age	Title
Mr. LIU Lit Man	77	Executive Chairman
Dr. LIU Lit Mo	68	Vice Chairman
Mr. LIU Lit Chi	67	Managing Director and Chief Executive Officer
Mr. Don Tit Shing LIU	44	Executive Director and Deputy Chief Executive Officer
Mr. Wilfred Chun Ning LIU	45	Executive Director
Mr. LAU Wai Man	48	Executive Director
Mr. Frank Shui Sang JIN	49	Executive Director
Mr. Andrew Chiu Wing TSANG	49	Executive Director
Mr. George Har Kar WONG	53	Executive Director
Mr. Timothy George FRESHWATER	62	Non-executive Director
Mr. Toshiaki ARAI	52	Non-executive Director
Mr. Andrew LIU	50	Non-executive Director
Dr. SUN Jiakang	46	Non-executive Director

Name	Age	Title
Mr. Christopher Kwun Shing LIU	31	Non-executive Director
Mr. Alfred Cheuk Yu CHOW	55	Non-executive Director
Mr. WANG Zhi	44	Non-executive Director
Dr. Robin Yau Hing CHAN	74	Independent Non-executive Director
Mr. Wanchai CHIRANAKHORN	67	Independent Non-executive Director
Mr. CHENG Yuk Wo	45	Independent Non-executive Director

Mr. LIU Lit Man, GBS, JP, FIBA, *Executive Chairman*

Mr. Liu joined the Bank in 1950 and has been a Director since 1955. He is also the Chairman of both Liu Chong Hing Investment Limited and Chong Hing Insurance Company Limited. His other directorships include those in The Hong Kong and China Gas Company Limited, Asia Commercial Bank Limited and COSCO Pacific Limited. He was a Director of Tung Wah Group of Hospitals, the President of the Hong Kong Chiu Chow Chamber of Commerce (presently Permanent Honorary President), a founder and a Permanent Honorary Chairman of the Chiu Chow Association Building (Property Holding) Limited, as well as the founder and the first Chairman of the Teochew International Convention (now Permanent Honorary Chairman). Presently, he is a Permanent Honorary Chairman of The Chinese General Chamber of Commerce, Hong Kong. Mr. Liu is also a founder and a Manager of Liu Po Shan Memorial College, a Director of New Asia College of The Chinese University of Hong Kong, and the founder of the Chiu Chow Association Secondary School. In 1975, he was appointed a Justice of the Peace and was elected Fellow of the International Banker Association. He has been a Member of the Consultative Committee for the Basic Law from 1985 to 1990 and was a Member of the Selection Committee of the First Government of the Hong Kong Special Administrative Region. He was a Member of the First Election Committee constituted under the Chief Executive Election Ordinance. Mr. Liu was awarded the Gold Bauhinia Star by the Government of the Hong Kong Special Administrative Region in July 2001.

Dr. LIU Lit Mo, LLD, MBE, JP, Vice *Chairman and Executive Director*

Dr. Liu was appointed a Director in 1958 and was a Deputy Managing Director of the Bank from 1961 to 1973. Dr. Liu is also the Managing Director of Liu Chong Hing Investment Limited and a Director of China Motor Bus Company Limited. As for community service, Dr. Liu was the Chairman of Tung Wah Group of Hospitals in 1967 and is now serving as an Adviser of the Group. He had also been President of the Hong Kong Chiu Chow Chamber of Commerce, Chairman of the Hong Kong Football Association and District Governor of District 3450, Rotary International. Presently, he is a member of the Board of Trustees of United College, The Chinese University of Hong Kong and a Manager of Liu Po Shan Memorial College. He was awarded the Silver Jubilee medal by Her Majesty the Queen in 1977. Dr. Liu was conferred an Honorary Doctor's Degree in Laws by the Lingnan University in 2005.

Mr. LIU Lit Chi, *Managing Director and Chief Executive Officer*

Mr. Liu has been a Director since 1958 and an Executive Director since 1961. Mr. Liu is also an executive director of Liu Chong Hing Investment Limited and holds directorships in a number of other companies in Hong Kong and overseas. Mr. Liu received his education in Hong Kong and the United Kingdom.

Mr. Don Tit Shing LIU, *Executive Director and Deputy Chief Executive Officer*

Mr. Liu graduated from Oxford University and is an associate member of the Institute of Chartered Accountants in England & Wales and a fellow of the Hong Kong Institute of Certified Public Accountants. Mr. Liu joined the Bank in 1992.

Mr. Wilfred Chun Ning LIU, *Executive Director*

Mr. Liu is an Executive Director in charge of the Securities Business Division of the Bank. He holds a Bachelor's degree in Economics from the University of Newcastle-upon-Tyne (UK). He joined the Bank in 1993 and became a Director in 1998.

Mr. LAU Wai Man, *Executive Director*

Mr. Lau is an Executive Director in charge of the Retail Banking Business Division of the Bank. He holds a Bachelor of Law degree and a Master of Business Administration degree. Mr. Lau is a member of the Hong Kong Institute of Certified Public Accountants, a fellow of the Association of Chartered Certified Accountants and a Certified Financial Planner^{CM}. He was a senior associate of the Australian Institute of Bankers. Mr. Lau joined the Bank as the Chief Auditor in 1988 and became a Director of the Bank in August 2001. Before joining the Bank, he had worked for an international bank and an international accounting firm.

Mr. Frank Shui Sang JIN, *Executive Director*

Mr. Jin is an Executive Director in charge of the Finance and Treasury Management Division of the Bank. He holds a Master of Business Administration degree from City University in London, and is a certified public accountant (practising) registered in Hong Kong. Mr. Jin joined the Bank in 1997 and became a Director of the Bank in August 2001. Before joining the Bank, he held senior positions in an international accounting firm and a listed company.

Mr. Andrew Chiu Wing TSANG, *Executive Director*

Mr. Tsang is an Executive Director in charge of the Information Technology Division of the Bank. He holds a Master of Science degree in Electronic Commerce and Internet Computing from the University of Hong Kong, and is a member of the Institute of Chartered Accountants in England & Wales and a fellow member of the Hong Kong Institute of Certified Public Accountants. Mr. Tsang joined the Bank in 2000 and became a Director of the Bank in August 2005. Before joining the Bank, he held senior positions in an international accounting firm and a major international bank in Hong Kong.

Mr. George Har Kar WONG, *Executive Director*

Mr. Wong is an Executive Director in charge of the Credit Control Division and Credit Risk Management Department of the Bank. He is a member of the Institute of Chartered Accountants in England & Wales and the Hong Kong Institute of Certified Public Accountants. Mr. Wong joined the Bank in 2002 and became a Director of the Bank in August 2005. Before joining the Bank, he held senior positions in an international accounting firm and a major international bank in Hong Kong.

Mr. Timothy George FRESHWATER, *Non-executive Director*

Mr. Freshwater was an Independent Non-executive Director since April 1997 and became a Non-executive Director of the Bank in September 2004. He is a solicitor in the UK and Hong Kong and is a past President of the Law Society of Hong Kong. After graduating from Cambridge University, he joined the international law firm Slaughter and May in 1967 and remained with them for 29 years, leaving in July 1996 to join Jardine Fleming. He became Chairman of Jardine Fleming in 1999. In 2001, Mr. Freshwater joined Goldman Sachs (Asia) L.L.C. and is now Vice Chairman.

Mr. Toshiaki ARAI, *Non-executive Director*

Mr. Arai is a Director, Regional Head for Hong Kong and General Manager of The Bank of Tokyo-Mitsubishi UFJ, Ltd, Hong Kong Branch. He joined The Bank of Tokyo, Ltd in 1977 and has more than 28 years of experience in banking. Mr. Arai's expertise lies in the area of Corporate Banking and Corporate Banking Planning activities. During this period, Mr. Arai has been appointed to work in The Bank of Tokyo Trust Co in New York and also the London Branch of The Bank of Tokyo, Ltd. He is currently a Committee Member of The Hong Kong Association of Banks. Mr. Arai graduated from Hitotsubashi University in 1977 with a Bachelor's degree in Commerce and Management. He was appointed a Non-executive Director of the Bank in November 2003.

Mr. Andrew LIU, *Non-executive Director*

Mr. Liu has been a member of the Board since 1977 and was redesignated from Executive Director to Non-executive Director of the Bank in May 1999. Mr. Liu is also a Director of Liu Chong Hing Investment Limited. He is the Chief Executive Officer of CCMP Capital Asia Pte Ltd (formerly known as "JP Morgan Partners Asia Pte Ltd"). Mr. Liu, holder of a Master of Arts degree from the Oxford University in England, was a solicitor with Slaughter and May in London before joining Morgan Stanley & Co Inc in New York in 1981. Mr. Liu was promoted to Managing Director in 1990 before relocating to Morgan Stanley Asia Limited in Hong Kong, where he assumed the position of President and Managing Director until his resignation in September 1997. Mr. Liu remains associated with Morgan Stanley as an Advisory Director. He is a son of Mr. Liu Lit Man.

Dr. SUN Jiakang, *Non-executive Director*

Dr. Sun has been a member of the Board since November 2002. He is also the Vice Chairman and Managing Director of COSCO Pacific Limited, an Executive Vice President of China COSCO Holdings Company Limited, a director of China International Marine Containers (Group) Co., Ltd., a fellow member of the Hong Kong Institute of Directors and a member of the International WHO's WHO of Professionals and a visiting professor at Dalian Maritime University. Dr. Sun graduated from the Faculty of Navigation of Dalian Maritime Transportation Institute with a bachelor degree in shipping management in 1982 and obtained a bachelor degree in economic management of industrial enterprises from the People's University of China in 1987, a master degree in management from Dalian Maritime University in 2001 and a doctor or philosophy (PhD) degree in management from Preston University, USA in 2005. After graduating from university in 1982, Dr. Sun joined the COSCO Group and was the Assistant to the President and Spokesman of China Ocean Shipping (Group) Company. For the past 24 years, Dr. Sun has committed to shipping management and has accumulated rich experiences in international shipping and logistics operations and has demonstrated excellent management skills. Dr. Sun joined COSCO Pacific Limited in September 2002 and is responsible for the overall strategic planning, corporate development, management and administration of COSCO Pacific Limited.

Mr. Christopher Kwun Shing LIU, *Non-executive Director*

Mr. Liu is a qualified solicitor in both England & Wales and Hong Kong. A holder of a Master of Arts degree in Jurisprudence from the University of Oxford, Mr. Liu is currently a practising solicitor with Deacons in Hong Kong. Mr. Liu served as an Alternate Director to Dr. Liu Lit Chung, a former Director of the Bank, from July 2000 to July 2002. He became a Director of the Bank in July 2002. Mr. Liu is also a director of Liu Chong Hing Investment Limited as an alternate director to Dr. Liu Lit Chung.

Mr. Alfred Cheuk Yu CHOW, JP, *Non-executive Director*

Mr. Chow was redesignated from Independent Non-executive Director, an office that he had held since February 2003, to Non-executive Director of the Bank in September 2004. He graduated from the University of Hong Kong with a Bachelor of Laws Degree and a Master of Social Sciences (Public Administration) Degree. With 17 years of working experience in the civil service and over 20 years as a solicitor, Mr. Chow is presently the senior partner of Kwan & Chow, Solicitors, a law firm in Hong Kong. He is also a China-Appointed Attesting Officer.

Mr. WANG Zhi, *Non-executive Director*

Mr. Wang has been a member of the Board since November 2005. He is also a deputy managing director of COSCO Pacific Limited. He joined COSCO Pacific Limited in April 2001 and was appointed as an executive director of COSCO Pacific Limited in July 2005. He graduated from Jimei Navigation College in 1980. He then furthered his studies in the Shanghai Maritime University and obtained an International Executive Master of Business Administration degree from the International School of Management in Paris in 2000. Prior to joining COSCO Pacific Limited, he worked in COSCO Guangzhou in 1980 and gained more than 13 years of work experience in shipping industries there. Since 1993, he has been the Deputy Chief Executive Officer of COSCO (UK) Limited, the Managing Director of Crystal Logistics Ltd and the Managing Director of COSCO France SA. Mr. Wang is now responsible for the management and investment of the container terminals and container-related industrial businesses of COSCO Pacific Limited.

Dr. Robin Yau Hing CHAN, GBS, LLD, JP, EOE, *Independent Non-executive Director*

Dr. Chan has been a member of the Board since October 1981 and was redesignated from Non-executive Director to Independent Non-executive Director of the Bank in April 2005. He is a Deputy to the Chinese National People's Congress and the Ex-officio Life Honorary Chairman of the Chinese General Chamber of Commerce, Hong Kong. Dr. Chan, the Chairman of Asia Financial Holdings Limited, also serves as an independent non-executive director for certain other listed companies.

Mr. Wanchai CHIRANAKHORN, *Independent Non-executive Director*

Mr. Chiranakhorn has been an Independent Non-executive Director of the Bank since September 1998 and is the Chairman of the Executive Board of Directors of C Wans Assets Co, Ltd. He has more than 25 years of experience as an international banker. Upon graduation from Baptist College, Hong Kong in 1964, he served in banks in Hong Kong, London, Bangkok and Malaysia. He joined the Bank in 1985 and became a Director in 1987. Before his departure in May 1995, Mr. Chiranakhorn served as an executive director in charge of the Overseas Business Development Department. He was a Non-executive Director of the Bank from May 1995 to September 1998.

Mr. CHENG Yuk Wo, *Independent Non-executive Director*

Mr. Cheng has been an Independent Non-executive Director of the Bank since September 2004. Mr. Cheng is also a member of the Bank's Audit Committee and Remuneration Committee. Mr. Cheng, a co-founder of a Hong Kong merchant banking firm as well as consultant to several listed companies, is currently the proprietor of a certified public accountant practice in Hong Kong. Mr. Cheng obtained a Master of Science (Economics) degree in Accounting and Finance from the London School of Economics, England and a Bachelor of Arts (Honours) degree in Accounting from the University of Kent, England. He is a fellow of the Institute of Chartered Accountants in England & Wales and the Hong Kong Institute of Certified Public Accountants, and a member of the Institute of Chartered Accountants of Ontario, Canada. Mr. Cheng has more than 20 years of expertise in financial and corporate advisory services in mergers, acquisitions and investments. He has worked at Coopers and Lybrand (now known as PricewaterhouseCoopers) in London and Swiss Bank Corporation (now known as UBS AG) in Toronto, and held senior management positions in a number of Hong Kong listed companies. Mr. Cheng also serves as an independent non-executive director for certain other listed companies.

Organisation

The Board of Directors of the Bank is responsible for the overall management of the Bank and its subsidiaries. To assist the Board of Directors in managing the Group, a number of committees have been established, including the Audit Committee and the Remuneration Committee. The Audit Committee comprises two independent non-executive directors and one non-executive director and is required, amongst other things, to oversee the relationship with the external auditors, to advise the Board of Directors on the appointment and retention of the external auditors, to review the external auditors' independence and objectivity, to review the half-yearly and annual reports and accounts, to review the external auditors' management letter, to hold meetings with the HKMA, to assess the adequacy and effectiveness of the Bank's systems of internal control, to review the internal audit function, and to review and recommend internal procedures to ensure compliance with regulatory requirements and generally accepted accounting standards. The Remuneration Committee comprises two independent Non-executive Directors and one Non-executive Director and reviews and makes recommendations to the Board of Directors on the remuneration policy applicable to Directors and senior management of the Bank, and ensures that the Bank is able to attract, retain, and motivate a high-calibre team of senior executives which is essential to the success of the Bank.

In addition to the Audit Committee and the Remuneration Committee, the Bank has a number of other committees which assist management in the operation of the Bank. These include:

- the Executive Committee, which comprises all the Executive Directors and is responsible for steering the Group's policy and operational decisions on a day-to-day basis and attending to matters that require the review and supervision of the Board of Directors between regular board meetings;

- the Executive Management Committee, comprising the Managing Director and Chief Executive Officer, certain other Executive Directors and division heads, which is responsible for formulating operation and management policies, discussing significant daily operational issues, reviewing key business performance and discussing business opportunities arising from changing market and competitive conditions;

- the Executive Loans Committee which comprises all the Executive Directors and serves to guide and review the operations of, and to delegate proper authorities as it deems appropriate from time to time to, the Loans Committee, as well as approving large and certain specific new loan applications and applications for renewal and amendment of existing loans, having due regard to the Bank's lending policy and the relevant laws and regulations;

- the Loans Committee, which is responsible for ensuring that the Group's lending policy is adequate, issuing guidelines from time to time to guide lending activities of the Group, directing the Credit Risk Management Department to monitor loans portfolio quality and take corrective actions such as implementing debt-restructuring schemes and maintaining adequate provisions for loan losses, meeting regularly to evaluate loan applications and make credit decisions, monitoring of compliance with statutory lending limits, assessing and approving new loan products and attending to instructions of the Executive Loans Committee;

- the Asset and Liability Management Committee, which comprises senior staff members of all major divisions and is responsible for facilitating the oversight of the Board of Directors in the management of the assets and liabilities of the Group from the perspective of containing the pertinent liquidity, interest rate, foreign exchange and other market risks as well as assessing the impact of the current economic and business climate on the Group's balance sheet, the formulation of the corresponding strategies and plans and the evaluation of non-credit related products;

- the Risk Management and Compliance Committee, which comprises senior staff members who are responsible for risk management, compliance issuers and operations and is responsible for facilitating the oversight of the Board of Directors concerning risk management and compliance issues of the Bank. It discharges its responsibility by identifying and analysing major risk management and compliance issues, and by approving and overseeing the implementation of the risk management and compliance policies and procedures. It is also responsible for coordinating and monitoring the implementation of the recommendations made by the regulators. Regular reports as prepared by this committee are submitted to the Board;

- the Information Technology Committee, which comprises senior staff members including the Executive Directors in charge of the Retail Banking Business Division and the Information Technology Division and formulates the information technology strategic plan and policy to concur with the development of banking business, reviews and approves annual budget proposals of information technology services, oversees information technology operations and developments, appraises the viability and worth of information technology projects to be undertaken and recommends priorities and funding for projects, promotes and facilitates uniformity in the development of information systems and exchanges of data through use of standards, and facilitates the use of information technology in ways that minimise fraud, enhance safety and protect privacy; and

- the Human Resources Committee, which comprises senior staff members of the Bank and formulates human resources polices that cover areas including recruitment and retention, selection and assessment, grading and succession planning, pay, pensions, performance management and incentives, job rotation, staff training and personal development, management development and employee relationship. It also plans, monitors, evaluates and reviews all matters relating to staff training.

MATERIAL RELATED PARTY TRANSACTIONS

The Bank has, from time to time, entered into a number of transactions with its related parties, including its jointly controlled entities, substantial shareholders, and directors and their family members and companies controlled or significantly influenced by them. The transactions include, among others, lending, accepting deposits from and extending credit facilities to them, participating in loan syndicates, providing cheque clearing services, stockbroking and nominee services, remittances and foreign exchange services to them, accepting property consultancy and property management services from them, and leasing office premises from them. Such transactions have included transactions with the members of the Liu family or companies controlled or significantly influenced by them, including but not limited to Liu Chong Hing Investment Limited.

The Bank conducts all transactions with its related parties on an arm's length basis and believes that such transactions have been generally as favourable to it as similar transactions with unrelated third parties would have been. The Bank has three directors who are independent directors in accordance with the criteria set out in the listing rules of the HKSE and maintains internal policies and procedures to prevent possible conflicts of interest. As a matter of internal policy, the relevant related party as well as all other parties interested in any proposed related party transaction are not allowed to participate in the decision-making process relating to such transaction. The Bank is also subject to, and must comply with, the listing rules of the HKSE which govern "connected transactions" (as defined in the HKSE listing rules) as well as the requirements of the HKMA. As at the date of this Offering Circular, the Bank has been and is in full compliance with all HKMA requirements, including but not limited to Sections 81 and 83 of the Banking Ordinance, and all requirements and regulations of the HKSE and all other relevant regulatory bodies.

The HKSE has issued waiver letters dated 17 June 1994 and 28 November 1997 to the Bank, which states that the Bank will not be required to comply with certain requirements set out in Chapter 14 of the HKSE listing rules in respect of certain banking transactions between the Group and Liu Chong Hing Investment Limited, The Bank of Tokyo-Mitsubishi UFJ, Ltd and COSCO Pacific Limited (each a substantial shareholder of the Bank) and their respective subsidiaries, subject to, among others, the condition that an auditor's letter, stating that such transactions have been approved by the Bank's Board of Directors and that they have been entered into based on normal commercial terms, must be submitted by the Bank to the HKSE on an annual basis. As at 31 December 2005 and 30 June 2006, the interest income derived from related party transactions represented 2.6% and 2.1% of the Bank's gross interest income respectively.

In addition, with respect to loan transactions, the Banking Ordinance stipulates, among others, that exposure to any one person or group of companies must be limited to 25.0% of the Bank's capital base and that no unsecured loans above the amount of HK$1 million may be provided to a related party (being an individual). As at 31 December 2005 and 30 June 2006, related party lending represented 4.0% and 2.9% of the Bank's total assets respectively.

A summary of significant transactions entered into by the Bank with its related parties in 2005 and 2006 is set out below.

In accordance with a conditional sale and purchase agreement dated 3 March 2005 between the Bank and Liu Chong Hing Investment Limited, the Bank acquired Chong Hing Insurance Company Limited (formerly known as "Liu Chong Hing Insurance Company Limited") from Liu Chong Hing Investment Limited for a total cash consideration of HK$212 million. The purpose of the transaction was to improve the operation efficiency of both the Bank and Liu Chong Hing Investment Limited. The transaction is entered into under normal commercial terms and priced based on relevant market rates at the time of the transaction and is under the same terms as those available to unrelated third parties.

In accordance with a sale and purchase agreement dated 16 March 2006 between the Bank and Bonsun Enterprises Limited, a wholly-owned subsidiary of Liu Chong Hing Investment Limited, the Bank acquired a property in Hong Kong from Bonsun Enterprises Limited for a total cash consideration of approximately HK$13.8 million. The purpose of the transaction was to obtain additional warehousing space for the Bank. The transaction is entered into under normal commercial terms and priced based on relevant market rates at the time of the transaction and is under the same terms as those available to unrelated third parties.

As at 30 June 2006, all interest rates in connection with the deposits taken and credit facilities extended are under terms and conditions normally applicable to customers of comparable standing. The interest received from and interest paid to the Bank's related parties for the years ended 31 December 2004 and 2005 and the six months ended 30 June 2006, and the outstanding balances of amounts due from and due to them as at 31 December 2004, 31 December 2005 and 30 June 2006, are set out in the table below as a percentage of the Group's consolidated interest income, interest expense, total assets and total deposits, respectively:

	As at 31 December		**As at 30 June**
	2004	**2005**	**2006**
	(Percentage of the Group's total assets)		
Interest income	3.1	2.6	2.1
Interest expense	1.1	2.2	2.0
Amount due from related parties(1)(2)	5.1	4.0	2.9
Amount due to related parties(2)(3)	2.7	2.5	3.2

Notes:

(1) Based on total assets (excluding cash and short-term funds, placements with banks and other financial institutions maturing between one and twelve months), interests in jointly controlled entities, property and equipment and prepaid lease payments for land.

(2) Related parties include, without limitation, members of the Liu family.

(3) Based on deposits from customers.

PRINCIPAL SHAREHOLDERS AND DIRECTORS' INTERESTS

Registered Shareholders

As at 30 June 2006, the following corporations were holding 5% or more of the issued shares of the Bank according to its Register of Members:

Name of Shareholder	Number of shares held	Percentage of shares
Liu Chong Hing Estate Company, Limited	199,145,628[1),(3]	45.78
Bauhinia 97 Ltd	87,000,000[2]	20.00
The Bank of Tokyo-Mitsubishi UFJ, Ltd (formerly known as "The Mitsubishi Bank, Limited" and "The Bank of Tokyo-Mitsubishi, Ltd")	42,000,000[3]	9.66
Third Avenue Management LLC	26,241,000[4]	6.03

Interests of Substantial Shareholders and Other Persons

As at 30 June 2006, the following interests and short positions of Substantial Shareholders and Other Persons of the Bank in the shares and underlying shares of the Bank were recorded in the Register required to be kept by the Bank under section 336 of the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong) (the "**SFO**"):

Name of Shareholder	Number of shares held	Percentage of shares
Liu Chong Hing Investment Limited	199,145,628[1)(3]	45.78
Liu's Holdings Limited	199,145,628[1)(3]	45.78
COSCO Pacific Limited	87,000,000[2]	20.00
COSCO Pacific Investment Holdings Limited	87,000,000[2]	20.00
China COSCO Holdings Company Limited	87,000,000[2]	20.00
China Ocean Shipping (Group) Company	87,000,000[2]	20.00
Mitsubishi UFJ Financial Group, Inc (formerly known as "Mitsubishi Tokyo Financial Group, Inc")	42,000,000[3]	9.66

Notes:

(1) Liu Chong Hing Estate is a wholly-owned subsidiary of Liu Chong Hing Investment Limited, a public company listed on the Hong Kong Stock Exchange. Liu's Holdings Limited, a private company, had interests in about 45% of Liu Chong Hing Investment Limited's issued and fully-paid share capital. The references to the 199,145,628 shares in question all relate to the same block of 199,145,628 shares held by Liu Chong Hing Estate.

(2) China Ocean Shipping (Group) Company has a 63.5% interest in China COSCO Holdings Company Limited ("**COSCO Holdings**"), which in turn wholly owns COSCO Pacific Investment Holdings Limited ("**COSCO Pacific Investment Holdings**"). COSCO Pacific Investment Holdings has a 51.58% interest in COSCO Pacific Limited. Both COSCO Holdings and COSCO Pacific Limited are public companies listed on the Hong Kong Stock Exchange. The references to the 87,000,000 shares in question all relate to the same block of 87,000,000 shares registered in the name of Bauhinia 97 Ltd, which is a company wholly-owned by COSCO Pacific Limited.

(3) The Bank of Tokyo-Mitsubishi UFJ, Ltd is a wholly-owned subsidiary of Mitsubishi UFJ Financial Group, Inc (formerly known as Mitsubishi Tokyo Financial Group, Inc). The references to the 42,000,000 shares in question both relate to the same block of 42,000,000 shares registered in the name of The Bank of Tokyo-Mitsubishi UFJ, Ltd.

Pursuant to an agreement in 1994, The Bank of Tokyo-Mitsubishi UFJ, Ltd has granted an option to Liu Chong Hing Estate exercisable at any time during the term of that agreement to purchase 40,000,000 of the 42,000,000 shares in question and The Bank of Tokyo-Mitsubishi UFJ, Ltd is required to offer to sell all such 40,000,000 shares to Liu Chong Hing Estate in certain circumstances.

(4) Third Avenue Management LLC ("**Third Avenue Management**"), a United States based Registered Investment Adviser, acts as adviser to various portfolios held for the benefit of mutual funds, private partnerships, institutions, individuals,, etc. Third Avenue Management has investment advisory authority over portfolios holding in the aggregate of 26,241,000 shares in the Bank.

Save as disclosed above, no other interest or short position in the shares or underlying shares of the Bank were recorded in the Register.

Interests of Directors and Chief Executive Officer in the Securities of the Bank and Associated Corporations

As at 30 June 2006, the following interests and short positions of the Directors and Chief Executive Officer of the Bank in the shares, underlying shares and debentures of the Bank and its associated corporations were recorded in the Register required to be kept under section 352 of the SFO:

Name of Director	Personal interests	Corporate interests	Total interests
Mr. LIU Lit Man	3,447,928	239,145,628 (1)	242,593,556
Dr. LIU Lit Mo	1,009,650	239,145,628 (1)	240,155,278
Mr. LIU Lit Chi	313,248	241,408,839 (1)(2)	241,722,087
Mr. Don Tit Shing LIU	15,000	–	15,000
Dr. Robin Yau Hing CHAN	48,400	1,018,000 (3)	1,066,400
Mr. Timothy George FRESHWATER	396	–	396
Mr. Andrew LIU	60,000	–	60,000

Notes:

(1) 239,145,628 shares in the Bank are attributed as follows:

(i) 199,145,628 shares held by public listed Liu Chong Hing Investment Limited's wholly-owned subsidiary, Liu Chong Hing Estate, in which each of Messrs Liu Lit Man, Liu Lit Mo and Liu Lit Chi (being both a shareholder and a director of Liu's Holdings Limited) is deemed under the SFO to be interested through Liu's Holdings Limited, a private company holding approximately 45% of Liu Chong Hing Investment Limited's issued and fully-paid share capital; and

(ii) 40,000,000 shares held by The Bank of Tokyo-Mitsubishi UFJ, Ltd. Pursuant to an agreement in 1994, The Bank of Tokyo-Mitsubishi UFJ, Ltd has granted an option to Liu Chong Hing Estate exercisable at any time during the term of that agreement to purchase all such shares and The Bank of Tokyo-Mitsubishi UFJ, Ltd is required to offer to sell all such shares to Liu Chong Hing Estate in certain circumstances. By virtue of the interests of Messrs Liu Lit Man, Liu Lit Mo and Liu Lit Chi in Liu Chong Hing Estate through Liu's Holdings Limited, each of them is deemed under the SFO to be interested in such shares.

As a result of the attribution of aggregate corporate interests in shares of the Bank as described above, the Directors and the Chief Executive Officer of the Bank were attributed with the following interests in shares of the Bank (equal to the sum of the relevant individual's personal interest, if any, and the attributable aggregate corporate interest), as a percentage of the Bank's total issued share capital, as of 30 June 2006:

Name of Director	Percentage of Issued Share Capital
Mr. Liu Lit Man	55.76863
Dr. Liu Lit Mo	55.20811
Mr. Liu Lit Chi	55.56830
Mr. Don Tit Shing LIU	0.00345
Dr. Robin Yau Hing CHAN	0.24515
Mr. Timothy George FRESHWATER	0.00009
Mr. Andrew LIU	0.01379

(2) 2,263,211 shares in the Bank are held by Alba Holdings Limited, shareholders of which include Mr. Liu Lit Chi and his associates. Accordingly, Mr. Liu Lit Chi is deemed under the SFO to be interested in such shares.

(3) 1,018,000 shares in the Bank are held collectively by Asia Panich Investment Company (Hong Kong) Limited and United Asia Company Limited. These corporations or their directors are accustomed to acting in accordance with Dr. Robin Yau Hing Chan's directions or instructions.

Save as disclosed above, no other interest or short positions in the shares, underlying shares or debentures of the Bank or any of its associated corporations were recorded in the Register.

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 30 September 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 30 September 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 30 September 2006, there were 137 licensed banks, 32 restricted licence banks and 34 deposit-taking companies operating in Hong Kong; 24 of the licensed banks were incorporated in Hong Kong (including the Bank), with the balance of 113 incorporated overseas.

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 30 June 2006 the Group's capital adequacy ratio was 14.79%. 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 at a compound annual rate of 6.27% from HK$5,999,078 million as at 31 December 2002 to HK$7,246,969 million as at 31 December 2005. As at 31 August 2006, the total assets of all authorised institutions increased to HK$8,002,800 million. Within this total, Hong Kong dollar assets increased at a compound annual rate of 4.28% while assets denominated in foreign currencies increased at a compound annual rate of 8.24% from 31 December 2002 to 31 December 2005. As at 31 August 2006, 57.03% of the assets of all authorised institutions were denominated in foreign currencies.

Loans and Advances

As at 30 June 2006, loans and advances to customers represented 31.53% 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 decreased at a compound annual rate of 2.39% from HK$2,076,325 million as at 31 December 2002 to HK$1,930,316 million as at 31 December 2005. Approximately 77.01% of loans and advances to customers extended by all authorised institutions in Hong Kong were denominated in Hong Kong dollars as at 30 June 2006, with the rest in foreign currencies. As at that date, of the total loans and advances to customers of HK$2,417,491 million extended by all authorised institutions, 6.30% was extended to finance imports to or exports or re-exports from Hong Kong and merchandising trade not touching Hong Kong, 81.57% was classified as "Loans and Advances for use in Hong Kong" and 12.14% was 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 30 June 2006.

Sector	Percentage of Total
Professional and Private Individuals	38.79
Building, Construction, Property Development and Investment	24.30
Financial Concerns	9.26
Wholesale and Retail Trade	5.30
Manufacturing	6.10
Transport and Transport Equipment	6.49
Electricity, Gas and Telephone	1.76
Others	8.01
Total	100.00

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 30 June 2006, interbank lending represented 26.47% of the total assets of all authorised institutions in Hong Kong, with 77.51% of such lending being to banks outside Hong Kong.

Funding

Deposits from Customers

As at 30 June 2006, deposits from customers represented 55.47% of the total liabilities of all authorised institutions in Hong Kong. Total deposits from customers of all authorised institutions increased at a compound annual rate of 7.03% from HK$3,317,542 million as at 31 December 2002 to HK$4,067,901 million as at 31 December 2005 and, at the end of 31 August 2006, total deposits increased to HK$4,453,158 million, of which 53.05% of total customer deposits with authorised institutions were denominated in Hong Kong dollars. As at 31 August 2006, deposits from customers with licensed banks represented 99.39% of deposits from customers with all authorised institutions in Hong Kong. As at 31 August 2006, time deposit accounts, demand accounts and savings accounts accounted for 65.80%, 6.88%, and 27.33%, 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 August 2006, interbank liabilities represented 27.64% 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 August 2006, 77.17% 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 August 2006, the total outstanding value of negotiable certificates of deposit issued by authorised institutions in Hong Kong amounted to HK$253,246 million, of which 53.29% was denominated in Hong Kong dollars.

The business of banking in Hong Kong principally 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 (that is, a bank which has been granted a banking licence ("**licence**") by the HKMA) may carry on banking business (as defined in the Banking Ordinance) in Hong Kong and contains controls and restrictions on such banks ("**licensed banks**").

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 report by the licensed bank's auditors (approved by the HKMA for the purpose of preparing the report) confirming, amongst other things, that the returns referred to in (1) above have been correctly compiled from the licensed bank's books and records, that the licensed bank has adequate systems of control to enable the licensed bank to comply with relevant 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 beneficial ownership of such companies' share capital 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 if they cease to carry on the business of taking deposits or of the likelihood of them becoming unable to meet their obligations and, in the case of licensed banks incorporated in Hong Kong, of the commencement of civil proceedings material to their financial position;

(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 incorporated in Hong Kong 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 or of a person ceasing to be auditor other than as a result of a resolution to so remove or replace him.

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 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 other 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 affairs, 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 appointed by the HKMA;

(3) to direct that such of the business, affairs and property of the licensed bank shall be managed by a Manager appointed by the HKMA for a period specified by the HKMA; 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 authorisation and the requirements for registration;

(2) the licensed bank is likely to become unable to meet its obligations or to suspend payment 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 or executive officer in breach of the requirements of the Banking Ordinance;

(6) the interests of the depositors or potential depositors are threatened by the licensed bank continuing to be licensed; or

(7) the licensed bank is engaging in practices likely to prejudice Hong Kong as an international financial centre or in practices specified in guidelines issued pursuant to a notice under the Banking Ordinance 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, namely, renewable periods of up to 6 months 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 8.0%, calculated as the ratio (expressed as a percentage) of its capital base to its risk-weighted exposure in accordance with the third schedule of the Banking Ordinance 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 vary the ratio and 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, after non-binding discussions with the licensed bank, 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, advances 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% as being the percentage of the relevant item to which the risk-weight factor should be applied.

The Banking (Amendment) Ordinance 2005, enacted on 6 July 2005, has put in place a legislative framework for the implementation of the Basel Committee on Banking Supervision's revised capital adequacy standards (commonly known as "Basel II") in Hong Kong. The HKMA has announced that it intends to adopt the Basel II Accord capital adequacy standards in Hong Kong in the beginning of 2007.

Liquidity

Licensed banks 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 to 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, after non-binding discussions with the licensed bank, 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 and the liquidity ratio provisions apply to this "separate" licensed bank.

Highly liquid 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 on 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 25.0% 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;

(3) financial exposure specified by the HKMA; and

(4) 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 authorised institutions or financial exposure generally to the extent it is secured by a cash deposit, a guarantee, an undertaking which in the opinion of the HKMA is similar to a guarantee, certain specified securities or a letter of comfort in each case accepted by the HKMA.

If a person or a company to whom an authorised institution is financially exposed is a trustee of more than one trust, the HKMA may, by notice in writing and subject to such conditions as it may wish to impose, extend the limit on the licensed bank'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 or incur any other liability 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 unsecured facilities which a Hong Kong incorporated licensed bank may make available to its controllers, its directors, their relatives or certain of its employees and persons associated with any of them shall be subject to restrictions; 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 25.0% 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 25.0% 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.

A licensed bank incorporated in Hong Kong shall not acquire or hold all or part of the share capital of a company to a value exceeding 5.0% of the licensed bank's capital base at the time of the acquisition except with the approval of the HKMA.

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 80.0% of a licensed bank's capital base.

Charges

A licensed bank incorporated in Hong Kong is not, except with the approval of the HKMA, permitted to create any charges over its assets if either the aggregate value of all charges existing over its total assets is 5.0% 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 5.0% 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 impose in respect of any such approved overseas companies such 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 the HKMA 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 he 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 on the shares shall be paid.

In addition, the HKMA may, whether at the request of the relevant controller or of its own volition, 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 and an alternative chief executive (in the case of non-Hong Kong licensed banks only, in respect of the Hong Kong business of the licensed banks) ordinarily resident in Hong Kong. A person requires the 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. Notice must be given to the HKMA of the appointment or termination of managers of a licensed bank's business together with certain particulars of the business of the licensed bank in relation to which the relevant person is, or has ceased to be, a manager.

Supervision of Securities Business

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 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 securities businesses of banks and other 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$125,000,000 Floating Rate Subordinated Notes due 2016 (the "**Notes**", which expression shall in these Conditions, unless the context otherwise requires, include any further Notes issued pursuant to Condition 16) of Liu Chong Hing Bank Limited (the "**Issuer**") are constituted by a Trust Deed (the "**Trust Deed**") dated 15 December 2006 (the "**Issue Date**") made between the Issuer and DB Trustees (Hong Kong) Limited (the "**Trustee**", which expression shall include its successors(s)) as trustee for the holders (as defined below) of the Notes.

The issue of the Notes was authorised by a resolution of the Board of Directors of the Issuer on 29 November 2006.

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 Agency Agreement dated 15 December 2006 (the "**Agency Agreement**") made between the Issuer, Deutsche Bank AG, Hong Kong Branch as principal paying agent and the agent bank (the "**Principal Paying Agent**" and the "**Agent Bank**"), Deutsche Bank AG, Hong Kong Branch as registrar (the "**Registrar**") and the other Agents named therein and the Trustee 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 55th Floor, Cheung Kong Center, 2 Queen's Road Central, Hong Kong, and at the specified office of each of the 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. 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 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.*

1. Form, Denomination and Title

(1) *Form and Denomination*

The Notes are issued in registered form, serially numbered, in 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 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 of Noteholders. 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 (other than a duly completed and signed form of transfer), 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 of Noteholders.

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 any of the Agents.

(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 relevant Agent of the duly completed form of transfer endorsed on the relevant Certificate, be mailed by uninsured mail at the risk of the holder entitled to the Note to the address 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 Agent with whom a Certificate is deposited in connection with a transfer is located.

Except in the limited circumstances described herein (see "The Global Certificate — Change of Registration of Title"), 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 relevant Agent of the original Certificate, be mailed by uninsured mail at the risk of the holder of the Notes not so transferred to the address of such holder appearing on the register of Noteholders 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 any Agent may reasonably 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 of Noteholders 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 and the Trustee. 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*

(a) The Notes constitute direct, unsecured and, in accordance with sub-paragraph (b) below, subordinated obligations of the Issuer, ranking *pari passu* without any preference among themselves.

(b) The claims of the holders of the Notes will, in the event of the winding up of the Issuer, be subordinated in right of payment in the manner provided in the Trust Deed to the claims of depositors and all other unsubordinated creditors of the Issuer and will rank, in the event of the winding up of the Issuer, at least *pari passu* in right of payment with all other Subordinated Indebtedness, present and future, of the Issuer. Claims in respect of the Notes will rank in priority to the rights and claims of holders of subordinated liabilities which by their terms rank or are expressed to rank in right of payment junior to the Notes and of all classes of equity securities of the Issuer, including holders of preference shares, if any.

(2) *Waiver of Set-Off*

Claims in respect of any Notes may not be set-off, or be the subject of a counterclaim, by the holder against or in respect of any obligations of the holder to the Issuer or to any other persons and the holder of any Note shall, by virtue of being the holder of any Note, be deemed to have waived all such rights of set-off and counterclaim to the fullest extent permitted by applicable law.

(3) *Noteholders to Account*

In the event that any Noteholder nevertheless receives (whether by set-off or otherwise) directly in a winding up proceeding in respect of the Issuer any payment by, or distribution of assets of, the Issuer of any kind or character, whether in cash, property or securities, in respect of any amount owing to it by the Issuer arising under or in connection with the Notes, other than in accordance with this Condition 3 and Clause 7 *(Subordination)* of the Trust Deed, such Noteholder shall, subject to applicable law, immediately pay an amount equal to the amount of such payment or discharge to the liquidator for the time being in the winding up of the Issuer for distribution in accordance with Clause 7 *(Subordination)* of the Trust Deed and each Noteholder, by virtue of becoming a Noteholder, shall be deemed to have so agreed and undertaken with and to the Issuer and all depositors and other unsubordinated creditors of the Issuer for good consideration.

(4) *Definition*

For the purposes of this Condition, "**Subordinated Indebtedness**" means all indebtedness which is subordinated, in the event of the winding up of the Issuer, in right of payment to the claims of depositors and other unsubordinated creditors of the Issuer, and for this purpose indebtedness shall include all liabilities, whether actual or contingent.

4. Interest

(1) *Interest Rate and Interest Payment Dates*

The Notes bear interest at the rate per annum equal to the floating interest rate (as defined below) from, and including, 15 December 2006 to, but excluding, the Optional Redemption Date (as defined in Condition 6(3)), payable quarterly in arrear on 16 March, 16 June, 16 September and 16 December in each year (each an "**Interest Payment Date**") and, thereafter, at a rate per annum equal to the reset interest rate (as defined below) from, and including, the Optional Redemption Date to, but excluding, the Maturity Date (as defined in Condition 6(l)), payable quarterly in arrear on 16 March, 16 June, 16 September and 16 December in each year (each an "**Interest Payment Date**"), save that the first payment of interest, which will be made on 16 March 2007, will be in respect of the period from and including 15 December 2006 to, but excluding, 16 March 2007. If any Interest Payment Date falls on a day which is not a Business Day (as defined below) in Hong Kong, London and New York City, the Interest Payment Date will be the next succeeding Business Day in Hong Kong, London and New York City unless it would thereby fall in the next calendar month in which event the Interest Payment Date shall be brought forward to the immediately preceding Business Day in Hong Kong, London and New York City. The period from and including an Interest Payment Date (or, in the case of the first Interest Period, the Issue Date) to but excluding the next succeeding Interest Payment Date (or, in the case of the last Interest Period, the Maturity Date), is called an "**Interest Period**".

For the purposes of the these Conditions, "**floating interest rate**" means the Rate of Interest (as defined below) plus 0.93 per cent. per annum and "**reset interest rate**" means the Rate of Interest plus 1.93 per cent. per annum.

The rate of interest payable from time to time in respect of the Notes (the "**Rate of Interest**") will be determined on the basis of the following provisions:

(i) On each Interest Determination Date (as defined below), the Agent Bank or its duly appointed successor will determine the Screen Rate (as defined below) at approximately 11.00 a.m. (London time) on that Interest Determination Date. If the Screen Rate is unavailable, the Agent Bank will request the principal London office of each of the Reference Banks (as defined below) to provide the Agent Bank with the rate at which deposits in US dollars are offered by it to prime banks in the London interbank market for three months at approximately 11.00 a.m. (London time) on the Interest Determination Date in question and for a Representative Amount (as defined below).

(ii) The Rate of Interest for the relevant Interest Period shall be the Screen Rate or, if the Screen Rate is unavailable, and if at least two of the four Reference Banks which have been requested by the Agent Bank to provide such rates, provide such rates, the arithmetic mean (rounded if necessary to the fifth decimal place, with 0.000005 being rounded upwards) as established by the Agent Bank of such rates, plus the Margin.

(iii) If fewer than two rates are provided as requested, the Rate of Interest for that Interest Period will be the arithmetic mean of the rates quoted by major banks in New York City selected by the Agent Bank, at approximately 11.00 a.m. (New York City time) on the relevant Interest Determination Date for loans in US dollars to leading European banks for a period of three months commencing on the first day of such Interest Period and for a Representative Amount, plus the Margin. If the Rate of Interest cannot be determined in accordance with the above provisions, the Rate of Interest shall be determined as at the last preceding Interest Determination Date.

In these Conditions, (except where otherwise defined), the expression:

(a) "**Business Day**" means, in relation to any place, a day (other than a Saturday or Sunday) which is a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealings in foreign exchange and foreign currency deposits) in such place;

(b) "**Interest Determination Date**" means the second Business Day in London before the commencement of the Interest Period for which the rate will apply;

(c) "**Reference Banks**" means the principal London office of each of four major banks engaged in the London interbank market selected by the Agent Bank;

(d) "**Representative Amount**" means, in relation to any quotation of a rate for which a Representative Amount is relevant, an amount that is representative for a single transaction in the relevant market at the relevant time; and

(e) "**Screen Rate**" means the rate for three month deposits in US dollars which appears on the Moneyline Telerate Page 3750 (or such replacement page on that service which displays the information).

(2) *Determination of Interest Amount*

The Agent Bank will, as soon as practicable after 11.00 a.m. (London time) on each Interest Determination Date, but in no event later than the third Business Day in London thereafter, determine the United States dollar amount (the "**Interest Amount**") payable in respect of interest on the US$1,000 in principal amount of each Note for the relevant Interest Period. The Interest Amount shall be determined by applying the fixed interest rate or reset interest rate, as the case may be, to the US$1,000 in principal amount of a Note, multiplying the sum by the actual number of days in the Interest Period concerned divided by 360 and rounding the resultant figure to the nearest cent (half a cent being rounded upwards).

(3) *Publication of Rate of Interest and Interest Amount*

The Agent Bank shall cause the floating interest rate or, as the case may be, the reset interest rate and the Interest Amount for each Interest Period and the Interest Payment Date relating to such Interest Period to be notified to the Issuer, the Trustee and to any stock exchange or other relevant authority on which the Notes are at the relevant time listed and to be published in accordance with Condition 12 as soon as possible after their determination, and in no event later than the second Business Day in Hong Kong thereafter. The Interest Amount and Interest Payment Date may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without notice to the Noteholders in the event of an extension or shortening of the Interest Period.

(4) *Determination by the Trustee*

If the Agent Bank defaults at any time in its obligation to determine the floating interest rate or, as the case may be, the reset interest rate and Interest Amount in accordance with the above provisions, the Trustee shall determine (i) the floating interest rate or, as the case may be, the reset interest rate 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 (ii) the Interest Amount in the manner provided in paragraph (2) above, and all such determinations shall be deemed to be determinations by the Agent Bank.

(5) *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 4, whether by the Reference Banks (or any of them), the Agent Bank or the Trustee, will (in the absence of wilful default, bad faith or manifest error) be binding on the Issuer, the Trustee, the Agent Bank, the Paying Agents and all Noteholders and (in the absence of wilful default, bad faith or manifest error) no liability to the Issuer or the Noteholders shall attach to the Reference Banks (or any of them), the Agent Bank or, if applicable, the Trustee in connection with the exercise or non-exercise by any of them of their powers, duties and discretions under this Condition 4.

(6) *Agent Bank*

The Issuer shall procure that, so long as any of the Notes remains outstanding, there is at all times a Agent Bank for the purposes of the Notes and the Issuer may, subject to the prior written approval of the Trustee (such approval not to be unreasonably withheld, delayed or refused), terminate the appointment of the Agent Bank. In the event of the appointed office of any bank being unable or unwilling to continue to act as the Agent Bank or failing duly to determine the floating interest rate or, as the case may be, the reset interest rate and the Interest Amount for any Interest Period, the Issuer shall, subject to the prior written approval of the Trustee (such approval not to be unreasonably withheld, delayed or refused), appoint the London office of another major bank engaged in the London interbank market to act in its place. The Agent Bank may not resign its duties or be removed without a successor having been appointed.

(7) *Interest Accrual*

Each Note will cease to bear interest from, and including, its due date for redemption unless, upon due presentation, payment of the principal in respect of the Note is improperly withheld or refused or unless default is otherwise made in respect of payment in which event interest will continue to accrue (as well after as before any judgment) as provided in the Trust Deed.

5. Payments

(1) *Payments in respect of Notes*

Payments of principal and interest will be made by transfer to the registered account of the Noteholder or by US dollar cheque drawn on a bank that processes payments in US 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 of Noteholders at the close of business on the date (the "**record date**") being the fifteenth day before the relevant Interest Payment Date.

For the purposes of this Condition, a Noteholder's "**registered account**" means the US dollar account maintained by or on behalf of it with a bank that processes payments in US dollars, details of which appear on the register of Noteholders 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 (as defined below) 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 of Noteholders at that time.

(2) *Payments subject to Applicable Laws*

Payments in respect of principal and interest on 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) *No commissions*

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

(4) *Payment on Business Days*

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 (as defined below), 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 Business Day preceding 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 or is lost in the mail.

In this Condition "**Business Day**" means a day (other than a Saturday or Sunday) on which commercial banks are open for business in Hong Kong, New York City, London and, in the case of presentation of a Note Certificate, in the place in which the Note Certificate is presented.

(5) *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 of Noteholders with a record of the amount of principal or interest in fact paid.

(6) *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:

(a) a Principal Paying Agent;

(b) an Agent Bank;

(c) a Registrar in Hong Kong; and

(d) so long as the Notes are listed on the Hong Kong Stock Exchange, a Paying Agent (which may be the Principal Paying Agent) with a specified office in Hong Kong.

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.

6. Redemption and Purchase

(1) *Redemption at Maturity*

Unless previously redeemed or purchased and cancelled as provided below, the Issuer will redeem the Notes at their principal amount on the Interest Payment Date falling on or about 16 December 2016 (the "**Maturity Date**").

(2) *Redemption for Taxation Reasons*

Subject to Condition 6(7), if the Issuer satisfies the Trustee immediately before the giving of the notice referred to below that (a) as a result of any change in, or amendment to, the laws or regulations of a Relevant Jurisdiction (as defined in Condition 7(2)(b) below) or any change in the official interpretation of the laws or regulations of a Relevant Jurisdiction, which change or amendment becomes effective after 8 December 2006, on the occasion of the next payment due in respect of the Notes the Issuer would be required to pay additional amounts as provided or referred to in Condition 7, and (b) the requirement cannot be avoided by the Issuer taking reasonable measures available to it, the Issuer may at its option, having given not less than 30 nor more than 60 days' notice to the Noteholders in accordance with Condition 12 (which notice shall be irrevocable and shall specify the date fixed for redemption), redeem all the Notes, but not some only, on the next Interest Payment Date at their principal amount together with interest accrued to but excluding the date of redemption, provided that no notice of redemption shall be given earlier than 90 days before the earliest date on which the Issuer would be required to pay the additional amounts were a payment in respect of the Notes then due. Prior to the publication of any notice of redemption pursuant to this paragraph, the Issuer shall deliver to the Trustee a certificate signed by two Authorised Signatories (as defined in the Trust Deed) of the Issuer stating that the requirement referred to in (a) above will apply on the occasion of the next payment due in respect of the Notes and cannot be avoided by the Issuer taking reasonable measures available to it and the Trustee shall be entitled to accept the certificate as sufficient evidence of the satisfaction of the conditions precedent set out above, in which event it shall be binding on the Noteholders.

(3) *Redemption at the Option of the Issuer*

Subject to Condition 6(7), the Issuer may, having given:

(a) not less than 15 nor more than 60 days' notice to the Noteholders in accordance with Condition 12; and

(b) not less than 10 days before the giving of the notice referred to in (a), notice to the Trustee and the Principal Paying Agent

(which notice shall be irrevocable and shall specify the date fixed for redemption), redeem all, but not some only, of the Notes on the Interest Payment Date falling on or about 16 December 2011 (the "**Optional Redemption Date**") at their principal amount.

(4) *Purchases*

Subject to Condition 6(7) below, the Issuer or any of its Subsidiaries (as defined in the Trust Deed) may at any time purchase Notes in any manner and at any price.

(5) *Cancellations*

All Notes which are (a) redeemed or (b) purchased by or on behalf of the Issuer will forthwith be cancelled and accordingly may not be held, reissued or resold. For the avoidance of doubt, this provision shall not apply to the Issuer holding the Notes in a purely nominee capacity.

(6) *Notices Final*

Upon the expiry of any notice as is referred to in paragraph (2) or (3) above, the Issuer shall be bound to redeem the Notes to which the notice refers in accordance with the terms of such paragraph.

(7) *Conditions for Redemption and Purchase*

Notwithstanding any other provision in these Conditions, the Notes (subject as provided below) may not be redeemed (other than pursuant to Condition 6(l) or 9) or purchased without the prior written consent of the Hong Kong Monetary Authority or any successor thereto (the "**HKMA**"). Accordingly, the Issuer shall not redeem any of the Notes (other than pursuant to Condition 6(l) or 9) and the Issuer or any of its Subsidiaries shall not purchase any of the Notes unless the prior written consent of the HKMA thereto shall have been obtained. For the avoidance of doubt, this provision shall not apply to the Issuer or any of its Subsidiaries holding the Notes in a purely nominee capacity.

Noteholders should note that it is intended that the Notes should constitute Category II Supplementary Capital 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 of the Notes, other than at maturity or following an event of default, and any purchase of the Notes by the Issuer or any of its Subsidiaries, is subject to the prior written consent of the HKMA at the relevant time.

7. Taxation

(1) *Payment without Withholding or Deduction*

All payments 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 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:

(a) 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;

(b) 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(4));

(c) 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

(d) 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 in a Member State of the European Union.

(2) *Interpretation*

In these Conditions:

(a) "**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

(b) "**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 or interest on the Notes.

(3) *Additional Amounts*

Any reference in these Conditions to any amounts in respect of the Notes 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

Claims in respect of principal and interest will become prescribed unless made within 10 years (in the case of principal) and five years (in the case of interest) from the Relevant Date.

9. Events of Default

(1) If default is made in the payment of principal or interest due in respect of the Notes or any of them and the default continues for a period of five Business Days in Hong Kong (in the case of principal) or ten Business Days in Hong Kong (in the case of interest) (each such event, an "**Event of Default**"), then the Trustee at its discretion may, subject as provided in Condition 10(2), in order to enforce payment, without further notice, institute proceedings for the winding up of the Issuer in Hong Kong, 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, liquidation or dissolution of the Issuer in Hong Kong (except for the purposes of a reconstruction, amalgamation or reorganisation the terms of which have previously been approved by an Extraordinary Resolution of the Noteholders) (such event also, an "**Event of Default**"), then the Trustee at its discretion may, subject as provided in Condition 10(2), give written notice to the Issuer that the Notes are, and they shall forthwith thereupon become, immediately due and repayable at their principal amount together with accrued interest as provided in the Trust Deed.

10. Enforcement

(1) Without prejudice to Condition 9, the Trustee may, subject as provided below, at its discretion and without further notice, institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition or provision binding on the Issuer under the Notes or the Trust Deed (other than any obligation for the payment of any principal or interest in respect of the Notes), provided that the Issuer shall not as a consequence of such proceedings be obliged to pay any sum or sums representing or measured by reference to principal or interest in respect of the Notes sooner than the same would otherwise have been payable by it.

(2) The Trustee shall not be bound to take action as referred to in Condition 9 or paragraph (1) above or any other action under the Trust Deed unless (i) it shall have been so requested in writing by Noteholders holding at least one-quarter of the principal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution of the Noteholders and (ii) it shall have been indemnified and/or secured to its satisfaction.

(3) 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 to institute proceedings in Hong Kong (or elsewhere) for the winding up of the Issuer or to submit a claim in such winding up except that, if the Trustee, having become bound to institute such 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 proceedings for the winding up of the Issuer in Hong Kong (but not elsewhere) 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 Principal Paying Agent 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 of Noteholders maintained by the Registrar. 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. Any such notice will be deemed to have been given on the second day after being so mailed. If notification as provided above is not practicable, notice shall be given in such other manner, and shall be deemed to have been given on such date, as the Trustee may approve.

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 Noteholders of at least 90 per cent. in aggregate principal amount of Notes for the time being outstanding who for the time being are entitled to receive notice of a meeting of Noteholders will take effect as if 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 the consent of the Noteholders, that any Event of Default or Potential Event of Default (as defined in the Trust Deed) 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 referred to in Condition 14 shall be binding on the Noteholders and, unless the Trustee agrees otherwise, 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 of any Subsidiary of the Issuer, subject to:

(a) prior written approval of the HKMA;

(b) the Trustee being satisfied that the interests of the Noteholders will not be materially prejudiced by the substitution; and

(c) certain other conditions set out in the Trust Deed being complied with.

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 its 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 its 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 (whether in bearer or registered form) 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 which is 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 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 competent jurisdiction.

(3) *Appointment of Process Agent*

The Issuer has in the Trust Deed irrevocably and unconditionally appointed Law Debenture Corporate Services Limited at its office for the time being (now at 5th 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.

THE GLOBAL CERTIFICATE

The Global Certificate contains the following provisions which apply to the Notes 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 7 below.

1. Accountholders

For so long as all of the Notes are represented by the Global Certificate and the 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 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 Certificate. 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 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 Global Certificate.

3. Payments

Payments of principal and interest in respect of Notes represented by the 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 the 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 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 the 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. Change of 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 the 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 or 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 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 and Clearstream, Luxembourg and their respective participants in accordance with the rules and procedures of Euroclear and 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 Offering Circular 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. Persons considering the purchase of the Notes should consult their own tax advisers concerning the application of Hong Kong tax laws to their particular situations as well as any consequences of the purchase, ownership and disposition of the Notes arising under the laws of any other taxing jurisdiction.

Hong Kong

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 Laws 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 person (other than a financial institution) carrying on a trade, profession or business in Hong Kong and, where that person is not a company, the interest is derived from the use of the funds of that trade, profession or business; or

(ii) 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.

Any capital gains from the sale of the Notes will not be subject to taxes in Hong Kong, except that Hong Kong profits tax may be chargeable in the case of owners of Notes who carry on a trade, profession or business in Hong Kong if such gains form part of the revenue profits of such trade, profession or business.

Stamp Duty

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

EU Savings Directive

On 3 June 2003, the European Council of Economics and Finance Ministers adopted a Directive on the taxation of savings income. Under the Directive, Member States will (if equivalent measures have been introduced by certain non-EU countries) be required, from 1 July 2005, to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State. However, for a transitional period, Belgium, Luxembourg and Austria will instead be required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries).

SUBSCRIPTION AND SALE

Each of Goldman Sachs (Asia) L.L.C. and The Hongkong and Shanghai Banking Corporation Limited (together the "**Managers**") has, pursuant to a subscription agreement dated 8 December 2006 (the "**Subscription Agreement**"), severally agreed with the Issuer, subject to the satisfaction of certain conditions, to subscribe for the principal amount of the Notes set out opposite its name below as its underwriting commitment. Each Manager's underwriting commitment may not represent the amount of Notes actually subscribed by each Manager.

Manager	**Underwriting Commitment**
	(US$)
Goldman Sachs (Asia) L.L.C.	62,500,000
The Hongkong and Shanghai Banking Corporation Limited	62,500,000
	125,000,000

The Issuer has agreed to pay to the Managers a management and underwriting commission in connection with their underwriting commitments in accordance with the Subscription Agreement. The Issuer has also agreed to indemnify the Managers against certain liabilities incurred in connection with the issue of the Notes. In addition, the Issuer 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 Issuer.

The Issuer has agreed that, from the date of this Offering Circular until the date falling 30 days after the Closing Date, it will 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 Issuer to its customers) issued or guaranteed by the Issuer are either placed or syndicated, directly or on its behalf, in any manner which might, in the opinion of the Managers (following consultation with the Issuer, if practicable), have a detrimental effect on the successful placement of the Notes.

In connection with the offering of the Notes, the Managers may purchase and sell Notes in the open market. These transactions may include short sales, stabilising transactions and purchases to cover positions created by short sales. Short sales involve the sale by the Managers of a greater number of Notes than they are required to purchase in the offering. Stabilising transactions consist of certain bids or purchases made for the purpose of preventing or retarding a decline in the market price of the Notes while the offering is in progress.

The Managers also may impose a penalty bid. This occurs when a particular Manager repays to the Managers a portion of the underwriting discount received by it because the representatives have repurchased Notes sold by or for the account of such Manager in stabilising or short covering transactions.

These activities by the Managers may stabilise, maintain or otherwise affect the market price of the Notes. As a result, the price of the Notes may be higher than the price that otherwise might exist in the open market. If these activities are commenced, they may be discontinued by the Managers at any time. These transactions may be effected in the over-the-counter market or otherwise.

The Issuer has agreed to indemnify the several Managers against certain liabilities, including liabilities under the U.S. Securities Act of 1933.

Certain of the Managers and their respective affiliates have, from time to time, performed, and may in the future perform, various financial advisory and investment banking services for the Issuer, for which they received or will receive customary fees and expenses.

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 or to, or for the account or benefit of, U.S. persons except in accordance with Regulation S under the Securities Act ("**Regulation S**") or pursuant to an exemption from or in a transaction not subject to, the registration requirements of the Securities Act. No Notes have been offered or sold, or will be offered or sold, except in accordance with Rule 903 of Regulation S. Terms used in this paragraph have the meanings given to them by Regulation S.

Except as permitted by the Subscription Agreement, no Notes will be offered, sold or delivered, (i) as part of their distribution at any time or (ii) otherwise until 40 days after the later of the commencement of the offering and the closing of the issue of the Notes, within the United States or to, or for the account or benefit of, U.S. persons, and each dealer to which Notes are sold during the restricted period a confirmation or other notice setting forth the restrictions on offers and sales of the Notes within the United States or to, or for the account or benefit of, U.S. persons. Terms used in this paragraph have the meanings given to them by Regulation S.

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

Notwithstanding anything herein to the contrary, investors (and each employee, representative, or agent of the investors) may disclose to any and all persons, without limitation of any kind, the tax treatment and tax structure of the offering and all materials of any kind (including opinions or other tax analyses) that are provided to the investors relating to such tax treatment and tax structure. However, any information relating to the U.S. federal income tax treatment or tax structure shall remain confidential (and the foregoing sentence shall not apply) to the extent reasonably necessary to enable any person to comply with applicable securities laws. For this purpose, "**tax treatment**" means U.S. federal or state income tax treatment, and "**tax structure**" means any facts relevant to the U.S. federal income tax treatment of the offering but does not include information relating to the identity of the issuer of the Notes, the issuer of any assets underlying the Notes, or any of their respective affiliates that are offering the Notes.

European Economic Area

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a "**Relevant Member State**"), with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the "**Relevant Implementation Date**"), no offer of Notes has been made or will be made to the public in that Relevant Member State prior to the publication of a prospectus in relation to the Notes which has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, all in accordance with the Prospectus Directive, except that, with effect from and including the Relevant Implementation Date, an offer of Notes may be made to the public in that Relevant Member State at any time:

(a) to legal entities which are authorised or regulated to operate in the financial markets or, if not so authorised or regulated, whose corporate purpose is solely to invest in securities;

(b) to any legal entity which has two or more of (i) an average of at least 250 employees during the last financial year; (ii) a total balance sheet of more than €43,000,000 and (iii) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts; or

(c) in any other circumstances which do not require the publication by the Issuer of a prospectus pursuant to Article 3 of the Prospectus Directive.

For the purposes of this provision, the expression an "**offer of Notes to the public**" in relation to any Notes in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Notes to be offered so as to enable an investor to decide to purchase or subscribe the Notes, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State and the expression "**Prospectus Directive**" means Directive 2003/71/EC and includes any relevant implementing measure in each Relevant Member State.

United Kingdom

No offer of the Notes has been made or will be made to the public in the United Kingdom within the meaning of Section 102B of the Financial Services and Markets Act 2000, as amended (the "**FSMA**"), except to legal entities which are authorised or regulated to operate in the financial markets or, if not so authorised or regulated, whose corporate purpose is solely to invest in securities or otherwise in circumstances which do not require the publication by the Issuer of a prospectus pursuant to the Prospectus Rules of the Financial Services Authority. Any invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) (i) has only been communicated or caused to be communicated and will only be communicated or caused to be communicated to persons who have professional experience in matters relating to investments falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 or in circumstances in which Section 21 of FSMA does not apply to the Issuer and (ii) all applicable provisions of the FSMA has been, and will be complied with, with respect to anything done in relation to the Notes in, from or otherwise involving the United Kingdom.

Hong Kong

No Notes may not be offered or sold by means of any document other than (i) in circumstances which do not constitute an offer to the public within the meaning of the Companies Ordinance (Cap. 32 of the Laws of Hong Kong), or (ii) to "**professional investors**" within the meaning of the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong) and any rules made thereunder, or (iii) in other circumstances which do not result in the document being a "**prospectus**" within the meaning of the Companies Ordinance (Cap. 32 of the Laws of Hong Kong), and no advertisement, invitation or document relating to the Notes may be issued or may be in the possession of any person for the purpose of issue (in each case whether in Hong Kong or elsewhere), which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the laws of Hong Kong) other than with respect to the Notes which are or are intended to be disposed of only to persons outside Hong Kong or only to "**professional investors**" within the meaning of the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong) and any rules made thereunder.

Singapore

This Offering Circular has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, this Offering Circular and any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the Notes may not be circulated or distributed, nor may the Notes be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to persons in Singapore other than (i) to an institutional investor under Section 274 of the Securities and Futures Act, Chapter 289 of Singapore (the "**SFA**"), (ii) to a relevant person pursuant to Section 275(1) of the SFA or any person pursuant to Section 275(1A) and in accordance with the conditions specified in Section 275 of the SFA or (iii) otherwise pursuant to, and in accordance with, the conditions of any other applicable provision of the SFA.

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

(a) a corporation (which is not an accredited investor) 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 is an accredited investor, shares, debentures and units of shares and debentures of that corporation or the beneficiaries' rights and interest in that trust shall not be transferable for 6 months after that corporation or that trust has acquired the Notes under Section 275 except:

    (1) 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 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 $200,000 Singapore dollars (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 in addition, for corporations, pursuant to Section 275(1A) and in accordance with the conditions specified in Section 275 of the SFA;

    (2) where no consideration is given for the transfer; or

    (3) where the transfer is by operation of law.

Japan

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, directly or indirectly, offered or sold and will not, directly or indirectly, offer or sell any Notes 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, or for the benefit of, 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

The offering of the Notes has not been registered pursuant to Italian securities legislation and, accordingly, no Notes may be offered, sold or delivered, nor may copies of the Offering Circular or of any other document relating to the Notes be distributed in the Republic of Italy, except:

(i) to professional investors (*operatori qualificati*), as defined in Article 31, second paragraph, of CONSOB (the Italian Securities Exchange Commission) Regulation No. 11522 of 1 July 1998, as amended (**Regulation No. 11522**); or

(ii) in circumstances which are exempted from the rules on solicitation of investments pursuant to Article 100 of Legislative Decree No. 58 of 24 February 1998, as amended (the **Financial Services Act**) and Article 33, first paragraph, of CONSOB Regulation No. 11971 of 14 May 1999, as amended.

Any offer, sale or delivery of the Notes or distribution of copies of the Offering Circular or any other document relating to the Notes in the Republic of Italy under (i) or (ii) above must be:

(a) made by an investment firm, bank or financial intermediary permitted to conduct such activities in the Republic of Italy in accordance with the Financial Services Act, Regulation No. 11522 and Legislative Decree No. 385 of 1 September 1993, as amended (the **Banking Act**); and

(b) in compliance with Article 129 of the Banking Act and the implementing guidelines of the Bank of Italy, as amended from time to time, pursuant to which the Bank of Italy may request information on the issue or the offer of securities in the Republic of Italy; and

(c) in compliance with any other applicable laws and regulations or requirement imposed by CONSOB.

In any case, the Notes shall not be placed, sold or offered either in the primary or secondary markets to individuals residing in Italy.

General

No action has been taken or will be taken by the Issuer or the Managers that would, or is intended to, permit a public offer of the Notes or possession or distribution of this Offering Circular or any other offering or publicity material relating to the Notes in any country or jurisdiction where action for any such purpose is required. Accordingly, each Manager has undertaken that it will not, directly or indirectly, offer or sell any Notes or have in its possession, distribute or publish any offering circular, prospectus, form of application, advertisement or other document or information in any country or jurisdiction except under circumstances that will result in compliance in all material respects with any applicable laws and regulations and all offers and sales of Notes by it will be made on the same terms.

Investors who purchase Notes from a Manager may be required to pay stamp taxes and other charges in accordance with the laws and practices of the country of purchase in addition to the offering price set forth on the cover page of this Offering Circular.

GENERAL INFORMATION

1. **Clearing Systems:** The Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg with the Common Code of 027885853. The International Securities Identification Number (ISIN) for the Notes is XS0278858534.

2. **Listing of Notes:** Application has been made to the HKSE for the listing of, and permission to deal in, the Notes. It is expected that dealing will, if permission is granted to deal in and for the listing of the Notes on the HKSE, commence on or about 18 December 2006.

3. **Litigation:** Except as disclosed in this Offering Circular, neither the Issuer nor any of its 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 Issuer or any of its subsidiaries aware that any such proceedings are pending or threatened.

4. **Authorisations:** The Issuer 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 a resolution of the Board of Directors of the Issuer passed on 29 November 2006. Listing of the Notes on the HKSE is conditional upon satisfaction of the requirements of that exchange, including execution of the Trust Deed and the Agency Agreement.

5. **No Material Adverse Change:** Except as disclosed in this Offering Circular, there has been no material adverse change in the financial or trading position of the Issuer and the Group since 31 December 2005 and no material adverse change in the financial position or prospects of the Group since 31 December 2005.

6. **Available Documents:** Copies of the following documents may be inspected at a specified office of the Principal Paying Agent at 55th Floor, Cheung Kong Center, 2 Queen's Road Central, Hong Kong and at a specified office of the Paying Agent at 55th Floor, Cheung Kong Center, 2 Queen's Road Central, Hong Kong:

   (a) the Memorandum and Articles of Association of the Issuer;

   (b) a copy of the auditors' reports of Deloitte Touche Tohmatsu, the Issuer's external auditors, and the audited consolidated financial statements of the Issuer as at and for the years ended 31 December 2005, 2004 and 2003;

   (c) a copy of the independent review report of Deloitte Touche Tohmatsu, the Issuer's external auditors, and the unaudited consolidated financial statements of the Issuer as at and for the six months ended 30 June 2006;

   (d) copies of the most recent annual and interim reports (including the financial statements) published by the Issuer; and

   (e) the Trust Deed and the Agency Agreement, each to be dated on or about 15 December 2006.

   Copies of the auditors' reports and the audited consolidated financial statements referred to above and the most recent annual audited consolidated financial statements (and audited unconsolidated balance sheet) of the Issuer and interim unaudited consolidated financial statements published by the Issuer, will be made available free of charge at a specified office of the Principal Paying Agent at 55th Floor, Cheung Kong Center, 2 Queen's Road Central, Hong Kong and at a specified office of the Paying Agent at 55th Floor, Cheung Kong Center, 2 Queen's Road Central, Hong Kong.

7. **Auditors:** The consolidated financial statements of the Issuer as at and for the years ended 31 December 2005 and 2004 included in this Offering Circular have been audited by Deloitte Touche Tohmatsu, Certified Public Accountants, as stated in the auditors' report appearing in this Offering Circular in relation to such consolidated financial statements. The consolidated interim financial statements of the Issuer as at and for the six months ended 30 June 2006 included in this Offering Circular have not been audited by Deloitte Touche Tohmatsu. Deloitte Touche Tohmatsu have conducted a review of such interim financial statements in accordance with the Statement of Auditing Standards 700, "Engagements to review interim financial reports" issued by the HKICPA, as stated in their review report appearing in this Offering Circular in respect of such consolidated interim financial statements.

   Deloitte Touche Tohmatsu has given and not withdrawn its written consent for the purposes of paragraph 8(2) of Appendix 1 Part C of the Listing Rules 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 2004 and with references to Deloitte Touche Tohmatsu and to its independent review report on the published interim consolidated financial statements of the Issuer for the six months ended 30 June 2006, in each case in the form and context in which they appear.

SUMMARY OF CERTAIN EFFECTS OF NEW AND REVISED HKFRSs

The Bank prepares its financial statements in accordance with HKFRSs. The HKICPA has issued a number of amended HKFRSs, amended Hong Kong Accounting Standards ("**HKASs**") and new Interpretations, which are effective for accounting periods beginning after 31 December 2005 or 1 January 2006.

- HKAS 19 (Amendment) – Actuarial gains and losses, group plans and disclosures.
- HKAS 39 (Amendment) – The fair value option.
- HKAS 39 and HKFRS 4 (Amendments) – Financial guarantee contracts.
- HK(IFRIC) – Int 4 – Determining whether an arrangement contains a lease.

The adoption of the above-mentioned amended HKFRSs, amended HKASs and new Interpretations have no material effect on how the results for the current or prior accounting periods are prepared and presented. The information contained herein is not intended to provide a comprehensive description of the impact which these new or amended HKFRSs, HKASs or Interpretations will or may have on the Group's forthcoming financial statements.

The Group has not adopted the following new standards, amendments and new interpretations which have been issued but not yet effective.

- HKAS 1 (Amendment) – Capital Disclosures.
- HKFRS 7 – Financial Instruments : Disclosures.
- Revised Guidance on Implementing HKFRS 4 – Insurance Contracts.
- HK(IFRIC)-Int 8 – Scope of HKFRS 2.
- HK(IFRIC)-Int 9 – Reassessment of Embedded Derivatives.

The Directors of the Bank anticipate that the application of the above-mentioned new standards, amendments and new interpretations that have been issued but not yet effective will not have significant impact to the results and financial positions on the Group. The information contained herein is not intended to provide a comprehensive description of the impact which these new or amended HKFRSs, HKASs or Interpretations have or will or may have on the Group's forthcoming financial statements.

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INDEPENDENT REVIEW REPORT

TO THE BOARD OF DIRECTORS OF LIU CHONG HING BANK LIMITED
(Incorporated in Hong Kong with limited liability)

Introduction

We have been instructed by the Company to review the interim financial report set out on pages F-3 to F-16.

Directors' responsibilities

The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of an interim financial report to be in compliance with Hong Kong Accounting Standard 34 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants and the relevant provisions thereof. The interim financial report is the responsibility of, and has been approved by, the directors.

It is our responsibility to form an independent conclusion, based on our review, on the interim financial report, and to report our conclusion solely to you, as a body, in accordance with agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Review work performed

We conducted our review in accordance with Statement of Auditing Standards 700 ("SAS 700") "Engagements to Review Interim Financial Reports" issued by the Hong Kong Institute of Certified Public Accountants. A review consists principally of making enquiries of the Company's management and applying analytical procedures to the interim financial report and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the interim financial report.

Review conclusion

On the basis of our review which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial report for the six months ended 30 June 2006.

Without modifying our review conclusion, we draw to your attention that the comparative condensed consolidated income statement, the comparative condensed consolidated statement of changes in equity, and the comparative condensed consolidated cash flow statement for the six months ended 30 June 2005 disclosed in the interim financial report have not been reviewed in accordance with SAS 700.

Deloitte Touche Tohmatsu
Certified Public Accountants

Hong Kong, 16 August 2006

CONDENSED CONSOLIDATED INCOME STATEMENT

	6 months ended 30 June 2006	6 months ended 30 June 2005
	HK$'000	*HK$'000*
Interest income	1,336,416	668,178
Interest expense	(895,020)	(313,501)
Net interest income	441,396	354,677
Other operating income *(Note 4)*	137,128	102,498
Operating income	578,524	457,175
Operating expenses *(Note 5)*	(278,623)	(238,355)
Operating profit before impairment allowances, fair value adjustments and disposal of long term assets	299,901	218,820
Impairment allowances		
— New allowances	(69,544)	(32,209)
— Amounts reversed	31,255	18,440
	(38,289)	(13,769)
Net gain/(loss) on disposal of property and equipment	36	(800)
Net gain on disposal of available-for-sale securities	27,947	22,353
Profit from operations	289,595	226,604
Share of results of jointly controlled entities	6,391	568
Profit before taxation	295,986	227,172
Taxation *(Note 6)*		
— Hong Kong	(43,563)	(33,704)
— Overseas	81	(177)
— Deferred tax	(3,663)	(1,302)
	(47,145)	(35,183)
Profit for the period	248,841	191,989
Proposed dividend	82,650	78,300
Earnings per share, basic and diluted *(Note 7)*	HK$0.57	HK$0.44
Proposed dividend per share	HK$0.19	HK$0.18

CONDENSED CONSOLIDATED BALANCE SHEET

	30 June 2006	31 December 2005
	HK$'000	*HK$'000*
Assets		
Cash and short-term funds *(Note 9)*	9,638,463	11,798,479
Placements with banks and other financial institutions maturing between one and twelve months	4,210,999	2,029,416
Financial assets at fair value through profit or loss *(Note 10)*	533,590	854,767
Available-for-sale securities *(Note 10)*	915,862	801,769
Held-to-maturity securities *(Note 10)*	13,001,827	9,192,906
Advances and other accounts *(Note 11)*	25,761,648	24,508,061
Interests in jointly controlled entities	72,101	65,710
Loan to a jointly controlled entity	31,000	31,000
Investment properties	76,860	76,860
Property and equipment *(Note 12)*	271,605	196,760
Prepaid lease payments for land	299,412	300,969
Deferred tax assets	2,786	6,449
Goodwill	110,606	110,606
Total assets	54,926,759	49,973,752
Liabilities		
Deposits and balances of banks and other financial institutions	736,177	2,263,504
Deposits from customers *(Note 13)*	47,727,764	41,506,292
Other accounts and accruals	478,461	340,496
Current tax liabilities	60,410	30,324
Total liabilities	49,002,812	44,140,616
Shareholders' equity		
Share capital	217,500	217,500
Reserves	5,706,447	5,615,636
Shareholders' funds	5,923,947	5,833,136
Total liabilities and shareholders' equity	54,926,759	49,973,752

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Goodwill	Investment revaluation reserve	General reserve	Translation reserve	Regulatory reserve	Retained profits	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
At 1 January 2006	217,500	1,542,817	(182)	163,125	1,388,500	(1,691)	122,837	2,400,230	5,833,136
Revaluation gains of available-for-sale securities	–	–	–	40,904	–	–	–	–	40,904
Exchange differences arising from translation of foreign operations	–	–	–	–	–	1,327	–	–	1,327
Net income recognised directly in equity	–	–	–	40,904	–	1,327	–	–	42,231
Profit for the period	–	–	–	–	–	–	–	248,841	248,841
Reversal of reserves upon disposal of available-for-sale securities	–	–	–	(17,561)	–	–	–	–	(17,561)
Total recognised income for the period	–	–	–	23,343	–	1,327	–	248,841	273,511
Final dividend paid	–	–	–	–	–	–	–	(182,700)	(182,700)
Earmark of retained profits as regulatory reserve	–	–	–	–	–	–	23,000	(23,000)	–
At 30 June 2006	217,500	1,542,817	(182)	186,468	1,388,500	(364)	145,837	2,443,371	5,923,947
At 1 January 2005	217,500	1,542,817	(182)	130,689	1,388,500	(26)	103,883	2,273,501	5,656,682
Revaluation gains of available-for-sale securities	–	–	–	49	–	–	–	–	49
Exchange differences arising from translation of foreign operations	–	–	–	–	–	(454)	–	–	(454)
Net income recognised directly in equity	–	–	–	49	–	(454)	–	–	(405)
Profit for the period	–	–	–	–	–	–	–	191,989	191,989
Reversal of reserves upon disposal of available-for-sale securities	–	–	–	(6,561)	–	–	–	–	(6,561)
Total recognised income for the period	–	–	–	(6,512)	–	(454)	–	191,989	185,023
Final dividend paid	–	–	–	–	–	–	–	(174,000)	(174,000)
Earmark of retained profits as regulatory reserve	–	–	–	–	–	–	6,799	(6,799)	–
At 30 June 2005	217,500	1,542,817	(182)	124,177	1,388,500	(480)	110,682	2,284,691	5,667,705

The regulatory reserve is set up in compliance with the Hong Kong Monetary Authority's requirements and is distributable to the shareholders of the Bank subject to consultation with the Hong Kong Monetary Authority.

The general reserve comprises transfers from prior years' retained profits and inner reserves.

CONDENSED CONSOLIDATED CASH FLOW STATEMENT

	6 months ended 30 June 2006	6 months ended 30 June 2005
	HK$'000	*HK$'000*
OPERATING ACTIVITIES		
Profit from operations	289,595	226,604
Adjustments for:		
Net (gain)/loss on disposal of property and equipment	(36)	800
Net gain on disposal of available-for-sale securities	(27,947)	(22,353)
Impairment allowances	38,289	13,769
Dividend income on equity securities	(6,865)	(5,972)
Depreciation	13,933	17,321
Amortisation of prepaid lease payments for land	2,567	5,499
Interest income from available-for-sale securities and held-to-maturity securities	(205,224)	(75,147)
Exchange adjustments	1,336	(1,401)
Operating cash flows before movements in operating assets and liabilities	105,648	159,120
Increase in placements with banks and other financial institutions (with original maturity over three months)	–	(155,426)
Decrease/(increase) in financial assets at fair value through profit or loss	321,177	(228,584)
Increase in bills receivable	(110,707)	(77,696)
Increase in trade bills	(6,783)	(26,167)
Increase in other advances to customers	(1,125,412)	(1,721,310)
Increase in interest receivable and other accounts	(52,730)	(13,832)
Decrease in advances to banks and other financial institutions	224	685
Increase in deposits from customers	6,221,472	3,766,066
Increase in other accounts and accruals	137,965	230,789
Cash generated from operations	5,490,854	1,933,645
Hong Kong Profits Tax paid	(13,477)	(15,296)
Overseas tax refund/(paid)	81	(177)
NET CASH GENERATED FROM OPERATING ACTIVITIES	5,477,458	1,918,172

CONDENSED CONSOLIDATED CASH FLOW STATEMENT (Continued)

	6 months ended 30 June 2006	6 months ended 30 June 2005
	HK$'000	*HK$'000*
INVESTING ACTIVITIES		
Interest received from available-for-sale securities and held-to-maturity securities	208,747	57,973
Dividends received on equity securities	6,865	5,972
Purchase of available-for-sale securities	(159,795)	(84,715)
Purchase of held-to-maturity securities	(7,898,583)	(3,779,552)
Purchase of property and equipment	(88,791)	(22,872)
Purchase of prepaid lease payments for land	(1,010)	–
Purchase of a subsidiary	–	(122,959)
Proceeds from sale and redemption of available-for-sale securities	96,992	61,377
Proceeds from redemption of held-to-maturity securities	4,089,662	1,563,620
Proceeds from disposal of property and equipment	49	2,008
NET CASH USED IN INVESTING ACTIVITIES	(3,745,864)	(2,319,148)
FINANCING ACTIVITY		
Dividends paid	(182,700)	(174,000)
NET CASH USED IN FINANCING ACTIVITY	(182,700)	(174,000)
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	1,548,894	(574,976)
CASH AND CASH EQUIVALENTS AT 1 JANUARY	11,564,391	13,592,009
CASH AND CASH EQUIVALENTS AT 30 JUNE	13,113,285	13,017,033

NOTES TO THE FINANCIAL STATEMENTS

for the six-month period ended 30 June 2006

1. Basis of preparation

This interim financial report has been prepared in accordance with the applicable disclosure requirements of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, and with the Hong Kong Accounting Standard ("HKAS") 34 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA").

The accounting policies and basis of preparation adopted in these interim financial statements are consistent with those adopted in the Bank's Annual Report for the year ended 31 December 2005 except for the adoption of certain amended Hong Kong Financial Reporting Standards ("HKFRSs"), amended HKASs and new interpretations ("Interpretations") as disclosed in note 2 below.

2. Impact of amended HKFRSs, amended HKASs and new Interpretations

The HKICPA has issued a number of amended HKFRSs, amended HKASs and new Interpretations, which are effective for accounting periods beginning after 1 January 2006 or 31 December 2005. The Group has adopted the following amended HKFRSs, amended HKASs and new Interpretations which are pertinent to its operations and relevant to this interim financial report.

HKAS 19 (Amendment)	Actuarial gains and losses, group plans and disclosures
HKAS 39 (Amendment)	The fair value option
HKAS 39 and HKFRS 4 (Amendments)	Financial guarantee contracts
HK(IFRIC) – Int 4	Determining whether an arrangement contains a lease

The adoption of the above-mentioned amended HKFRSs, amended HKASs and new Interpretations have no material effect on how the results for the current or prior accounting periods are prepared and presented.

The Group has not early adopted the following new standard, amendment and new interpretations which have been issued but not yet effective, in this interim financial report.

HKAS 1 (Amendment)	Capital Disclosures
HKFRS 7	Financial Instruments: Disclosures
HK(IFRIC) – Int 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies
HK(IFRIC) – Int 8	Scope of HKFRS 2
HK(IFRIC) – Int 9	Reassessment of Embedded Derivatives

The Directors of the Bank anticipate that the application of the above new standard, amendment and new interpretations that have been issued but not yet effective will not have significant impact to the results and financial positions on the Group.

3. Business and geographical segments

(a) Business segments

Segment information by business segments for the six months ended 30 June 2006 is presented below:

INCOME STATEMENT

	Corporate and retail banking	Treasury and foreign exchange activities	Other business activities	Eliminations	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Interest income from external customers	751,890	584,526	–	–	1,336,416
Interest expense to external customers	(857,972)	(37,048)	–	–	(895,020)
Inter-segment income *(Note)*	403,771	–	–	(403,771)	–
Inter-segment expense *(Note)*	–	(403,771)	–	403,771	–
Net interest income	297,689	143,707	–	–	441,396
Other operating income	61,107	9,253	66,768	–	137,128
Operating income	358,796	152,960	66,768	–	578,524
Impairment allowances	(38,289)	–	–	–	(38,289)
Net gain on disposal of property and equipment	36	–	–	–	36
Net gain on disposal of available-for-sale securities	–	–	27,947	–	27,947
Operating expenses	(150,422)	(10,478)	(22,004)	–	(182,904)
Segment profit	170,121	142,482	72,711	–	385,314
Unallocated corporate expenses					(95,719)
Profit from operations					289,595
Share of results of jointly controlled entities			6,391		6,391
Profit before taxation					295,986
Taxation					(47,145)
Profit for the period					248,841

Notes: Inter-segment pricing is charged at prevailing customer deposits interest rates.

Segment information by business segments for the six months ended 30 June 2005 is presented below:

INCOME STATEMENT

	Corporate and retail banking	Treasury and foreign exchange activities	Other business activities	Eliminations	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Interest income from external customers	384,292	283,886	–	–	668,178
Interest expense to external customers	(298,584)	(14,917)	–	–	(313,501)
Inter-segment income *(Note)*	109,311	–	–	(109,311)	–
Inter-segment expense *(Note)*	–	(109,311)	–	109,311	–
Net interest income	195,019	159,658	–	–	354,677
Other operating income	47,243	12,118	43,137	–	102,498
Operating income	242,262	171,776	43,137	–	457,175
Impairment allowances	(13,769)	–	–	–	(13,769)
Net gain/(loss) on disposal of property and equipment	(831)	–	31	–	(800)
Net gain on disposal of available-for-sale securities	–	–	22,353	–	22,353
Operating expenses	(151,696)	(9,251)	(10,346)	–	(171,293)
Segment profit	75,966	162,525	55,175	–	293,666
Unallocated corporate expenses					(67,062)
Profit from operations					226,604
Share of results of jointly controlled entities			568		568
Profit before taxation					227,172
Taxation					(35,183)
Profit for the period					191,989

Notes: Inter-segment pricing is charged at prevailing customer deposits interest rates.

(b) Geographical segments

Geographical segmentation is analysed based on the locations of the principal operations of the branches and subsidiaries responsible for reporting the results or booking the assets. For both six months ended 30 June 2005 and 30 June 2006, more than 90% of the Group's revenue and profit before taxation were generated by assets booked by the principal operations of the branches and subsidiaries located in Hong Kong.

4. Other operating income

	6 months ended 30 June 2006	6 months ended 30 June 2005
	HK$'000	*HK$'000*
Fees and commission income	87,432	58,497
Less: Fees and commission expenses	(2,123)	(1,157)
Net fees and commission income	85,309	57,340
Dividend income	6,865	5,972
Net gains on dealing in foreign currencies	9,322	12,118
Gross rents from properties	1,983	2,243
Less: Outgoings	(362)	(322)
Net rental income	1,621	1,921
Safe deposit box rentals	10,558	10,524
Insurance underwriting	7,457	–
Other banking services income	16,200	14,416
Others	(204)	207
	137,128	102,498

5. Operating expenses

	6 months ended 30 June 2006	6 months ended 30 June 2005
	HK$'000	*HK$'000*
Staff costs		
Salaries and other costs	149,497	119,412
Retirement benefits scheme contributions	10,659	9,093
Total staff costs	160,156	128,505
Depreciation	13,933	17,321
Amortisation of prepaid lease payments for land	2,567	5,499
Premises and equipment expenses, excluding depreciation and amortisation of prepaid lease payments for land		
Rentals and rates for premises	22,004	20,868
Others	9,748	7,264
Other operating expenses	70,215	58,898
	278,623	238,355

6. Taxation

Hong Kong Profits Tax is calculated at 17.5% (2005: 17.5%) of the estimated assessable profit for the period.

Taxation arising in other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions.

7. Earnings per share

The calculation of basic and diluted earnings per share is based on the profit attributable to shareholders of HK$248,841,000 (2005: HK$191,989,000) and on 435,000,000 (2005: 435,000,000) ordinary shares in issue during the period.

8. Dividend paid

The final dividend for the year ended 31 December 2005 paid during the current period was approximately HK$182,700,000.

The final dividend for the year ended 31 December 2004 paid during last period was approximately HK$174,000,000.

9. Cash and short-term funds

	30 June 2006	31 December 2005
	HK$'000	*HK$'000*
Cash and balances with banks and other financial institutions	747,170	1,047,503
Money at call and short notice	8,370,827	10,264,463
Exchange fund bills	520,466	486,513
	9,638,463	11,798,479

10. Investments in securities/Certificates of deposits held

	Financial assets at fair value through profit or loss				
	Trading assets	Assets designated at fair value	Available-for-sale securities	Held-to-maturity securities	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
30 June 2006					
Equity securities:					
Listed in Hong Kong	900	–	293,427	–	294,327
Listed overseas	–	–	6,734	–	6,734
	900	–	300,161	–	301,061
Unlisted	–	–	293,062	–	293,062
	900	–	593,223	–	594,123
Debt securities:					
Certificates of deposits held	–	–	–	1,702,073	1,702,073
Other debt securities – Unlisted	–	513,066	322,639	11,299,754	12,135,459
	–	513,066	322,639	13,001,827	13,837,532
Derivatives	19,624	–	–	–	19,624
Total:					
Listed in Hong Kong	900	–	293,427	–	294,327
Listed overseas	–	–	6,734	–	6,734
Unlisted	19,624	513,066	615,701	13,001,827	14,150,218
	20,524	513,066	915,862	13,001,827	14,451,279
Market value of listed securities:					
Listed in Hong Kong	900	–	293,427	–	294,327
Listed overseas	–	–	6,734	–	6,734
	900	–	300,161	–	301,061
As analysis by issuing entities:					
Central government and central banks	–	–	–	289,887	289,887
Public sector entities	–	–	–	21,154	21,154
Banks and other financial institutions	2,009	201,657	35,186	10,848,672	11,087,524
Corporate entities	40	–	246,306	1,842,114	2,088,460
Others	18,475	311,409	634,370	–	964,254
	20,524	513,066	915,862	13,001,827	14,451,279

	Financial assets at fair value through profit or loss				
	Trading assets	**Assets designated at fair value**	**Available-for-sale securities**	**Held-to-maturity securities**	**Total**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
31 December 2005					
Equity securities:					
Listed in Hong Kong	562	–	268,756	–	269,318
Listed overseas	–	–	6,385	–	6,385
	562	–	275,141	–	275,703
Unlisted	–	–	248,232	–	248,232
	562	–	523,373	–	523,935
Debt securities:					
Certificates of deposits held	–	–	278,396	1,960,915	2,239,311
Other debt securities – Unlisted	–	808,598	–	7,231,991	8,040,589
	–	808,598	278,396	9,192,906	10,279,900
Derivatives	45,607	–	–	–	45,607
Total:					
Listed in Hong Kong	562	–	268,756	–	269,318
Listed overseas	–	–	6,385	–	6,385
Unlisted	45,607	808,598	526,628	9,192,906	10,573,739
	46,169	808,598	801,769	9,192,906	10,849,442
Market value of listed securities:					
Listed in Hong Kong	562	–	268,756	–	269,318
Listed overseas	–	–	6,385	–	6,385
	562	–	275,141	–	275,703
As analysis by issuing entities:					
Central government and central banks	–	–	–	95,109	95,109
Public sector entities	1	–	2	25,274	25,277
Banks and other financial institutions	46,024	163,158	28,804	7,129,927	7,367,913
Corporate entities	–	–	227,121	1,942,596	2,169,717
Others	144	645,440	545,842	–	1,191,426
	46,169	808,598	801,769	9,192,906	10,849,442

The fair value of held-to-maturity securities as at 30 June 2006 amounted to HK$13,014,270,000 (31 December 2005: HK$9,172,671,000).

Certain held-to-maturity certificates of deposit of approximately HK$24,444,000 (31 December 2005: HK$23,924,000) held by the San Francisco Branch of the Bank have been pledged to the State of California of the United States of America in compliance with the requirements of the California Financial Code.

Other debt securities under assets designated at fair value above represented bonds investment trust funds, credit linked notes and convertible debt securities.

11. Advances and other accounts

	30 June 2006	31 December 2005
	HK$'000	*HK$'000*
Advances to customers		
Bills receivable	440,416	330,409
Trade bills	138,332	131,549
Other advances to customers	24,869,716	23,834,686
	25,448,464	24,296,644
Interest receivable	205,779	196,225
Impairment allowances		
– Individually assessed	(24,294)	(54,640)
– Collectively assessed	(109,495)	(131,933)
	(133,789)	(186,573)
	25,520,454	24,306,296
Advances to banks and other financial institutions	56,985	57,209
	25,577,439	24,363,505
Other accounts	184,209	144,556
	25,761,648	24,508,061

Included in the "Advances to banks and other financial institutions" of the Group is an amount of approximately HK$56,985,000 (31 December 2005: HK$57,209,000) placed as reserve funds with the financial institutions in the People's Republic of China by the Shantou Branch of the Bank in compliance with the requirements of Regulations Governing Foreign Financial Institutions of the People's Republic of China.

Details of the impaired loans are as follows:

	30 June 2006	31 December 2005
	HK$'000	*HK$'000*
Gross impaired loans	560,395	642,788
Less: Impairment allowances under individual assessment	(24,294)	(54,640)
Net impaired loans	536,101	588,148
Gross impaired loans as a percentage of gross advances to customers	2.20%	2.65%
Market value of collateral pledged	545,846	617,345

In addition to the individually assessed loan impairment allowance, the Group has also provided collectively assessed loan impairment allowance for loans that are individually insignificant or advances where no impairment has been identified individually.

12. Property and equipment

During the six months ended 30 June 2006, the Group purchased property and equipment as follows:

	HK$'000
Buildings	33,258
Equipment	24,955
Construction in progress	30,578
	88,791

13. Deposits from customers

	30 June 2006	31 December 2005
	HK$'000	*HK$'000*
Demand deposits and current accounts	2,132,081	2,144,820
Savings deposits	7,194,219	6,462,001
Time, call and notice deposits	38,401,464	32,899,471
	47,727,764	41,506,292

14. Maturity profiles

The maturity profiles of certain assets and liabilities of the Group as at 30 June 2006 are analysed as follows:

	Repayable on demand	Repayable within 3 months or less (except those repayable on demand)	Repayable after 3 months but within 1 year	Repayable after 1 year but within 5 years	Repayable after 5 years	Undated	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Assets							
Cash and short-term funds	853,372	8,415,223	289,965	79,903	–	–	9,638,463
Placements with banks and other financial institutions	–	4,210,999	–	–	–	–	4,210,999
Advances to customers	1,597,340	4,108,850	3,750,188	9,076,163	6,306,044	609,879	25,448,464
Advances to banks and other financial institutions	–	18,985	38,000	–	–	–	56,985
Debt securities included in:							
– Financial assets at fair value through profit or loss	–	101,597	–	411,469	–	–	513,066
– Available-for-sale securities	–	–	70,975	155,398	96,266	–	322,639
– Held-to-maturity securities	–	5,628,662	1,985,581	5,164,414	223,170	–	13,001,827
	–	5,730,259	2,056,556	5,731,281	319,436	–	13,837,532
Liabilities							
Deposits and balances of banks and other financial institutions	83,276	652,901	–	–	–	–	736,177
Deposits from customers	9,334,875	36,144,986	2,150,511	97,392	–	–	47,727,764

The maturity profiles of certain assets and liabilities of the Group as at 31 December 2005 are analysed as follows:

	Repayable on demand	Repayable within 3 months or less (except those repayable on demand)	Repayable after 3 months but within 1 year	Repayable after 1 year but within 5 years	Repayable after 5 years	Undated	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Assets							
Cash and short-term funds	1,140,954	10,319,189	99,501	228,835	10,000	–	11,798,479
Placements with banks and other financial institutions	–	2,029,416	–	–	–	–	2,029,416
Advances to customers	1,615,723	4,635,235	3,254,009	8,116,115	6,087,700	587,862	24,296,644
Advances to banks and other financial institutions	–	19,209	38,000	–	–	–	57,209
Debt securities included in:							
– Financial assets at fair value through profit or loss	16,024	164,920	50,968	498,309	78,377	–	808,598
– Available-for-sale securities	–	–	38,388	144,857	95,151	–	278,396
– Held-to-maturity securities	–	2,741,346	2,298,402	3,849,468	303,690	–	9,192,906
	16,024	2,906,266	2,387,758	4,492,634	477,218	–	10,279,900
Liabilities							
Deposits and balances of banks and other financial institutions	529,613	1,733,891	–	–	–	–	2,263,504
Deposits from customers	8,630,741	31,289,581	1,385,276	200,694	–	–	41,506,292

AUDITORS' REPORT

Deloitte.
德勤

TO THE MEMBERS OF LIU CHONG HING BANK LIMITED
(incorporated in Hong Kong with limited liability)

We have audited the financial statements of Liu Chong Hing Bank Limited (the Bank) and its subsidiaries (the Group) from pages F-18 to F-79 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, in accordance with section 141 of the 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 financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Bank and the Group, 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 financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Bank and the Group as at 31 December 2005 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Ordinance.

DELOITTE TOUCHE TOHMATSU
Certified Public Accountants
Hong Kong

10 March 2006

CONSOLIDATED INCOME STATEMENT
for the year ended 31 December 2005

	Note	2005 HK$'000	2004 HK$'000 (restated)
Interest income		1,719,338	990,813
Interest expense		(966,486)	(341,316)
Net interest income	7	752,852	649,497
Other operating income	8	217,129	268,053
Operating income		969,981	917,550
Operating expenses	9	(493,129)	(457,214)
Operating profit before impairment allowances/provisions, fair value adjustments and disposal of long-term assets		476,852	460,336
Impairment allowances/charge for bad and doubtful debts	16	(67,807)	(51,175)
Net gain on disposal of property and equipment		1,150	4,912
Net gain on disposal of available-for-sale securities		47,534	–
Net gain on disposal of other securities and an associate		–	3,863
Net gain on fair value adjustment on investment properties		7,500	–
Net loss on liquidation of a subsidiary	29	(4)	–
Profit from operations		465,225	417,936
Share of results of jointly controlled entities		3,576	11,319
Profit before taxation		468,801	429,255
Taxation	11	(70,818)	(69,398)
Profit for the year		397,983	359,857
Dividends	12	261,000	247,950
Earnings per share, basic and diluted	13	HK$0.91	HK$0.83

CONSOLIDATED BALANCE SHEET

as at 31 December 2005

	Note	2005 HK$'000	2004 HK$'000 (restated)
Assets			
Cash and short-term funds	*14*	11,798,479	13,606,947
Placements with banks and other financial institutions maturing between one and twelve months		2,029,416	1,544,695
Trading securities	*15*	–	234,663
Financial assets at fair value through profit or loss	*15*	854,767	–
Available-for-sale securities	*15*	801,769	–
Held-to-maturity securities	*15*	9,192,906	3,388,300
Other securities	*15*	–	377,847
Certificates of deposit held	*15*	–	1,309,515
Advances and other accounts	*16*	24,508,061	20,246,034
Interests in jointly controlled entities	*18*	65,710	37,875
Loan to a jointly controlled entity	*18A*	31,000	31,000
Investment properties	*19*	76,860	69,360
Property and equipment	*20*	196,760	190,005
Prepaid lease payments for land	*21*	300,969	306,039
Deferred tax assets	*25*	6,449	18,951
Goodwill	*28*	110,606	–
Total assets		49,973,752	41,361,231
Liabilities			
Deposits and balances of banks and other financial institutions		2,263,504	1,559,633
Deposits from customers	*22*	41,506,292	33,951,631
Other accounts and accruals		340,496	279,129
Current tax liabilities		30,324	11,187
Total liabilities		44,140,616	35,801,580
Shareholders' equity			
Share capital	*23*	217,500	217,500
Reserves		5,615,636	5,342,151
Shareholders' funds		5,833,136	5,559,651
Total liabilities and shareholders' equity		49,973,752	41,361,231

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2005

	Share capital	Share premium	Goodwill	Investment property revaluation reserve	land and buildings revaluation reserve	Investment revaluation reserve	General reserve	Translation reserve	Regulatory reserve	Retained profits	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
THE GROUP											
At 1 January 2005											
– as originally stated . . .	217,500	1,542,817	(182)	34,340	644,108	130,689	1,388,500	(26)	–	2,245,680	6,203,426
– effect of changes in accounting policies *(Note 2A)*	–	–	–	(5,318)	(644,108)	–	–	–	–	5,651	(643,775)
– as restated	217,500	1,542,817	(182)	29,022	–	130,689	1,388,500	(26)	–	2,251,331	5,559,651
Effect of initial application of HKAS 39	–	–	–	–	–	–	–	–	–	96,390	96,390
Effect of initial application of HKAS 40	–	–	–	(29,022)	–	–	–	–	–	29,022	–
Effect of initial application of HKFRS 3	–	–	–	–	–	–	–	–	–	641	641
Earmark of retained profits as regulatory reserve . . .	–	–	–	–	–	–	–	–	103,883	(103,883)	–
As restated on 1 January 2005	217,500	1,542,817	(182)	–	–	130,689	1,388,500	(26)	103,883	2,273,501	5,656,682
Revaluation gains	–	–	–	–	–	55,995	–	–	–	–	55,995
Exchange differences arising from translation of foreign operations . . .	–	–	–	–	–	–	–	(1,665)	–	–	(1,665)
Net income recognised directly in equity	–	–	–	–	–	55,995	–	(1,665)	–	–	54,330
Profit for the year	–	–	–	–	–	–	–	–	–	397,983	397,983
Reversal of reserves upon disposal	–	–	–	–	–	(23,559)	–	–	–	–	(23,559)
Total recognised income for the year	–	–	–	–	–	32,436	–	(1,665)	–	397,983	428,754
Interim dividend paid	–	–	–	–	–	–	–	–	–	(78,300)	(78,300)
Final dividend paid	–	–	–	–	–	–	–	–	–	(174,000)	(174,000)
Earmark of retained profits as regulatory reserve . . .	–	–	–	–	–	–	–	–	18,954	(18,954)	–
At 31 December 2005	217,500	1,542,817	(182)	–	–	163,125	1,388,500	(1,691)	122,837	2,400,230	5,833,136
At 1 January 2004											
– as originally stated . . .	217,500	1,542,817	(182)	29,344	572,240	74,473	1,388,500	2,586	–	2,117,130	5,944,408
– effect of changes in accounting policies *(Note 2A)*	–	–	–	(4,707)	(572,240)	–	–	–	–	544	(576,403)
– as restated	217,500	1,542,817	(182)	24,637	–	74,473	1,388,500	2,586	–	2,117,674	5,368,005
Revaluation gains	–	–	–	4,996	–	52,616	–	–	–	–	57,612
Deferred taxation arising from revaluation gains	–	–	–	(611)	–	–	–	–	–	–	(611)
Exchange differences arising from translation of foreign operations . . .	–	–	–	–	–	–	–	953	–	–	953
Net income recognised directly in equity	–	–	–	4,385	–	52,616	–	953	–	–	57,954
Profit for the year	–	–	–	–	–	–	–	–	–	359,857	359,857
Reversal of reserves upon disposal	–	–	–	–	–	3 ,600	–	(3,565)	–	–	35
Total recognised income for the year	–	–	–	4,385	–	56,216	–	(2,612)	–	359,857	417,846
Interim dividend paid	–	–	–	–	–	–	–	–	–	(73,950)	(73,950)
Final dividend paid	–	–	–	–	–	–	–	–	–	(152,250)	(152,250)
At 31 December 2004	217,500	1,542,817	(182)	29,022	–	130,689	1,388,500	(26)	–	2,251,331	5,559,651

The retained profits of the Group included accumulated losses of HK$15,049,000 (2004: HK$18,625,000) retained by the jointly controlled entities of the Group.

The regulatory reserve is set up in compliance with Hong Kong Monetary Authority's requirements and is distributable to shareholders of the Bank subject to consultation with the Hong Kong Monetary Authority.

The general reserve comprises transfers from previous years' retained profits and inner reserve.

CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 December 2005

	2005	2004
	HK$'000	*HK$'000* (restated)
OPERATING ACTIVITIES		
Profit from operations	465,225	417,936
Adjustments for:		
Net gain on disposal of property and equipment	(1,150)	(4,912)
Net loss on liquidation of a subsidiary	4	–
Net gain on disposal of other securities and an associate	–	(3,863)
Net gain on disposal of available-for-sale securities	(47,534)	–
Impairment allowances/charge for bad and doubtful debts	67,807	51,175
Dividend income on equity securities	(10,243)	(53,429)
Net gain on fair value adjustment on investment properties	(7,500)	–
Depreciation	35,605	38,784
Amortisation of prepaid lease payments for land	5,063	5,063
Interest income from investments in securities and certificates of deposit held	(223,118)	(100,301)
Exchange adjustments	(1,665)	953
Operating cash flows before movements in operating assets and liabilities	282,494	351,406
(Increase) decrease in interest receivable and other accounts	(15,765)	158,981
Increase in other accounts and accruals	33,426	6,660
Decrease in placements with banks and other financial institutions (with original maturity over three months)	–	77,645
Decrease in bills receivable	79,011	121,563
Increase in trade bills	(42,183)	(20,011)
Increase in other advances to customers	(4,155,297)	(382,714)
Decrease in interest in suspense account	–	(94,672)
Decrease in advances to banks and other financial institutions	1,003	157
Increase in trading securities	–	(13,694)
Increase in financial assets at fair value through profit or loss	(111,817)	–
Increase in deposits from customers	7,554,661	1,360,041
Cash generated from operations	3,625,533	1,565,362
Hong Kong Profits Tax paid	(56,549)	(62,594)
Overseas tax paid	(797)	(3,602)
NET CASH GENERATED FROM OPERATING ACTIVITIES	3,568,187	1,499,166

	Note	2005 HK$'000	2004 HK$'000 (restated)
INVESTING ACTIVITIES			
Interest received on investments in securities		146,285	104,016
Dividends received on equity securities		10,243	53,429
Purchase of held-to-maturity securities		(7,120,470)	(2,135,374)
Purchase of certificates of deposit held		(1,299,334)	(744,651)
Purchase of other securities		–	(98,627)
Purchase of available-for-sale securities		(191,591)	–
Purchase of property and equipment		(44,633)	(55,538)
Purchase of investment properties		–	(16,496)
Purchase of a subsidiary	*28*	(122,959)	422
Repayment from an associate		–	261,817
Cash outflow on liquidation of a subsidiary	*29*	(46)	–
Repayment from jointly controlled entities		–	630
Proceeds from disposal of an associate		–	132,000
Proceeds from disposal of other securities		–	99,872
Proceeds from redemption of held-to-maturity securities		2,557,083	1,851,635
Proceeds from sale and redemption of available-for-sale securities		69,785	–
Proceeds from redemption of certificates of deposit held		647,934	727,543
Proceeds from disposal of property and equipment		4,198	5,743
NET CASH (USED IN) GENERATED FROM INVESTING ACTIVITIES		(5,343,505)	186,421
CASH USED IN FINANCING ACTIVITY			
Dividends paid		(252,300)	(226,200)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS		(2,027,618)	1,459,387
CASH AND CASH EQUIVALENTS AT 1 JANUARY		13,592,009	12,132,622
CASH AND CASH EQUIVALENTS AT 31 DECEMBER represented by			
Cash and balances with banks and other financial institutions		1,010,669	560,601
Money at call and short notice		10,301,297	12,548,402
Exchange fund bills		486,513	497,944
Placements with banks and other financial institutions maturing between one and twelve months (with original maturity within three months)		2,029,416	1,544,695
Deposits and balances of banks and other financial institutions (with original maturity within three months)		(2,263,504)	(1,559,633)
		11,564,391	13,592,009

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

1. GENERAL

The Bank is a listed public limited company incorporated in Hong Kong and is engaged in the provision of banking and related financial services. The address of the registered office of the Bank is disclosed in the Annual Report.

The financial statements are presented in Hong Kong dollars, which is also the functional currency of the Bank.

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/CHANGES IN ACCOUNTING POLICIES

(a) Application of Hong Kong Financial Reporting Standards

In the current year, the Group and the Bank have applied, for the first time, a number of new Hong Kong Financial Reporting Standards ("HKFRSs"), Hong Kong Accounting Standards ("HKASs") and Interpretations (hereinafter collectively referred to as "new HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") that are effective for accounting periods beginning on or after 1 January 2005. The application of the new HKFRSs has resulted in a change in the presentation of the consolidated income statement, balance sheets and consolidated statement of changes in equity.

The application of the new HKFRSs has resulted in changes to the Group's and Bank's accounting policies in the following areas that have an effect on how the results for the current and/or prior accounting years are prepared and presented:

Owner-occupied leasehold interest in land

In previous years, owner-occupied leasehold land and buildings were included in property and equipment and measured using the revaluation model. In the current year, the Group and the Bank have applied HKAS 17 "Leases". Under HKAS 17, the land and buildings elements of a lease of land and buildings are considered separately for the purposes of lease classification, unless the lease payments cannot be allocated reliably between the land and buildings elements, in which case, the entire lease is generally treated as a finance lease. To the extent that the allocation of the lease payments between the land and buildings elements can be made reliably, the leasehold interests in land are reclassified to prepaid lease payments under operating leases, which are carried at cost and amortised over the lease term on a straight-line basis. This change in accounting policy has been applied retrospectively (see Note 2A for the financial impact).

Investment properties

In the current year, the Group and the Bank have, for the first time, applied HKAS 40 "Investment Property". The Group and the Bank have elected to use the fair value model to account for its investment properties which requires gains or losses arising from changes in the fair value of investment properties to be recognised directly in profit or loss for the year in which they arise. In previous years, investment properties under the predecessor Standard were measured at open market values, with revaluation surplus or deficits credited or charged to investment property revaluation reserve unless the balance on this reserve was insufficient to cover a revaluation decrease, in which case the excess of the revaluation decrease over the balance on the investment property revaluation reserve was charged to the income statement. Where a decrease had previously been charged to the income statement and a revaluation surplus subsequently arose, that increase was credited to the income statement to the extent of the decrease previously charged. The Group and the Bank have applied the relevant transitional provisions in

HKAS 40 and elected to apply HKAS 40 from 1 January 2005 onwards. The amount held in the investment property revaluation reserve at 1 January 2005 has been transferred to the Group's and the Bank's retained profits (Note 2A for the financial impact).

Deferred taxes related to investment properties

In previous years, deferred tax consequences in respect of revalued investment properties were assessed on the basis of the tax consequence that would follow from recovery of the carrying amount of the properties through sale in accordance with the predecessor Interpretation. In the current year, the Group and the Bank have applied HK(SIC) Interpretation 21 "Income Taxes – Recovery of Revalued Non-Depreciable Assets" which removes the presumption that the carrying amount of investment properties is to be recovered through sale. Therefore, the deferred tax consequences of the investment properties are now assessed on the basis that reflect the tax consequences that would follow from the manner in which the Group and the Bank expect to recover the property at each balance sheet date. In the absence of any specific transitional provisions in HK(SIC) Interpretation 21, this change in accounting policy has been applied retrospectively. Comparative figures for 2004 have been restated.

Business combinations

In the current year, the Group has applied HKFRS 3 "Business Combinations" which is effective for business combinations for which the agreement date is on or after 1 January 2005. The principal effects of the application of HKFRS 3 to the Group are summarised below:

Goodwill

In previous years, goodwill arising on acquisitions prior to 1 January 2001 was held in reserves, and goodwill arising on acquisitions after 1 January 2001 was capitalised and amortised over its estimated useful life. The Group has applied the relevant transitional provisions in HKFRS 3. Goodwill previously recognised in reserves of HK$182,000 as at 1 January 2005 continues to be held in reserves and will be transferred to the retained earnings of the Group at the time when the business to which the goodwill relates is disposed of or when a cash-generating unit to which the goodwill relates becomes impaired.

In accordance with HKFRS 3, 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 acquisition ("discount on acquisition") is recognised immediately in profit or loss in the period in which the acquisition takes place. In previous periods, negative goodwill arising on acquisitions prior to 1 January 2001 was held in reserves, and negative goodwill arising on acquisitions after 1 January 2001 was presented as a deduction from assets and released to income based on an analysis of the circumstances from which the balance resulted. In accordance with the relevant transitional provisions in HKFRS 3, the Group derecognised all negative goodwill on 1 January 2005 (of which negative goodwill of HK$641,000 was previously presented as a deduction from assets). A corresponding adjustment to the Group's retained profits of HK$641,000 has been made.

Goodwill arising on acquisition after 1 January 2005 is measured at cost less accumulated impairment losses (if any) after initial recognition. As a result of this change in accounting policy, no amortisation of goodwill has been charged in the current year. Comparative figures for 2004 have not been restated (see Note 2A for the financial impact).

Financial instruments

In the current year, the Group and the Bank have applied HKAS 32 "Financial Instruments: Disclosure and Presentation" and HKAS 39 "Financial Instruments: Recognition and Measurement". HKAS 32 requires retrospective application. The application of HKAS 32 has had no material effect on how the results for the current or prior accounting years are prepared. HKAS 39, which is effective for annual periods beginning on or after 1 January 2005, generally does not permit the recognition, derecognition or measurement of financial assets and liabilities on a retrospective basis. The principal effects resulting from the implementation of HKAS39 are summarised as follows:

Classification and measurement of financial assets and financial liabilities

The Group and the Bank have applied the relevant transitional provisions in HKAS 39 with respect to the classification and measurement of financial assets and financial liabilities that are within the scope of HKAS 39.

Debt and equity securities

Prior to 31 December 2004, the Group and the Bank classified and measured its investments in debt and equity securities in accordance with the alternative treatment of Statement of Standard Accounting Practice 24 ("SSAP 24"). Under SSAP 24, investments in debt or equity securities are classified as "trading securities", "other securities" or "held-to-maturity securities" as appropriate. Both "trading securities" and "other securities" are measured at fair value. Unrealised gains or losses of "trading securities" are reported in profit or loss for the period in which gains or losses arise. Unrealised gains or losses of "other securities" are reported in equity until the securities are sold or determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the net profit or loss for that period.

From 1 January 2005 onwards, the Group and the Bank have classified and measured its investments in debt and equity securities in accordance with HKAS 39. Under HKAS 39, financial assets are classified as "financial assets at fair value through profit or loss", "available-for-sale financial assets", "loans and receivables", or "held-to-maturity financial assets". "Financial assets at fair value through profit or loss" and "available-for-sale financial assets" are carried at fair value, with changes in fair values recognised in profit or loss and equity respectively. Available-for-sale equity investments that do not have quoted market prices 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 measured at cost less impairment after initial recognition. "Loans and receivables" and "held-to-maturity financial assets" are measured at amortised cost using the effective interest method after initial recognition.

On 1 January 2005, the Group applied the relevant transitional provisions in HKAS 39 and reclassified its previous carrying amounts of trading securities of HK$234,663,000, held-to-maturity securities of HK$3,388,300,000, other securities of HK$377,847,000, and certificates of deposit held of HK$1,309,515,000 into various classes of financial assets. The reclassification resulted in the categorisation of the aforesaid investments in debt and equity securities and restatement into financial assets designated at fair value through profit or loss at HK$745,350,000, available-for-sale securities at HK$596,372,000, and held-to-maturity securities at HK$3,973,361,000.

The effect of fair value adjustments relating to the abovementioned reclassification and restatement increased the retained profits as at 1 January 2005 by HK$4,758,000, comprising the effect relating to financial assets designated at fair value through profit or loss amounted to HK$2,400,000, and that relating to available-for-sale securities amounted to HK$2,358,000.

On 1 January 2005, the Bank applied the relevant transitional provisions in HKAS 39 and reclassified its previous carrying amounts of trading securities of HK$234,508,000, held-to-maturity securities of HK$3,388,300,000, other securities of HK$347,141,000 and certificates of deposit held of HK$1,309,515,000 into various classes of financial assets. The reclassification resulted in the categorisation of the aforesaid investments in debt and equity securities and restatement into financial assets designated at fair value through profit or loss at HK$745,195,000, available-for-sale securities at HK$565,666,000 and held-to-maturity securities at HK$3,973,361,000.

The effect of fair value adjustments relating to the abovementioned reclassification and restatement increased the retained profits as at 1 January 2005 by HK$4,758,000, comprising the effect relating to financial assets at fair value through profit or loss amounted to HK$2,400,000, and that relating to available-for-sale securities amounted to HK$2,358,000.

Financial assets and financial liabilities other than debt and equity securities

From 1 January 2005 onwards, the Group and the Bank have classified and measured its financial assets and financial liabilities other than debt and equity securities (which were previously outside the scope of SSAP 24) in accordance with the requirements of HKAS 39. As mentioned above, financial assets under HKAS 39 are classified as "financial assets at fair value through profit or loss", "available-for-sale financial assets", "loans and receivables" or "held-to-maturity financial assets". Financial liabilities are generally classified as "financial liabilities at fair value through profit or loss" or "other financial liabilities". Financial liabilities at fair value through profit or loss are measured at fair value, with changes in fair value being recognised in profit or loss directly. Other financial liabilities are carried at amortised cost using the effective interest method after initial recognition.

Advances to customers

In prior years, advances to customers, advances to banks and other financial institutions and accrued interest and other accounts are stated in the consolidated balance sheet of the Group and balance sheet of the Bank after deducting provision for estimated losses.

Provisions for bad and doubtful debts are made, having regard to both specific and general risks.

The specific element of the provision relates to those loans that have been individually reviewed and specifically identified as bad or doubtful. Factors which are considered include expected cash flows, financial condition of the borrower and current economic conditions. The general element of the provision relates to those losses that, although not yet specifically identified, are known from experience to be present in the Group's portfolio of loans and advances. In determining the level of the provision required, management considers numerous factors including, but not limited to, domestic and international economic condition, the composition of the loan portfolio and prior loan loss experience.

From 1 January 2005 onwards following the adoption of HKAS 39, an impairment loss is recognised when there is objective evidence of impairment as a result of the occurrence of loss events that will impact on the estimated future cash flows.

Individual impairment allowances are assessed by a discounted cash flow method for loans and advances that are individually significant and have objective evidence of impairment. The individual impairment allowances are measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the original effective interest rate.

On collective impairment, individually insignificant advances or advances where no impairment has been identified individually are assessed on the basis of contractual cash flows and historical loss experience adjusted for current conditions.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement.

The Group and the Bank have applied the transitional rules in HKAS 39. At 1 January 2005, specific provision was fully reversed and individual impairment allowances were made resulting in a net increasing effect of HK$39,118,000 on the previous carrying amount of HK$101,391,000. Similarly, at 1 January 2005, general provision was fully reversed and collective impairment allowances were made resulting in a net decreasing effect of HK$102,102,000 on the previous carrying amount. In addition, the brought forward balance of HK$45,931,000 in interest-in-suspense account was fully written back on 1 January 2005. The combined effect of the above changes was a reduction of the previous carrying amount of the total provision for bad and doubtful debts or a corresponding increase of the previous carrying amount of advances and other accounts of HK$108,915,000.

In addition, a regulatory reserve has been set up in compliance with Hong Kong Monetary Authority's requirements by setting aside an amount of HK$103,883,000 upon application of HKAS 39 on 1 January 2005.

Due to the abovementioned a reversal of general provision of HK$102,102,000 on adoption of HKAS 39, the related deferred tax asset amounting to HK$17,868,000 was reversed accordingly.

Derivatives and hedging

Prior to 1 January 2005, financial derivative products, which include forward contracts, interest rate swaps and similar derivative products, are recognised on a trade-date basis and are initially measured at cost. Financial derivative products outstanding at the year end, except for those designated as hedges, are valued at fair value, with unrealised gains and losses included in the income statement. Gains and losses related to those derivative products that are designated as hedges are dealt with in accordance with the accounting treatment applicable to the position hedged and there is no offsetting of assets and liabilities until the position is closed. To qualify as a hedge, the derivative is expected to be effective in reducing the price or interest rate risk of the asset, liability or anticipated transaction to which it is linked and be designated as a hedge at inception of the derivative contract. Accordingly, changes in the market value of the derivative are expected to be highly correlated with changes in the market value of the underlying hedged item at inception of the hedge and over the life of the hedge contract. The financial derivative products of the Group are mainly used for hedging purposes.

From 1 January 2005 onwards, all derivatives that are within the scope of HKAS 39 are required to be carried at fair value at each balance sheet date regardless of whether they are deemed as held for trading or designated as effective hedging instruments. Under HKAS 39, derivatives (including embedded derivatives separately accounted for from the non-derivative host contracts) are deemed as held-for-trading financial assets or financial liabilities, unless they qualify and are designated as effective hedging instruments. The corresponding adjustments on changes in fair values would depend on whether the derivatives are designated as effective hedging instruments, and if so, the nature of the item being hedged. For derivatives that are deemed as held for trading, changes in fair values of such derivatives are recognised in profit or loss for the period in which they arise.

On 1 January 2005, the Group and the Bank applied the relevant transitional provisions in HKAS 39 and recognised the derivative financial instruments, not held for hedging purpose or not qualified as held for hedging under HKAS 39, as financial assets/liabilities designated at fair value through profit or loss on balance sheet. That resulted in the recognition of financial assets designated at fair value through profit or loss amounting to HK$734,000 and included in advances and other accounts. In addition, financial liabilities designated at fair value through profit or loss HK$149,000 was recognised and included in other accounts and accruals.

The net effect of the abovementioned recognition of derivative financial instruments amounted to an increase in retained profits as at 1 January 2005 of HK$585,000.

(b) Change of Accounting Policy for Property and Equipment

In the current year, the Group and the Bank have elected to use the cost model, which is allowable under HKAS 16, to account for its buildings held for own use, consistent with the measurement basis of the Group's interest in leasehold lands. Under the cost model, the buildings are carried at cost less accumulated depreciation and accumulated impairment losses (if any).

In previous years, buildings held for own use are stated in the balance sheet at their revalued amount, being the fair value at the date of revaluation less any subsequent accumulated depreciation and any subsequent accumulated impairment losses. Buildings held under the predecessor Standard were measured at open market values, with revaluation surplus or deficits credited or charged to property revaluation reserve unless the balance on this reserve was insufficient to cover a revaluation decrease, in which case the excess of the revaluation decrease over the balance on the revaluation reserve of the buildings was charged to the income statement. Where a decrease had previously been charged to the income statement and a revaluation surplus subsequently arose, that increase was credited to the income statement to the extent of the decrease previously charged.

The Group and the Bank have applied this change in accounting policy to carry the buildings at cost retrospectively. As a result, the carrying amount of property and equipment and the related deferred tax liabilities have been restated (Note 2A for the financial impact).

2A. SUMMARY OF THE EFFECTS OF THE CHANGES IN ACCOUNTING POLICIES

The effects of the changes in the accounting policies described above on the results for the current and prior years are as follows:

	2005	**2004**
	HK$'000	*HK$'000*
Decrease in negative goodwill released to income	(213)	–
Non-amortisation of goodwill	2,750	–
Gain on disposal of property and equipment	1,962	4,954
Gain on fair value adjustment of investment properties	7,500	–
Increase in operating expenses relating to prepaid lease payments for land *(Note 21)*	(5,063)	(5,063)
Reversal of depreciation of land and buildings	12,617	10,191
(Decrease) increase in deferred tax assets	(4,335)	772
Increase in interest income relating to impaired loans	21,224	–
Increase in impairment allowance – individual assessment	(21,955)	–
Decrease in impairment allowance – collective assessment	3,317	–
Decrease in fair value changes of derivatives	(372)	–
Increase in profit for the year	17,432	10,854

Analysis of increase in profit for the year by line items presented according to their function:

	2005	**2004**
	HK$'000	*HK$'000*
Increase in interest income	21,224	–
Decrease in other operating income	(585)	–
Decrease in operating expenses	7,554	5,128
Increase in gain on fair value adjustment on investment properties	7,500	–
Increase in gain on disposal of property and equipment	1,962	4,954
Increase in impairment allowance on loans and advances	(18,638)	–
Non-amortisation of goodwill	2,750	–
(Increase) decrease in taxation	(4,335)	772
Increase in profit for the year	17,432	10,854

THE GROUP

	As at 31 December 2004 (originally stated)	HKAS 16	HKAS 17	HK (SIC) INT-21	As at 31 December 2004	HKFRS 3	HKAS 39	HKAS 40	As at 1 January 2005
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Trading securities	234,663	–	–	–	234,663	–	(234,663)	–	–
Financial assets at fair value through profit or loss	–	–	–	–	–	–	745,350	–	745,350
Available-for-sale securities	–	–	–	–	–	–	596,372	–	596,372
Held-to-maturity securities	3,388,300	–	–	–	3,388,300	–	585,061	–	3,973,361
Other securities	377,847	–	–	–	377,847	–	(377,847)	–	–
Certificates of deposit held	1,309,515	–	–	–	1,309,515	–	(1,309,515)	–	–
Advances and other accounts	20,246,034	–	–	–	20,246,034	641	109,649	–	20,356,324
Property and equipment	1,264,949	(16,984)	(1,057,960)	–	190,005	–	–	–	190,005
Prepaid lease payments for land	–	–	306,039	–	306,039	–	–	–	306,039
Other accounts and accruals	(279,129)	–	–	–	(279,129)	–	(149)	–	(279,278)
Deferred tax (liabilities) assets	(106,179)	(2,093)	132,433	(5,210)	18,951	–	(17,868)	–	1,083
Total effects on assets and liabilities	26,436,000	(19,077)	(619,488)	(5,210)	25,792,225	641	96,390	–	25,889,256
Retained profits	2,245,680	(28,991)	34,534	108	2,251,331	641	(7,493)	29,022	2,273,501
Investment property revaluation reserve	34,340	–	–	(5,318)	29,022	–	–	(29,022)	–
Land and buildings revaluation reserve	644,108	9,914	(654,022)	–	–	–	–	–	–
Regulatory reserve	–	–	–	–	–	–	103,883	–	103,883
Total effects on equity	2,924,128	(19,077)	(619,488)	(5,210)	2,280,353	641	96,390	–	2,377,384

The financial effects of the application of the new HKFRSs to the Group's equity on 1 January 2004 are summarised below:

	As originally stated	Adjustments	As restated
	HK$'000	*HK$'000*	*HK$'000*
Retained profits	2,117,130	544	2,117,674
Investment property revaluation reserve	29,344	(4,707)	24,637
Land and buildings revaluation reserve	572,240	(572,240)	–
Total effects on equity	2,718,714	(576,403)	2,142,311

THE BANK

	As at 31 December 2004 (originally stated)	HKAS16	HKAS17	HK (SIC) INT-21	As at 31 December 2004	HKAS39	HKAS40	As at 1 January 2005
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Trading securities	234,508	–	–	–	234,508	(234,508)	–	–
Financial assets at fair value through profit or loss	–	–	–	–	–	745,195	–	745,195
Available-for-sale securities	–	–	–	–	–	565,666	–	565,666
Held-to-maturity securities	3,388,300	–	–	–	3,388,300	585,061	–	3,973,361
Other securities	347,141	–	–	–	347,141	(347,141)	–	–
Certificates of deposit held	1,309,515	–	–	–	1,309,515	(1,309,515)	–	–
Advances and other accounts	20,136,354	–	–	–	20,136,354	109,649	–	20,246,003
Property and equipment	712,853	3,316	(555,160)	–	161,009	–	–	161,009
Prepaid lease payments for land	–	–	222,901	–	222,901	–	–	222,901
Other accounts and accruals	(179,512)	–	–	–	(179,512)	(149)	–	(179,661)
Deferred tax (liabilities) assets	(96,815)	(192)	121,389	(5,210)	19,172	(17,868)	–	1,304
Total effects on assets and liabilities	25,852,344	3,124	(210,870)	(5,210)	25,639,388	96,390	–	25,735,778
Retained profits	1,924,145	2,171	38,501	108	1,964,925	(7,493)	27,518	1,984,950
Investment property revaluation reserve	32,836	–	–	(5,318)	27,518	–	(27,518)	–
Land and buildings revaluation reserve	601,340	953	(249,371)	–	352,922	–	–	352,922
Regulatory reserve	–	–	–	–	–	103,883	–	103,883
Total effects on equity	2,558,321	3,124	(210,870)	(5,210)	2,345,365	96,390	–	2,441,755

The financial effects of the application of the new HKFRSs to the Bank's equity on 1 January 2004 are summarised below:

	As originally stated	Adjustments	As restated
	HK$'000	*HK$'000*	*HK$'000*
Retained profits	1,829,896	35,575	1,865,471
Investment property revaluation reserve	29,344	(4,707)	24,637
Land and buildings revaluation reserve	529,472	(176,550)	352,922
Total effects on equity	2,388,712	(145,682)	2,243,030

The Group has not early applied the following standards, interpretations and amendments that have been issued but are not yet effective. The directors of the Bank anticipate that the application of the standards or interpretation will have no or any material impact on the financial statements of the Group.

HKAS 1 (Amendment)	Capital disclosure[1]
HKAS 19 (Amendment)	Actuarial gains and losses, group plans and disclosures[2]
HKAS 21 (Amendment)	Net investment in a foreign operation[2]
HKAS 39 (Amendment)	Cash flow hedge accounting of forecast intragroup transactions[2]
HKAS 39 (Amendment)	The fair value option[2]
HKAS 39 and HKFRS 4 (Amendments)	Financial guarantee contracts[2]
HKFRS 6	Exploration for and evaluation of mineral resources[2]
HKFRS 7	Financial instruments: Disclosures[1]
HKFRS – INT 4	Determining whether an arrangement contains a lease[2]
HKFRS – INT 5	Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds[2]
HK(IFRIC) – INT 6	Liabilities arising from participating in a specific market, waste electrical and electronic equipment[3]
HK(IFRIC) – INT 7	Applying the restatement approach under HKAS 29 Financial Reporting in Hyperinflationary Economies[4]

[1] *Effective for annual periods beginning on or after 1 January 2007.*

[2] *Effective for annual periods beginning on or after 1 January 2006.*

[3] *Effective for annual periods beginning on or after 1 December 2005.*

[4] *Effective for annual periods beginning on or after 1 March 2006.*

3. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared on the historical cost basis except for certain properties and financial instruments, which are measured at fair values, as explained in the accounting policies set out below.

The financial statements have been prepared in accordance with HKFRS issued by the HKICPA. In addition, the financial statements include applicable disclosures required by the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and by the Companies Ordinance.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Bank and its subsidiaries.

Subsidiary companies are companies in which the Group has the power to govern the financial and operating policies to obtain benefits from its activities and this is generally accompanied by a shareholding of more than one half of the voting rights.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Investments in subsidiaries are stated in the Bank's balance sheet at cost less provision for impairment losses. The results of subsidiary companies are accounted for by the Bank on the basis of dividends received or receivable.

Goodwill

Goodwill arising on acquisitions prior to 1 January 2005

Goodwill arising on an acquisition of a subsidiary or a jointly controlled entity for which the agreement date is before 1 January 2005 represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of the relevant subsidiary or jointly controlled entity at the date of acquisition.

Goodwill arising on acquisitions prior to 1 January 2001 continues to be held in reserves, and will be charged to the retained earnings at the time when the business to which the goodwill relates is disposed of or when a cash-generating unit to which the goodwill relates becomes impaired.

Goodwill arising on acquisitions on or after 1 January 2005

Goodwill arising on an acquisition of a subsidiary for which the agreement date is on or after 1 January 2005 represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of the relevant subsidiary at the date of acquisition. Such goodwill is carried at cost less any accumulated impairment losses.

Capitalised goodwill arising on an acquisition of a subsidiary is presented separately in the balance sheet.

For the purposes of impairment testing, goodwill arising from an acquisition is allocated to each of the relevant cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the acquisition. A cash-generating unit to which goodwill has been allocated is tested for impairment annually, and whenever there is an indication that the unit may be impaired. For goodwill arising on an acquisition in a financial year, the cash-generating unit to which goodwill has been allocated is tested for impairment before the end of that financial year. When the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated to reduce the carrying amount of any goodwill allocated to the unit first, and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognised directly in the income statement. An impairment loss for goodwill is not reversed in subsequent periods.

On subsequent disposal of a subsidiary or a jointly controlled entity, the attributable amount of goodwill capitalised is included in the determination of the amount of gain or loss on disposal.

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 acquisition ("discount on acquisition") is recognised immediately in profit or loss in the period in which the acquisition takes place.

Interests in jointly controlled entities

Joint venture arrangements that involve the establishment of a separate entity in which venturers have joint control over the economic activity of the entity are referred to as jointly controlled entities.

The results and assets and liabilities of jointly controlled entities are incorporated in the consolidated financial statements using the equity method of accounting. Under the equity method, investments in jointly controlled entities are carried in the consolidated balance sheet at cost as adjusted for post-acquisition changes in the Group's share of the profit or loss and of changes in equity of the jointly controlled entities, less any identified impairment loss. When the Group's share of losses of a jointly controlled entity equals or exceeds its interest in that jointly controlled entity (which includes any long-term interests that, in substance, form part of the Group's net investment in the jointly controlled entity), the Group discontinues recognising its share of further losses. An additional share of losses is provided for and a liability is recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of that jointly controlled entity.

When a group entity transacts with a jointly controlled entity of the Group, unrealised profits or losses are eliminated to the extent of the Group's interest in the jointly controlled entity, except to the extent that unrealised losses provide evidence of an impairment of the asset transferred, in which case, the full amount of losses is recognised.

Interest income and expenses

Interest income and expenses are recognised on a time-proportion basis using the effective interest method. 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, where appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. The calculation includes significant fees and transaction costs that are an integral part of the effective interest rate, and premiums or discounts.

When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cashflow discounted at original effective interest rate of the instrument, and thereafter amortising the discount as interest income.

Once a financial asset has been written down as a result of an impairment loss, interest income is recognised using the original rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

In prior years, interest income on loans and advances and debt securities and interest expense on deposits was recognised on an accrual basis using the contract or coupon interest rates. Amortisation of premium and discounts were recognised as interest expense and interest income respectively on a straight-line basis over the life of the asset or liability. In the case of doubtful debts, interest was credited to a suspense account which was netted off against accrued interest receivable except for credit card advances and overdrafts, where interest was accrued and the related specific provision on the interest receivable was included in the charge for bad and doubtful debts.

Fees and commission income

Fees and commission income are accounted for in the period when receivable, 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 on an appropriate basis over the relevant period.

Dividend income

Dividend income from investments in equity securities is recognised when the Group's right to receive payment has been established.

Property and equipment

Leasehold buildings and equipment are stated at cost less accumulated depreciation and accumulated impairment losses.

Depreciation is provided to write off the cost of leasehold buildings and equipment over their estimated useful lives after taking into account of their estimated residual value, using the straight-line method, at the following rates per annum:

Leasehold buildings	Over the shorter of the term of the lease or 2%
Equipment	10% – 20%

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year in which the item is derecognised.

Leasehold land and buildings under development for future owner-occupied purpose

When the leasehold land and buildings are in the course of development for production, rental or for administrative purposes, the leasehold land component is classified as a prepaid lease payment and amortised on a straight-line basis over the lease term. During the construction period, the amortisation charge provided for the leasehold land is included as part of costs of buildings under construction. Buildings under construction are carried at cost, less any identified impairment losses. Depreciation of buildings commences when they are available for use (i.e. when they are in the location and condition necessary for them to be capable of operating in the manner intended by management).

Investment properties

On initial recognition, investment properties are measured at cost, including any directly attributable expenditure. Subsequent to initial recognition, investment properties are measured using the fair value model. Gains or losses arising from changes in the fair value of investment properties are included in profit or loss for the period in which they arise.

An investment property is derecognised upon disposal or when the investment property is permanently withdrawn from use or no future economic benefits are expected from its disposals. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the income statement in the year in which the item is derecognised.

In prior years, investment properties are stated at their open market value based on independent professional valuations at the balance sheet date. Any revaluation increase or decrease arising on the revaluation of investment properties is credited or charged to the investment property revaluation reserve unless the balance of this reserve is insufficient to cover a revaluation decrease, in which case the excess of the revaluation decrease over the balance on the investment property revaluation reserve is charged to the income statement. Where a decrease has previously been charged to the income statement and a revaluation increase subsequently arises, this increase is credited to the income statement to the extent of the decrease previously charged. On disposal of an investment property, the balance on the investment property revaluation reserve attributable to that property is transferred to the income statement. No depreciation is provided on investment properties except where the unexpired term of the relevant lease is 20 years or less.

Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as lessor

Amounts due from lessees under finance leases are recorded as receivables at the amount of the Group's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Group's net investment outstanding in respect of the leases.

Rental income from operating leases is recognised in the income statement on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised as an expense on a straight-line basis over the lease term.

The Group as lessee

Assets held under finance leases are recognised as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly to profit or loss, unless they are directly attributable to qualifying assets.

Rentals payable under operating leases are charged to profit or loss on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are recognised as a reduction of rental expense over the lease term on a straight-line basis.

Prepaid lease payments for land

Leasehold premises held for own use is split into a lease of land and building in proportion to the relative fair values of the leasehold interests in the land element and the building element of the lease at the inception of the lease. Prepaid lease payments are stated at cost and amortised over the period of the lease.

Foreign currencies

In preparing the financial statements of each individual group entity, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in its functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchanges prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are recognised in profit or loss in the period in which they arise, except for exchange differences arising on a monetary item that forms part of the Bank's net investment in a foreign operation, in which case, such exchange differences are recognised in equity in the consolidated financial statements. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in profit or loss for the period except for differences arising on the retranslation of non-monetary items in respect of which gains and losses are recognised directly in equity, in which cases, the exchange differences are also recognised directly in equity.

For the purposes of presenting the consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated into the presentation currency of the Group (i.e. Hong Kong dollars) at the rate of exchange prevailing at the balance sheet date, and their income and expenses are translated at the average exchange rates for the year, unless exchange rates fluctuate significantly during the period, in which case, the exchange rates prevailing at the dates of transactions are used. Exchange differences arising, if any, are recognised as a separate component of equity (the translation reserve). Such exchange differences are recognised in income statement in the period in which the foreign operation is disposed of.

Goodwill and fair value adjustments on identifiable assets acquired arising on an acquisition of a foreign operation on or after 1 January 2005 are treated as assets and liabilities of that foreign operation and translated at the rate of exchange prevailing at the balance sheet date. Exchange differences arising are recognised in the translation reserve.

Retirement benefit costs

Payments to the Mandatory Provident Fund Scheme are charged as an expense as they fall due.

For defined benefit retirement benefit plans, the cost of providing benefits is determined using the projected unit credit method, with actuarial valuations being carried out with sufficient regularity. Actuarial gains and losses which exceed 10 per cent of the greater of the present value of the Group's pension obligations and the fair value of plan assets are amortised over the expected average remaining working lives of the participating employees. Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the amended benefits become vested. Any asset resulting from this calculation is limited to unrecognised actuarial losses and past service cost, plus the present value of available refunds and reductions in future contributions to the plan.

The amount recognised in the balance sheet represents the present value of the defined benefit obligation as adjusted for unrecognised actuarial gains and losses and unrecognised past service cost, and as reduced by the fair value of plan assets.

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax base used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and 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. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited to profit or loss, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Financial instruments

Financial assets and financial liabilities are recognised on the balance sheet when a group entity becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

Financial assets

The Group's and the Bank's financial assets are classified into one of the four categories, including financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments and available-for-sale financial assets. All regular way purchases or sales of financial assets are recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace. The accounting policies adopted in respect of each category of financial assets are set out below.

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are those designated at fair value through profit or loss on initial recognition and those held for trading. At each balance sheet date subsequent to initial recognition, financial assets at fair value through profit or loss are measured at fair value, with changes in fair value recognised directly in income statement in the period in which they arise.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. At each balance sheet date subsequent to initial recognition, loans and receivables including cash and short term funds, placement with and advances to banks and other financial institutions, interest receivable, trade bills and loans and advances to customers, loan to a jointly controlled entity and amounts due from subsidiaries are carried at amortised cost using the effective interest method, less any identified impairment losses.

An impairment loss is recognised in profit or loss when there is objective evidence of impairment as a result of the occurrence of loss events that will impact on the estimated future cash flows.

Individual impairment allowances are assessed by a discounted cash flow method for loans and advances that are individually significant and have objective evidence of impairment. The individual impairment allowances are measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the original effective interest rate.

On collective impairment, individually insignificant advances or advances where no impairment has been identified individually are assessed on the basis of contractual cash flows and historical loss experience adjusted for current conditions.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement.

If, in a subsequent period, the amount of the impairment decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment allowances are reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

When a loan is uncollectable, it is written off against the related allowances for loan impairment when all collaterals have been realised and further recoveries are considered unlikely. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the income statement.

In prior years, advances to customers, banks and other financial institutions and accrued interest and other accounts are stated in the balance sheet after deducting provision for estimated losses.

Provisions for bad and doubtful debts is made, having regard to both specific and general risks.

The specific element of the provision relates to those loans that have been individually reviewed and specifically identified as bad or doubtful. Factors which considered include expected cash flows, financial condition of the borrower and current economic conditions. The general element of the provision relates to those losses that, although not yet specifically identified, are known from experience to be present in the Group's portfolio of loans and advances. In determining the level of the provision required, management considers numerous factors including, but not limited to, domestic and international economic condition, the composition of the loan portfolio and prior loan loss experience.

Provisions are applied to write off advances when all collateral have been realised and further recoveries are considered unlikely.

Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity. At each balance sheet date subsequent to initial recognition, held-to-maturity investments are measured at amortised cost using the effective interest method, less any identified impairment losses. An impairment loss is recognised in profit or loss when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the effective interest rate computed on initial recognition. Impairment losses are reversed in subsequent periods when an increase in the investment's recoverable amount can be related objectively to an event occurring after the impairment was recognised, subject to the restriction that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated or not classified as any of the other categories (set out above). At each balance sheet date subsequent to initial recognition, available-for-sale financial assets are measured at fair value. Changes in fair value are recognised in equity, until the financial asset is disposed of or is determined to be impaired, at which time, the cumulative gain or loss previously recognised in equity is removed from equity and recognised in income statement. Any impairment losses on available-for-sale financial assets are recognised in income statement. Impairment losses on available-for-sale equity investments will not reverse in subsequent periods. For available-for-sale debt investments, impairment losses are subsequently reversed if an increase in the fair value of the investment can be objectively related to an event occurring after the recognition of the impairment loss.

Financial liabilities and equity

Financial liabilities and equity instruments issued by a group entity are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument.

An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities. The Group's financial liabilities are classified into other financial liabilities. The accounting policies adopted in respect of financial liabilities and equity instruments are set out below.

Other financial liabilities

Other financial liabilities, including deposits and balances of banks and other financial institutions and deposits from customers and amounts due to subsidiaries are subsequently measured at amortised cost, using the effective interest rate method.

Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when 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.

Equity instruments

Equity instruments issued by the Bank are recorded at the proceeds received, net of direct issue costs.

Derivative financial instruments

All derivatives of the Group do not meet the requirements of hedge accounting in accordance with HKAS 39. All derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at the fair values. The gain or loss on remeasurement to fair value at the balance sheet date is taken to the income statement.

Derecognition

Financial assets are derecognised when the rights to receive cash flows from the assets expire or, the financial assets are transferred and the Group has transferred substantially all the risks and rewards of ownership of the financial assets. On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of the consideration received and the cumulative gain or loss that had been recognised directly in equity is recognised in income statement.

For financial liabilities, they are removed from the Group's balance sheet when the obligation specified in the relevant contract is discharged, cancelled or expires. The difference between the carrying amount of the financial liability derecognised and the consideration received or receivable is recognised in income statement.

Embedded derivatives

Derivatives embedded in non-derivative host contracts are separated from the relevant host contracts and deemed as held-for-trading when the economic characteristics and risks of the embedded derivatives are not closely related to those of the host contracts, and the combined contracts are not measured at fair value through profit or loss. In all other circumstances, derivatives embedded are not separated and are accounted for together with the host contracts in accordance with appropriate standards. Where the Group needs to separate an embedded derivative but is unable to measure the embedded derivative, the entire combined contracts are treated as held-for-trading.

Impairment losses (other than goodwill)

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately, unless the relevant asset is carried at a revalued amount under another Standard, in which case the impairment loss is treated as a revaluation decrease under that Standard.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount under another Standard, in which case the reversal of the impairment loss is treated as a revaluation increase under that other Standard.

Repossessed assets

Collateral repossessed pending for realisation are in relation to those impaired loans and advances (or non-performing loans) continue to be reported as loans and advances. Impairment is made on the shortfall between the expected sales proceeds from realisation of the repossessed assets and the outstanding loans and advances.

Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Provisions are measured at the directors' best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material.

Fiduciary assets

The assets held in trust in a fiduciary capacity are not assets of the Group and accordingly are not included in the financial statements.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including: cash, balances with banks and other financial institutions, treasury bills, other eligible bills and certificates of deposit.

4. CRITICAL ACCOUNTING JUDGEMENT AND KEY SOURCE OF ESTIMATION UNCERTAINTY

Key sources of estimation

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are also discussed below.

(a) Impairment allowances on loans and advances

The Group establishes, through charges against profit, impairment allowances in respect of estimated incurred loss in loans and advances. The allowances consist of individual impairment allowances and collective impairment allowances. The overall impairment allowances represent the aggregate amount by which management considers necessary to write down its loan portfolio in order to state it in the balance sheet at its estimated net recoverable value.

In determining individual impairment allowances, management considers objective evidence of impairment. When a loan is impaired, an individual impairment allowance is assessed by a discounted cash flow method, measured at the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the original effective interest rate. The quantum of the allowance is also impacted by the collateral value and this in turn, may be discounted in certain circumstances to recognise the impact of forced sale or quick liquidation.

In determining collective impairment allowances, management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio.

The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. (Note 16)

(b) Fair value of derivatives

The fair value of financial instruments that are not quoted in active markets are determined by using valuation techniques. To the extent practical, models use only observable data, however areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates.

(c) Impairment of 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. This determination of what is significant or prolonged requires judgement. In making this judgement, the Group evaluates among other factors, the normal volatility in share price. In addition, impairment may be appropriate when there is evidence of a deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows. (Note 15)

(d) Estimated impairment of goodwill

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires the Group to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate the present value. Where the actual future cash flows are less than expected, a material impairment loss may arise.

Key sources of judgment

In the process of applying the entity's accounting policies which are described in note 3, management has made the following judgments that have significant effect on the amounts recognised in the financial statements.

Held-to-maturity investments

The Group classified certain non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. This classification requires judgement. In making this judgement, the Group evaluates its intention and ability to hold such investments to maturity. If the Group fails to keep these investments to maturity other than for the specific circumstances – for example, selling an insignificant amount close to maturity – it will be required to reclassify the entire class as available-for-sale. The investments would therefore be measured at fair value not amortised cost.

5. BUSINESS AND GEOGRAPHICAL SEGMENTS

(a) Business segments

For management purposes, the Group is currently organised into two operating divisions – corporate and retail banking, and treasury and foreign exchange activities. These divisions are the basis on which the Group reports its primary segment information.

Principal activities are as follows:

The corporate and retail banking services provided by the Group are principally lending and trade finance facilities, consumer financing, overdraft facilities, mandatory provident fund services, provision of fixed deposits, current and savings accounts, credit card and personal wealth management services. The Group also provides fully automated telephone and internet banking services to its customers. Other financial services offered include remittance and money exchange, safe deposit boxes, autopay and direct debit services.

Treasury activities mainly comprise inter-bank placement and deposit transactions, management of overall interest rate risk and liquidity of the Group and centralised cash management. Income from foreign exchange activities is generated from services provided to customers in the form of foreign exchange trading and forward contracts.

Other business activities of the Group include investment holding, securities trading, stockbroking, futures broking, insurance, other investment advisory services and property investment.

(i) *Segment information about these businesses for the year ended 31 December 2005 is presented below:*

INCOME STATEMENT

	Corporate and retail banking	Treasury and foreign exchange activities	Other business activities	Eliminations	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Interest income from external customers	997,780	721,558	–	–	1,719,338
Interest expense to external customers	(914,949)	(51,537)	–	–	(966,486)
Inter-segment income *(Note)*	333,259	–	–	(333,259)	–
Inter-segment expense *(Note)*	–	(333,259)	–	333,259	–
Net interest income	416,090	336,762	–	–	752,852
Other operating income	74,945	27,737	114,447	–	217,129
Operating income	491,035	364,499	114,447	–	969,981
Impairment allowances for impaired loans	(67,807)	–	–	–	(67,807)
Net (loss) gain on disposal of property and equipment	(909)	–	2,059	–	1,150
Net gain on disposal of available-for-sale securities	–	–	47,534	–	47,534
Net loss on liquidation of a subsidiary	–	–	(4)	–	(4)
Net gain on fair value adjustment on investment properties	–	–	7,500	–	7,500
Operating expenses	(324,108)	(19,445)	(27,890)	–	(371,443)
Segment profit	98,211	345,054	143,646	–	586,911
Unallocated corporate expenses					(121,686)
Profit from operations					465,225
Share of results of jointly controlled entities			3,576		3,576
Profit before taxation					468,801
Taxation					(70,818)
Profit for the year					397,983

Notes: Inter-segment pricing is charged at prevailing customer deposits interest rates.

BALANCE SHEET

	Corporate and retail banking	Treasury and foreign exchange activities	Other business activities	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Assets				
Segment assets	25,043,584	23,035,716	1,568,108	49,647,408
Interests in jointly controlled entities	–	–	65,710	65,710
Loan to a jointly controlled entity	–	–	31,000	31,000
Unallocated corporate assets				229,634
Consolidated total assets				49,973,752
Liabilities				
Segment liabilities	42,035,905	1,733,891	92,061	43,861,857
Unallocated corporate liabilities				278,759
Consolidated total liabilities				44,140,616

OTHER INFORMATION

	Corporate and retail banking	Treasury and foreign exchange activities	Other business activities	Unallocated	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Capital additions	17,092	118	1,955	26,236	45,401
Depreciation	18,438	312	2,009	14,846	35,605
Amortisation	3,751	–	–	1,312	5,063

(ii) Segment information about these businesses for the year ended 31 December 2004 is presented below:

INCOME STATEMENT

	Corporate and retail banking	Treasury and foreign exchange activities	Other business activities	Eliminations	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000* (restated)
Interest income from external customers	631,115	359,698	–	–	990,813
Interest expense to external customers	(333,967)	(7,349)	–	–	(341,316)
Inter-segment income *(Note)*	106,001	–	–	(106,001)	–
Inter-segment expense *(Note)*	–	(106,001)	–	106,001	–
Net interest income	403,149	246,348	–	–	649,497
Other operating income	95,939	27,562	144,552	–	268,053
Operating income	499,088	273,910	144,552	–	917,550
Charge for bad and doubtful debts	(51,175)	–	–	–	(51,175)
Net (loss) gain on disposal of property and equipment	(122)	–	5,034	–	4,912
Net gain on disposal of other securities and an associate	–	–	3,863	–	3,863
Operating expenses	(285,129)	(19,094)	(27,695)	–	(331,918)
Segment profit	162,662	254,816	125,754	–	543,232
Unallocated corporate expenses					(125,296)
Profit from operations					417,936
Share of results of jointly controlled entities			11,319		11,319
Profit before taxation					429,255
Taxation					(69,398)
Profit for the year					359,857

Notes: Inter-segment pricing is charged at prevailing customer deposits interest rates.

BALANCE SHEET

	Corporate and retail banking	Treasury and foreign exchange activities	Other business activities	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000* (restated)
Assets				
Segment assets	20,728,257	19,649,998	686,045	41,064,300
Interests in jointly controlled entities	–	–	37,875	37,875
Loan to a joint controlled entity	–	–	31,000	31,000
Unallocated corporate assets				228,056
Consolidated total assets				41,361,231
Liabilities				
Segment liabilities	33,988,496	1,522,769	99,159	35,610,424
Unallocated corporate liabilities				191,156
Consolidated total liabilities				35,801,580

OTHER INFORMATION

	Corporate and retail banking	Treasury and foreign exchange activities	Other business activities	Unallocated	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Capital additions	31,600	103	373	23,462	55,538
Depreciation	17,488	647	4,268	16,381	38,784
Amortisation	3,751	–	–	1,312	5,063

(b) Geographical segments

Geographical segmentation is analysed based on the locations of the principal operations of the branches and subsidiary companies responsible for reporting the results or booking the assets. For both years 2004 and 2005, more than 90% of the Group's revenue and profit before taxation were generated by assets booked by the principal operations of the branches and subsidiary companies located in Hong Kong. More than 90% of assets were located in Hong Kong and the remaining assets were extended to branches outside Hong Kong, mainly in Mainland China and America. Details of geographical segmentation are set out in note 3 and note 6 of the unaudited supplementary financial information.

6. FINANCIAL RISK MANAGEMENT

Strategy in using financial instruments

By their nature, the Group's activities are principally related to the use of financial instruments including derivatives. The Group accepts deposits from customers at both fixed and floating rates, and for various periods, and seeks to earn above-average interest margins by investing these funds in high-quality assets. The Group seeks to increase these margins by consolidating short-term funds and lending for longer period at higher rates, while maintaining sufficient liquidity to meet all claims that might fall due.

The Group also seeks to raise its interest margins by obtaining above-average margins, net of allowances, through lending to commercial and retail borrowers with a range of credit standing. Such exposures involve not just on-balance sheet loans and advances; the Group also enters into guarantees and other commitments such as letters of credit and performance, and other bonds.

The Group also trades in financial instruments where it takes positions in traded instruments to take advantage of short-term market movements in equities. The Board of Directors places trading limits on the level of exposure that can be taken in relation to both overnight and intra-day market positions. Foreign exchange and interest rate exposures associated with these derivatives are normally offset by entering into counterbalancing positions, thereby controlling the variability in the net cash amounts required to liquidate market positions.

Market risk arising from the trading book is considered immaterial, as the Group does not maintain significant positions of financial instruments leading to foreign exchange, interest rate, commodity and equity exposures. The Group's business activities involve the use of financial instruments, including derivatives. These activities expose the Group to a variety of financial risks, mainly credit risk, foreign exchange risk, interest rate risk and liquidity risk.

Credit risk

The Group takes on exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. The Group's maximum exposure to credit risk in the event of the counterparties failure to perform their obligations as at 31 December 2005 in relation to each class of recognised financial assets is the carrying amount of those assets as stated in the consolidated balance sheet. Impairment allowances are made for losses that have been incurred at the balance sheet date. Significant changes in the economy, or in the health of a particular industry segment, could result in losses that are different from those provided for at the balance sheet date. Management therefore carefully manages its exposure to credit risk.

The Group's lending policy sets out in detail the credit approval and monitoring mechanism, the loan classification system and provisioning policy, which is established in accordance with the requirements and provisions of the Banking Ordinance and the guidelines issued by the Hong Kong Monetary Authority.

Day-to-day credit management is performed by the Loans Committee with reference to the creditworthiness, and concentration risk of and the collateral pledged by the counterparties. Decisions made by the Loans Committee are reviewed regularly by the Executive Loans Committee comprising executive directors.

The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to a quarter or more frequent review. Limits on the level of credit risk by product, industry sector and by country are approved annually by the Board of Directors.

The exposure to any one borrower including banks and brokers is further restricted by sub-limits covering on and off-balance sheet exposures, and daily delivery risk limits in relation to trading items such as forward foreign exchange contracts. Actual exposures against limits are monitored daily.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees.

(a) Derivatives

The Group does not carry interest and foreign exchange rate positions on its trading book. The derivatives are used to manage the Group's own exposures to market risks as part of its asset and liability management process. The principal derivatives instruments used by the Group are interest and foreign exchange rate related contracts, which are over-the-counter derivatives. Most of the Group's foreign exchange rate and interest rate contracts have been entered into to meet customer demand and to manage the Group's own risk.

The Group maintains strict control limits on net open derivative positions (i.e. the difference between purchase and sale contracts), by both amount and term. At any one time, the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Group (i.e. assets where their fair values are positive), which is generally only a small fraction of the nominal value of the contract, or notional values used to express the volume of instruments outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements. Collateral or other security is not usually obtained for credit risk exposures on these instruments, except where the Group requires margin deposits from counterparties.

(b) Credit-related commitments

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit – which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties – carry the same credit risk as loans. Documentary and commercial letters of credit – which are written undertakings by the Group on behalf of a customer authorising a third party to draw drafts on the Group up to a stipulated amount under specific terms and conditions – are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct borrowing.

Commitments to extent credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group monitors the term of maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Although the Group's business segments are managed on a worldwide basis, their operations are mainly in East Asia. The Group's exposure to credit risk is concentrated in these areas.

Hong Kong is the home territory of the Bank, which is also the main operating entity. The areas of operation include all the primary business segments. As a well-established bank in Hong Kong, the Group accounts for a significant share of credit exposure to many sectors of the economy. However, credit risk is spread over a diversity of personal and commercial customers.

With the exception of Hong Kong, no other individual location contributed more than 10% of consolidated income or assets.

Foreign exchange risk

The Group and the Bank do not have any significant foreign exchange risk as foreign exchange dealing is moderate. Structural foreign exchange exposure arising from investments in foreign branches and subsidiaries is accounted for in the reserves account. Day-to-day foreign exchange management is performed by the Treasury Management Department within approved limits.

The Group and the Bank take on exposure to effect of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board of Directors sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily. Off-balance sheet notional position represents the contractual amounts of foreign currencies bought and sold under foreign exchange contracts. Bought currency is represented by positive amount and sold currency is represented by negative amount.

The following table indicates the concentration of currency risk at the balance sheet date:

THE GROUP

	HK$	US$	MOP	Others	Total
Hong Kong dollars equivalents *(HK$'000)*					
At 31 December 2005					
Assets					
Cash and short term funds	5,251,903	2,506,891	87,567	3,952,118	11,798,479
Placements with banks and other financial institutions	1,310,000	391,633	–	327,783	2,029,416
Financial assets at fair value through profit or loss	463,610	391,157	–	–	854,767
Available-for-sale securities	358,900	315,839	–	127,030	801,769
Held-to-maturity securities	4,707,785	4,283,575	–	201,546	9,192,906
Advances to customers *(Note 16)*	22,538,378	1,408,392	44,955	304,919	24,296,644
Other assets, including tax assets	893,953	91,112	191	14,515	999,771
Total assets	35,524,529	9,388,599	132,713	4,927,911	49,973,752
Liabilities					
Deposits and balances of banks and other financial institutions	1,554,492	622,000	–	87,012	2,263,504
Deposits from customers	28,069,955	8,601,850	72,446	4,762,041	41,506,292
Other liabilities, including tax liabilities	295,027	28,071	1,559	46,163	370,820
Total liabilities	29,919,474	9,251,921	74,005	4,895,216	44,140,616
Net on-balance sheet position	5,605,055	136,678	58,708	32,695	5,833,136
Off-balance sheet notional position	151,629	(129,072)	(4,004)	(18,553)	–

THE GROUP

	HK$	US$	MOP	Others	Total
Hong Kong dollars equivalents *(HK$'000)*					
At 31 December 2004					
Assets					
Cash and short term funds	7,247,933	3,316,429	74,774	2,967,811	13,606,947
Placements with banks and other financial institutions	639,000	622,184	–	283,511	1,544,695
Trading securities	156	96,806	–	137,701	234,663
Held-to-maturity securities	1,143,039	1,867,369	–	377,892	3,388,300
Other securities	274,766	99,867	–	3,214	377,847
Certificates of deposit held	1,270,628	38,887	–	–	1,309,515
Advances to customers *(Note 16)*	18,446,933	1,468,812	38,836	335,638	20,290,219
Other assets, including tax assets	590,434	5,326	–	13,285	609,045
Total assets	29,612,889	7,515,680	113,610	4,119,052	41,361,231
Liabilities					
Deposits and balances of banks and other financial institutions	1,127,958	277,035	–	154,640	1,559,633
Deposits from customers	22,847,087	7,188,584	45,138	3,870,822	33,951,631
Other liabilities, including tax liabilities	226,149	12,233	–	51,934	290,316
Total liabilities	24,201,194	7,477,852	45,138	4,077,396	35,801,580
Net on-balance sheet position	5,411,695	37,828	68,472	41,656	5,559,651
Off-balance sheet notional position	57,235	(25,522)	–	(31,713)	–

THE BANK

	HK$	US$	MOP	Others	Total
Hong Kong dollars equivalents *(HK$'000)*					
At 31 December 2005					
Assets					
Cash and short term funds	5,215,029	2,506,891	87,567	3,952,118	11,761,605
Placements with banks and other financial institutions	1,310,000	391,633	–	327,783	2,029,416
Financial assets at fair value through profit or loss	463,047	391,158	–	–	854,205
Available-for-sale securities	233,622	315,839	–	127,030	676,491
Held-to-maturity securities	4,707,785	4,283,575	–	201,546	9,192,906
Advances to customers *(Note 16)*	22,535,404	1,408,392	44,955	304,919	24,293,670
Other assets, including tax assets	1,376,184	91,112	191	14,513	1,482,000
Total assets	35,841,071	9,388,600	132,713	4,927,909	50,290,293
Liabilities					
Deposits and balances of banks and other financial institutions	1,554,492	622,000	–	87,012	2,263,504
Deposits from customers	28,065,800	8,601,850	72,446	4,762,040	41,502,136
Other liabilities, including tax liabilities	629,479	28,071	1,559	46,164	705,273
Total liabilities	30,249,771	9,251,921	74,005	4,895,216	44,470,913
Net on-balance sheet position	5,591,300	136,679	58,708	32,693	5,819,380
Off-balance sheet notional position	151,629	(129,072)	(4,004)	(18,553)	–
At 31 December 2004					
Assets					
Cash and short term funds	7,247,926	3,316,429	74,774	2,967,811	13,606,940
Placements with banks and other financial institutions	639,000	622,184	–	283,511	1,544,695
Trading securities	1	96,806	–	137,701	234,508
Held-to-maturity securities	1,143,039	1,867,369	–	377,892	3,388,300
Other securities	244,060	99,867	–	3,214	347,141
Certificates of deposit held	1,270,628	38,887	–	–	1,309,515
Advances to customers *(Note 16)*	18,441,704	1,468,812	38,836	335,638	20,284,990
Other assets, including tax assets	969,960	5,326	–	13,285	988,571
Total assets	29,956,318	7,515,680	113,610	4,119,052	41,704,660
Liabilities					
Deposits and balances of banks and other financial institutions	1,127,957	277,035	–	154,641	1,559,633
Deposits from customers	22,836,806	7,188,584	45,138	3,870,822	33,941,350
Other liabilities, including tax liabilities	545,079	12,233	–	51,934	609,246
Total liabilities	24,509,842	7,477,852	45,138	4,077,397	36,110,229
Net on-balance sheet position	5,446,476	37,828	68,472	41,655	5,594,431
Off-balance sheet notional position	57,235	(25,522)	–	(31,713)	–

Cash flow and fair value interest rate risk

Interest sensitivity of assets, liabilities and off balance sheet items – repricing analysis

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Group and the Bank take on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. Limits are set on the level of mismatch of interest rate repricing that may be undertaken, which is monitored regularly.

The Group and the Bank do not carry interest rate positions on its trading book. Certain interest rate contracts entered into to manage the Group's and the Bank's own risk are classified as trading securities under the requirements of HKAS 39. Interest rate risk arises primarily from the timing differences in the re-pricing of, and the different bases of pricing interest-bearing assets, liabilities and commitments, and from positions of non-interest bearing balances. Interest rate risk is monitored by regular sensitivity analyses of the net re-pricing gap and of different scenarios of pricing bases of assets and liabilities grouped with reference to their next contractual repricing date or maturity date.

The table below summarises the Group's and the Bank's exposure to interest rate risks. Included in the table are the Group's and the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

THE GROUP

	Effective interest rate	Up to 3 months	3 – 12 months	1 – 5 years	Over 5 years	Non-interest bearing	Total
	%	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
At 31 December 2005							
Assets							
Cash and short term funds	4.32%	10,769,415	99,501	228,835	10,000	690,728	11,798,479
Placements with banks and other financial institutions	4.52%	2,029,416	–	–	–	–	2,029,416
Financial assets at fair value through profit or loss	4.50%	565,737	–	203,047	–	85,983	854,767
Available-for-sale securities	2.28%	–	278,397	–	–	523,372	801,769
Held-to-maturity securities	4.15%	5,947,792	1,124,606	2,118,410	98	2,000	9,192,906
Advances to customers *(Note 16)*	5.44%	24,001,286	267,240	24,981	3,137	–	24,296,644
Other assets	–	–	–	–	–	999,771	999,771
Total assets		43,313,646	1,769,744	2,575,273	13,235	2,301,854	49,973,752
Liabilities							
Deposits and balances of banks and other financial institutions	4.14%	2,256,977	–	–	–	6,527	2,263,504
Deposits from customers	3.64%	37,413,235	1,676,101	267,837	–	2,149,119	41,506,292
Other liabilities	–	–	–	–	–	370,820	370,820
Total liabilities		39,670,212	1,676,101	267,837	–	2,526,466	44,140,616
Total interest sensitivity gap		3,643,434	93,643	2,307,436	13,235	(224,612)	5,833,136
At 31 December 2004							
Assets							
Cash and short term funds	0.51%	13,170,430	114,931	69,635	10,000	241,951	13,606,947
Placements with banks and other financial institutions	1.88%	1,544,695	–	–	–	–	1,544,695
Trading securities	3.49%	173,924	31,407	–	–	29,332	234,663
Held-to-maturity securities	2.69%	2,613,961	52,694	680,660	38,985	2,000	3,388,300
Certificates of deposit held	0.78%	65,887	1,243,628	–	–	–	1,309,515
Advances to customers *(Note 16)*	2.62%	18,956,360	470,760	5,840	3,096	854,163	20,290,219
Other assets	–	–	–	–	–	986,892	986,892
Total assets		36,525,257	1,913,420	756,135	52,081	2,114,338	41,361,231
Liabilities							
Deposits and balances of banks and other financial institutions	0.66%	1,401,782	150,000	–	–	7,851	1,559,633
Deposits from customers	1.19%	29,719,281	1,351,642	73,000	–	2,807,708	33,951,631
Other liabilities	–	–	–	–	–	290,316	290,316
Total liabilities		31,121,063	1,501,642	73,000	–	3,105,875	35,801,580
Total interest sensitivity gap		5,404,194	411,778	683,135	52,081	(991,537)	5,559,651

THE BANK

	Effective interest rate	Up to 3 months	3 – 12 months	1 – 5 years	Over 5 years	Non-interest bearing	Total
	%	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
At 31 December 2005							
Assets							
Cash and short term funds	4.32%	10,732,581	99,501	228,835	10,000	690,688	11,761,605
Placements with banks and other financial institutions	4.52%	2,029,416	–	–	–	–	2,029,416
Financial assets at fair value through profit or loss	4.50%	565,737	–	203,047	–	85,421	854,205
Available-for-sale securities	2.70%	–	278,396	–	–	398,095	676,491
Held-to-maturity securities	4.15%	5,947,791	1,124,607	2,118,410	98	2,000	9,192,906
Advances to customers *(Note 16)*	5.44%	23,998,741	267,093	24,699	3,137	–	24,293,670
Other assets	–	–	–	–	–	1,482,000	1,482,000
Total assets		43,274,266	1,769,597	2,574,991	13,235	2,658,204	50,290,293
Liabilities							
Deposits and balances of banks and other financial institutions	4.14%	2,256,976	–	–	–	6,528	2,263,504
Deposits from customers	3.64%	37,409,345	1,675,966	267,837	–	2,148,988	41,502,136
Amounts due to subsidiaries	3.09%	328,870	–	–	–	97,211	426,081
Other liabilities	–	–	–	–	–	279,192	279,192
Total liabilities		39,995,191	1,675,966	267,837	–	2,531,919	44,470,913
Total interest sensitivity gap		3,279,075	93,631	2,307,154	13,235	126,285	5,819,380
At 31 December 2004							
Assets							
Cash and short term funds	0.51%	13,170,430	114,931	69,635	10,000	241,944	13,606,940
Placements with banks and other financial institutions	1.88%	1,544,695	–	–	–	–	1,544,695
Trading securities	3.49%	173,924	31,407	–	–	29,177	234,508
Held-to-maturity securities	2.69%	2,613,961	52,694	680,660	38,985	2,000	3,388,300
Certificates of deposit held	0.78%	65,887	1,243,628	–	–	–	1,309,515
Advances to customers *(Note 16)*	2.61%	18,952,685	470,229	4,817	3,096	854,163	20,284,990
Other assets	–	–	–	–	–	1,335,712	1,335,712
Total assets		36,521,582	1,912,889	755,112	52,081	2,462,996	41,704,660
Liabilities							
Deposits and balances of banks and other financial institutions	0.67%	1,401,782	150,000	–	–	7,851	1,559,633
Deposits from customers	1.19%	29,710,663	1,351,508	73,000	–	2,806,179	33,941,350
Amounts due to subsidiaries	0.37%	76,802	260,415	–	–	83,346	420,563
Other liabilities	–	–	–	–	–	188,683	188,683
Total liabilities		31,189,247	1,761,923	73,000	–	3,086,059	36,110,229
Total interest sensitivity gap		5,332,335	150,966	682,112	52,081	(623,063)	5,594,431

Liquidity risk

The Group and the Bank have laid down liquidity policy which is reviewed regularly by the Board. This policy requires the Group to maintain a conservative level of liquid funds on a daily basis to ensure the availability of adequate liquid funds to meet all obligations, and the compliance with the statutory liquidity ratio requirement. The liquidity position is monitored through statutory liquidity ratio, loan-to-deposit ratio, maturity profile of assets and liabilities, and inter-bank transactions undertaken by the Group and the Bank.

The Group and the Bank are exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw-downs and guarantees, and from margin and other calls on cash-settled derivatives. The Group and the Bank do not maintain cash resources to meet all of these needs, as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. Limits are set on the minimum proportion of maturing funds available to meet such calls and on the minimum level of inter-bank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

The table below analyses the Group's and the Bank's assets and liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date.

THE GROUP

	Repayable on demand	Repayable within 3 months or less (except those repayable on demand)	Repayable after 3 months but within 1 year	Repayable after 1 year but within 5 years	Repayable after 5 years	Undated	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
As at 31 December 2005							
Assets							
Cash and short-term funds	1,140,954	10,319,189	99,501	228,835	10,000	–	11,798,479
Placements with banks and other financial institutions	–	2,029,416	–	–	–	–	2,029,416
Advances to banks and other financial institutions *(Note 16)*	–	19,209	38,000	–	–	–	57,209
Advances to customers *(Note 16)*	1,615,723	4,635,235	3,254,009	8,116,115	6,087,700	587,862	24,296,644
Debt securities included in:							
– financial assets at fair value through profit or loss	16,024	164,920	54,286	540,598	78,377	–	854,205
– available-for-sale securities	–	–	38,388	144,857	95,151	–	278,396
– held-to-maturity securities	–	2,741,346	2,298,402	3,849,468	303,690	–	9,192,906
	16,024	2,906,266	2,391,076	4,534,923	477,218	–	10,325,507
Liabilities							
Deposits and balances of banks and other financial institutions	529,613	1,733,891	–	–	–	–	2,263,504
Deposits from customers	8,630,741	31,289,581	1,385,276	200,694	–	–	41,506,292
As at 31 December 2004							
Assets							
Cash and short-term funds	699,814	12,712,567	114,931	69,635	10,000	–	13,606,947
Placements with banks and other financial institutions	–	1,544,695	–	–	–	–	1,544,695
Advances to banks and other financial institutions *(Note 16)*	–	20,212	38,000	–	–	–	58,212
Advances to customers *(Note 16)*	1,401,718	3,450,550	3,164,119	7,027,496	4,788,574	457,762	20,290,219
Debt securities included in:							
– trading securities	79,282	123,819	31,407	–	–	–	234,508
– held-to-maturity securities	–	784,141	553,405	1,880,617	170,137	–	3,388,300
	79,282	907,960	584,812	1,880,617	170,137	–	3,622,808
Certificates of deposit held	–	250,020	394,927	614,568	50,000	–	1,309,515
Liabilities							
Deposits and balances of banks and other financial institutions	36,865	1,522,768	–	–	–	–	1,559,633
Deposits from customers	11,777,613	20,749,367	1,351,642	73,009	–	–	33,951,631

THE BANK

	Repayable on demand	Repayable within 3 months or less (except those repayable on demand)	Repayable after 3 months but within 1 year	Repayable after 1 year but within 5 years	Repayable after 5 years	Undated	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
As at 31 December 2005							
Assets							
Cash and short-term funds	1,140,914	10,282,355	99,501	228,835	10,000	–	11,761,605
Placements with banks and other financial institutions	–	2,029,416	–	–	–	–	2,029,416
Advances to banks and other financial institutions *(Note 16)*	–	19,209	38,000	–	–	–	57,209
Advances to customers *(Note 16)*	1,615,723	4,635,003	3,253,395	8,115,019	6,086,694	587,836	24,293,670
Debt securities included in:							
– financial assets at fair value through profit or loss	16,024	164,920	54,286	540,598	78,377	–	854,205
– available-for-sale securities	–	–	38,388	144,857	95,151	–	278,396
– held-to-maturity securities	–	2,741,346	2,298,402	3,849,468	303,690	–	9,192,906
	16,024	2,906,266	2,391,076	4,534,923	477,218	–	10,325,507
Liabilities							
Deposits and balances of banks and other financial institutions	529,613	1,733,891	–	–	–	–	2,263,504
Deposits from customers	8,630,609	31,285,692	1,385,141	200,694	–	–	41,502,136
As at 31 December 2004							
Assets							
Cash and short-term funds	699,807	12,712,567	114,931	69,635	10,000	–	13,606,940
Placements with banks and other financial institutions	–	1,544,695	–	–	–	–	1,544,695
Advances to banks and other financial institutions *(Note 16)*	–	20,212	38,000	–	–	–	58,212
Advances to customers *(Note 16)*	1,401,718	3,450,174	3,163,023	7,025,143	4,787,196	457,736	20,284,990
Debt securities included in:							
– trading securities	79,282	123,819	31,407	–	–	–	234,508
– held-to-maturity securities	–	784,141	553,405	1,880,617	170,137	–	3,388,300
	79,282	907,960	584,812	1,880,617	170,137	–	3,622,808
Certificates of deposit held	–	250,020	394,927	614,568	50,000	–	1,309,515
Liabilities							
Deposits and balances of banks and other financial institutions	36,865	1,522,768	–	–	–	–	1,559,633
Deposits from customers	11,776,084	20,740,749	1,351,508	73,009	–	–	33,941,350

In addition to those assets and liabilities analysed above, the remaining assets and liabilities comprise property and equipment, investment properties and goodwill that are non-current, while the other remaining assets and liabilities are current.

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities are fundamental to the management of the Group. It is unusual for banks to be completely matched, as transacted business is often of uncertain term and of different types. An unmatched position potentially enhances profitability, but also increases the risk of losses.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature are important factors in assessing the liquidity of the Group and its exposure to changes in interest rates and exchange rates.

The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, as many of these commitments will expire or terminate without being funded.

Fair value of financial assets and liabilities

The following table summarises the carrying amounts and fair values of financial assets, held-to-maturity, of the Group and the Bank:

THE GROUP AND THE BANK

	Carrying value		Fair value	
	2005	**2004**	**2005**	**2004**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Financial assets				
– Held-to-maturity securities	9,192,906	3,388,300	9,172,671	3,410,258

Where quoted and observable market prices are not available, fair values are estimated based on a range of methodologies and assumptions. The principal ones are as follows:

The fair value of cash and short term funds, balances and placements with banks and other financial institutions, and amounts due from related parties are considered to approximate their carrying values because most of these are of negligible credit risk and are mainly priced in market interest rate.

The Group and the Bank consider the carrying amount of loans and advances to customers, and other accounts, as a reasonable approximation of their fair values. Presently, market and observable prices do not exist as there is currently no ready market wherein exchanges between willing parties occur. In estimating the fair value, loans are categorised into homogeneous groups by products type, risk characteristic, maturity and pricing profile, and non-performing accounts. In evaluating the reasonableness of fair value, the Group and the Bank perform analysis on each of the homogeneous groups, taking into account various hypothetical credit spread and market interest rate scenarios, future expected loss experience and estimated forced sale values of collateral. Impairment allowance under collective assessment is also deducted in arriving at the fair value as a discount for credit risk inherent in the large portfolio of advances to customers.

The Group and the Bank consider the carrying amount of all their deposits, such as non-bank customers' deposits and deposits and balances of banks, amounts due to related parties and amounts due to subsidiaries, as reasonable approximation of their respective fair values given that these are mostly repayable on demand or in the shorter term, and the interest rates are re-priced at short intervals.

7. NET INTEREST INCOME

	2005	2004
	HK$'000	*HK$'000*
Interest income		
Cash and short term funds	498,440	259,148
Investments in securities	223,118	100,301
Loans and advances	997,780	631,364
	1,719,338	990,813
Interest expense		
Banks and customers	(966,486)	(341,316)
Net interest income	752,852	649,497

Included in interest income is HK$21,224,000 (2004: Nil) with respect to effective interest income of impaired loans and advances released from impairment allowances, and HK$21,820,000 (2004: Nil) with respect of financial assets that are designated at fair value through profit or loss.

8. OTHER OPERATING INCOME

	2005	2004
	HK$'000	*HK$'000*
Fees and commission income		
Securities dealings	44,569	53,064
Credit lines	11,946	14,151
Trade finance	12,226	13,383
Credit card services	18,382	15,520
Agency services	21,050	23,241
Others	10,506	10,452
Total fees and commission income	118,679	129,811
Less: Fees and commission expense	(2,231)	(3,197)
Net fees and commission income	116,448	126,614
Dividend income		
Listed investments	7,238	6,899
Unlisted investments	3,005	46,530
Net gains on dealing in foreign currencies	27,737	27,562
Net gains on sale of trading securities	–	562
Net gains on financial assets at fair value through profit or loss		
– net realised losses	(52)	–
– net unrealised gains	703	–
Gross rents from properties	4,384	4,349
Less: Outgoings	(649)	(592)
Net rental income	3,735	3,757
Safe deposit box rentals	22,255	22,310
Insurance underwriting	5,671	–
Other banking services income	30,528	33,259
Others	(139)	560
	217,129	268,053

9. OPERATING EXPENSES

	2005	2004
	HK$'000	*HK$'000* (restated)
Amortisation of prepaid lease payments for land	5,063	5,063
Auditors' remuneration	2,442	2,004
Staff costs		
Salaries and other costs	251,349	225,979
Retirement benefits scheme contributions	18,901	17,249
Total staff costs	270,250	243,228
Depreciation	35,605	38,784
Premises and equipment expenses, excluding depreciation/amortisation		
Rentals and rates for premises	42,054	40,741
Others	12,207	12,622
Other operating expenses	125,508	114,772
	493,129	457,214

Included in the premises and equipment expenses are minimum lease payment under operating lease of HK$38,949,000 (2004: HK$37,959,000).

10. DIRECTORS' AND EMPLOYEES' EMOLUMENTS

The emoluments paid or payable to each of the 23 (2004: 20) directors were as follows:

	2005				2004			
	Fees	**Salaries and other benefits**	**Contribution to retirement benefits scheme**	**Total**	**Fees**	**Salaries and other benefits**	**Contribution to retirement benefits scheme**	**Total**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Executive directors (Hong Kong)								
Liu Lit Man	80	5,678	350	6,108	80	5,262	350	5,692
Liu Lit Mo	40	494	45	579	40	495	44	579
Liu Lit Chi	40	7,743	210	7,993	40	6,730	210	6,980
Don Tit Shing Liu	40	1,712	168	1,920	40	1,566	153	1,759
Wilfred Chun Ning Liu	40	1,914	137	2,091	40	1,990	103	2,133
Lau Wai Man	40	1,505	150	1,695	40	1,360	135	1,535
Frank Shui Sang Jin	40	1,715	143	1,898	40	1,602	115	1,757
Kevin Wai Hung Chu 1.1.2005 – 16.7.2005	22	693	46	761	23	792	52	867
Andrew Chiu Wing Tsang 17.8.2005 – 31.12.2005	15	633	47	695	–	–	–	–
George Har Kar Wong 17.8.2005 – 31.12.2005	15	707	39	761	–	–	–	–
Dominic Bing Hoi Lam 1.1.2005 – 10.5.2005	–	–	–	–	30	906	90	1,026
Total executive directors	372	22,794	1,335	24,501	373	20,703	1,252	22,328

	2005				2004			
	Fees	Salaries and other benefits	Contribution to retirement benefits scheme	Total	Fees	Salaries and other benefits	Contribution to retirement benefits scheme	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Non-executive directors (Hong Kong)								
Dominic Bing Hoi Lam 1.1.2005 – 10.5.2005	14	–	–	14	10	–	–	10
Wang Zhi 16.11.2005 – 31.12.2005	5	–	–	5	–	–	–	–
Timothy George Freshwater	40	80	–	120	70	80	–	150
Alfred Cheuk Yu Chow	60	–	–	60	70	–	–	70
Andrew Liu	40	1	–	41	40	1	–	41
Toshiaki Arai	40	–	–	40	40	–	–	40
Liu Guoyuan 1.1.2005 – 16.11.2005	35	–	–	35	40	–	–	40
Christopher Kwun Shing Liu	40	–	–	40	40	–	–	40
Sun Jiakang	40	–	–	40	40	–	–	40
Robin Yau Hing Chan 1.1.2005 – 26.4.2005	12	–	–	12	40	–	–	40
Total non-executive directors	326	81	–	407	390	81	–	471
Independent non-executive directors (Hong Kong)								
Robin Yau Hing Chan 26.4.2005 – 31.12.2005	55	–	–	55	–	–	–	–
Wanchai Chiranakhorn	80	–	–	80	80	–	–	80
Peter Alan Lee Vine 1.1.2005 – 13.4.2005	23	–	–	23	80	–	–	80
Cheng Yuk Wo	80	–	–	80	20	–	–	20
Total independent non-executive directors	238	–	–	238	180	–	–	180
Total	936	22,875	1,335	25,146	943	20,784	1,252	22,979

The five highest paid individuals in the Group in 2005 and 2004 were all directors of the Bank and details of their emoluments are included in note 10 above.

11. TAXATION

	2005	2004
	HK$'000	*HK$'000* (restated)
The tax charge comprises:		
Hong Kong Profits Tax		
– current year	75,663	58,818
– (over) under provision in prior years	(206)	2,455
	75,457	61,273
Overseas taxation	727	2,996
Deferred tax *(Note 25)*	(5,366)	5,129
	70,818	69,398

Hong Kong Profits Tax is calculated at 17.5% (2004: 17.5%) of the estimated assessable profit for the year.

Taxation arising in other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions. The tax charge for the year can be reconciled to the Group's profit per the income statement as follows:

	2005	2004
	HK$'000	*HK$'000* (restated)
Profit before taxation	468,801	429,255
Tax at the domestic income tax rate of 17.5% (2004: 17.5%)	82,040	75,120
Tax effect of share of results of jointly controlled entities	(626)	–
Tax effect of expenses not deductible for tax purpose	3,653	4,278
Tax effect of income not taxable for tax purpose	(13,638)	(12,433)
Tax effect of utilisation of tax losses not recognised previously	(398)	–
(Over) under provision in prior years	(206)	2,455
Effect of different tax rates of subsidiaries operating in other jurisdictions	(291)	(47)
Others	284	25
Tax charge for the year	70,818	69,398

12. DIVIDENDS

	2005	2004
	HK$'000	*HK$'000*
Ordinary shares:		
Interim dividend paid – HK$0.18 (2004: HK$0.17) per share	78,300	73,950
Final dividend proposed – HK$0.42 (2004: HK$0.40) per share	182,700	174,000
	261,000	247,950

A final dividend of HK$0.42 (2004: HK$0.40) per share has been proposed by the directors and is subject to approval by the shareholders at the forthcoming general meeting.

13. EARNINGS PER SHARE

The calculation of basic and diluted earnings per share is based on the profit attributable to shareholders of HK$397,983,000 (2004 (restated): HK$359,857,000) and on 435,000,000 (2004: 435,000,000) ordinary shares in issue during the year.

The following table summarise the impact on earnings per share as a result of changes in accounting policies.

	2005	2004
	HK$'000	*HK$'000*
Figures before adjustments	0.87	0.80
Adjustments arising from changes in accounting policies (Note 2)	0.04	0.03
As reported/restated	0.91	0.83

14. CASH AND SHORT-TERM FUNDS

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Cash and balances with banks and other financial institutions	1,010,669	560,601	1,010,629	560,594
Money at call and short notice	10,301,297	12,548,402	10,264,463	12,548,402
Exchange fund bills	486,513	497,944	486,513	497,944
	11,798,479	13,606,947	11,761,605	13,606,940

15. INVESTMENTS IN SECURITIES/CERTIFICATES OF DEPOSIT HELD

	THE GROUP					THE BANK				
	Financial assets at fair value through profit or loss					Financial assets at fair value through profit or loss				
	Trading assets	Assets designated at fair value	Held-to–maturity securities	Available–for-sale securities	Total	Trading assets	Assets designated at fair value	Held-to-maturity securities	Available-for-sale securities	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
2005										
Equity securities:										
Listed in Hong Kong	562	–	–	268,756	269,318	–	–	–	146,087	146,087
Listed overseas	–	–	–	6,385	6,385	–	–	–	6,385	6,385
	562	–	–	275,141	275,703	–	–	–	152,472	152,472
Unlisted	–	–	–	248,232	248,232	–	–	–	245,623	245,623
	562	–	–	523,373	523,935	–	–	–	398,095	398,095
Debt securities:										
Certificates of deposit held	–	–	1,960,915	278,396	2,239,311	–	–	1,960,915	278,396	2,239,311
Other debt securities – Unlisted	–	808,598	7,231,991	–	8,040,589	–	808,598	7,231,991	–	8,040,589
	–	808,598	9,192,906	278,396	10,279,900	–	808,598	9,192,906	278,396	10,279,900
Derivative	45,607	–	–	–	45,607	45,607	–	–	–	45,607
Total:										
Listed in Hong Kong	562	–	–	268,756	269,318	–	–	–	146,087	146,087
Listed overseas	–	–	–	6,385	6,385	–	–	–	6,385	6,385
Unlisted	45,607	808,598	9,192,906	526,628	10,573,739	45,607	808,598	9,192,906	524,019	10,571,130
	46,169	808,598	9,192,906	801,769	10,849,442	45,607	808,598	9,192,906	676,491	10,723,602
Market value of listed securities:										
Listed in Hong Kong	562	–	–	268,756	269,318	–	–	–	146,087	146,087
Listed overseas	–	–	–	6,385	6,385	–	–	–	6,385	6,385
	562	–	–	275,141	275,703	–	–	–	152,472	152,472
As analysed by issuing entities:										
Central government and central banks	–	–	95,109	–	95,109	–	–	95,109	–	95,109
Public sector entities	1	–	25,274	2	25,277	–	–	25,274	–	25,274
Banks and other financial institutions	46,024	163,158	7,129,927	28,804	7,367,913	45,607	163,158	7,129,927	20,290	7,358,982
Corporate entities	–	–	1,942,596	227,121	2,169,717	–	–	1,942,596	132,182	2,074,778
Others	144	645,440	–	545,842	1,191,426	–	645,440	–	524,019	1,169,459
	46,169	808,598	9,192,906	801,769	10,849,442	45,607	808,598	9,192,906	676,491	10,723,602

The Group and the Bank have applied HKAS 39 on 1 January 2005. Under the prospective application requirement of HKAS 39, certain financial assets were designated at fair value through profit or loss or classified as available for sale on 1 January 2005. There was no such designation in 2004.

At the balance sheet date, all available-for-sale securities and financial assets at fair value through profit or loss are stated at fair value. Fair value of the investments have been determined by reference to bid prices quoted in active markets. If without quoted price, the valuation will be performed by the qualified personnel by using reasonable valuation model.

Certain held-to-maturity certificates of deposit of approximately HK$23,924,000 (2004: HK$23,510,000) held by the San Francisco Branch of the Bank have been pledged to the State of California of the United States of America in compliance with the requirements of the California Financial Code.

	THE GROUP				THE BANK			
	Trading securities	**Held-to–maturity securities**	**Other securities**	**Total**	**Trading securities**	**Held-to–maturity securities**	**Other securities**	**Total**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
2004								
Equity securities:								
Listed in Hong Kong	155	–	157,678	157,833	–	–	126,972	126,972
Listed overseas	–	–	5,650	5,650	–	–	5,650	5,650
	155	–	163,328	163,483	–	–	132,622	132,622
Unlisted	–	–	214,519	214,519	–	–	214,519	214,519
	155	–	377,847	378,002	–	–	347,141	347,141
Debt securities:								
Unlisted	234,508	3,388,300	–	3,622,808	234,508	3,388,300	–	3,622,808
Total:								
Listed in Hong Kong	155	–	157,678	157,833	–	–	126,972	126,972
Listed overseas	–	–	5,650	5,650	–	–	5,650	5,650
Unlisted	234,508	3,388,300	214,519	3,837,327	234,508	3,388,300	214,519	3,837,327
	234,663	3,388,300	377,847	4,000,810	234,508	3,388,300	347,141	3,969,949
Market value of listed securities:								
Listed in Hong Kong	155	–	157,678	157,833	–	–	126,972	126,972
Listed overseas	–	–	5,650	5,650	–	–	5,650	5,650
	155	–	163,328	163,483	–	–	132,622	132,622
As analysed by issuing entities:								
Central government and central banks	–	50,024	–	50,024	–	50,024	–	50,024
Public sector entities	–	29,762	41,380	71,142	–	29,762	39,896	69,658
Banks and other financial institutions	35	1,915,305	16,457	1,931,797	–	1,915,305	13,658	1,928,963
Corporate entities	120	1,392,514	82,111	1,474,745	–	1,392,514	79,068	1,471,582
Others	234,508	695	237,899	473,102	234,508	695	214,519	449,722
	234,663	3,388,300	377,847	4,000,810	234,508	3,388,300	347,141	3,969,949
Certificates of deposit held				1,309,515				1,309,515

16. ADVANCES AND OTHER ACCOUNTS

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Advances to customers				
Bills receivable	330,409	410,792	330,409	410,792
Trade bills	131,549	89,366	131,549	89,366
Other advances to customers	23,834,686	19,790,061	23,831,712	19,784,832
	24,296,644	20,290,219	24,293,670	20,284,990
Interest receivable	196,225	86,900	195,900	86,893
Impairment allowances				
– Individually assessed	(54,640)	–	(54,640)	–
– Collectively assessed	(131,933)	–	(131,901)	–
Provision for bad and doubtful debts				
– General	–	(201,876)	–	(201,818)
– Specific	–	(101,391)	–	(101,391)
Interest in suspense	–	(45,931)	–	(45,931)
	24,306,296	20,027,921	24,303,029	20,022,743
Advances to banks and other financial institutions	57,209	58,212	57,209	58,212
	24,363,505	20,086,133	24,360,238	20,080,955
Other accounts	144,556	159,901	66,802	55,399
	24,508,061	20,246,034	24,427,040	20,136,354

Included in the "Advances to customers" of the Group and the Bank are aggregate amounts of approximately HK$139,478,000 (2004: HK$225,503,000) due from companies having significant influence on the Group.

Included in the "Advances to banks and other financial institutions" of the Group and the Bank is an amount of approximately HK$57,209,000 (2004: HK$58,212,000) placed as reserve funds with the financial institutions in the People's Republic of China by the Shantou Branch of the Bank in compliance with the requirements of Regulations Governing Foreign Financial Institutions of the People's Republic of China.

Impairment allowances on advances:

	THE GROUP					THE BANK				
	Individual assessment	Collective assessment	Total assessment	Suspended interest	Total	Individual assessment	Collective assessment	Total assessment	Suspended interest	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Balance at 1 January 2005										
– as previously reported	101,391	201,876	303,267	45,931	349,198	101,391	201,818	303,209	45,931	349,140
– effect of application of HKAS 39	39,118	(102,102)	(62,984)	(45,931)	(108,915)	39,118	(102,102)	(62,984)	(45,931)	(108,915)
– as restated	140,509	99,774	240,283	–	240,283	140,509	99,716	240,225	–	240,225
Increase in impairment allowances	61,550	48,515	110,065	–	110,065	61,550	48,515	110,065	–	110,065
Effective interest income released	(21,224)	–	(21,224)	–	(21,224)	(21,224)	–	(21,224)	–	(21,224)
Amounts reversed	(4,692)	(16,342)	(21,034)	–	(21,034)	(4,692)	(16,316)	(21,008)	–	(21,008)
Net charge to income statement	35,634	32,173	67,807	–	67,807	35,634	32,199	67,833	–	67,833
Exchange difference	–	(14)	(14)	–	(14)	–	(14)	(14)	–	(14)
Amounts written off	(121,503)	–	(121,503)	–	(121,503)	(121,503)	–	(121,503)	–	(121,503)
Balance at 31 December 2005	54,640	131,933	186,573	–	186,573	54,640	131,901	186,541	–	186,541

Provisions against advances and other accounts as at 31 December 2004:

	THE GROUP				THE BANK			
	Specific	General	Total	Suspended interest	Specific	General	Total	Suspended interest
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Balance at 1 January 2004	215,255	215,730	430,985	140,603	214,474	214,608	429,082	140,528
New provisions	105,170	–	105,170	–	105,168	–	105,168	–
Amounts reversed	(41,142)	(12,853)	(53,995)	–	(41,142)	(12,796)	(53,938)	–
Net charge to income statement	64,028	(12,853)	51,175	–	64,026	(12,796)	51,230	–
Interest suspended during the year	–	–	–	40,142	–	–	–	40,142
Interest recovered during the year	–	–	–	(19,952)	–	–	–	(19,952)
Exchange difference	–	6	6	–	–	6	6	–
Amounts written off	(177,892)	(1,007)	(178,899)	(114,862)	(177,109)	–	(177,109)	(114,787)
Balance at 31 December 2004	101,391	201,876	303,267	45,931	101,391	201,818	303,209	45,931

The individual impairment allowances/specific provisions were made after taking into account the value of collateral in respect of the corresponding advances to customers.

Details of the impaired loans/non-performing loans are as follows:

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Gross non-performing loans	–	790,980	–	790,980
Gross impaired loans	642,788	–	642,788	–
Less: Impairment allowances under individual assessment	(54,640)	–	(54,640)	–
Less: Specific provisions	–	(95,142)	–	(95,142)
Net impaired/non-performing loans	588,148	695,838	588,148	695,838
Gross impaired/non-performing loans as a percentage of gross advances to customers	2.65%	3.90%	2.65%	3.90%
Market value of collateral pledged	617,345	704,626	617,345	704,626
Interest in suspense	–	45,931	–	45,931

In addition to the individually assessed loan impairment allowance, the Group has also provided collectively assessed loan impairment allowance for loans that are individually insignificant or advances where no impairment has been identified individually.

Advances to customers of the Group include receivables under finance leases as follows:

	Minimum lease payments		Present value of minimum lease payments	
	2005	2004	2005	2004
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Within one year	371	818	327	721
In the second to fifth year inclusive	403	1,104	377	1,023
	774	1,922	704	1,744
Less: Unearned finance income	(70)	(178)	–	–
Present value of minimum lease payments receivable	704	1,744	704	1,744
Analysed as:				
Non-current finance lease receivables (recoverable after 12 months)			377	1,023
Current finance lease receivables (recoverable within 12 months)			327	721
			704	1,744

17. INVESTMENTS IN SUBSIDIARIES

	2005	2004
	HK$'000	*HK$'000*
Unlisted shares, at cost	792,484	580,719

Details of all the subsidiaries as at 31 December 2005 are as follows:

Name of company	Place of incorporation/ operation	Issued and fully paid ordinary share capital	Percentage of issued share capital directly held	Principal activities
Liu Chong Hing (Management) Limited	Hong Kong	HK$100,000	100%	Provision of property management services
Liu Chong Hing (Nominees) Limited	Hong Kong	HK$100,000	100%	Provision of nominee services
Liu Chong Hing Finance Limited	Hong Kong	HK$25,000,000	100%	Deposit-taking and ending
Liu Chong Hing Data Processing Limited	Hong Kong	HK$100,000	100%	Provision of electronic data processing services

Name of company	Place of incorporation/ operation	Issued and fully paid ordinary share capital	Percentage of issued share capital directly held	Principal activities
Liu Chong Hing Banking Corporation, Cayman	Cayman Islands/ Hong Kong	US$65,000,000	100%	General merchant banking
Chong Hing Securities Limited	Hong Kong	HK$10,000,000	100%	Stockbroking
Chong Hing Commodities and Futures Limited	Hong Kong	HK$5,000,000	100%	Investment holding and commodities and futures broking
Right Way Investments Limited	Bermuda/ Hong Kong	US$12,000	100%	Property investment
Gallbraith Limited	Hong Kong	HK$16,550,000	100%	Property investment
Card Alliance Company Limited	Hong Kong	HK$18,000,000	100%	Credit card management
Chong Hing Insurance Company Limited *(Note 28)*	Hong Kong	HK$50,000,000	100%	Insurance

None of the subsidiaries had any debt security subsisting at the end of the year or at any time during the year.

17A. AMOUNTS DUE FROM SUBSIDIARIES

	2005	2004
	HK$'000	*HK$'000*
Amounts due from subsidiaries	33,305	14,546

The amounts due from subsidiaries are unsecured, non-interest bearing and, in the opinion of the directors, are not repayable within three months.

18. INTERESTS IN JOINTLY CONTROLLED ENTITIES

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Unlisted shares, at cost	–	–	56,500	56,500
Share of net assets	65,710	37,875	–	–
	65,710	37,875	56,500	56,500

The directors consider the Bank has joint control on those jointly controlled entities.

During the year, the Group has acquired 10.5% and 5% of the share capital, through acquisition of the subsidiary, of BC Reinsurance Limited and Hong Kong Life Insurance Limited respectively. The investments were reclassified to jointly controlled entities in accordance with the existing interest of the Group in the respective entities.

As at 31 December 2005, the Group had interests in the following jointly controlled entities:

Name of company	**Place of incorporation and operation**	**Class of share held**	**Ownership interest**	**Proportion of voting power**	**Nature of business**
Bank Consortium Holding Limited	Hong Kong	Ordinary	13.3%	14.3%	Investment holding and provision of trustee, administration and custodian services for retirement schemes
BC Reinsurance Limited	Hong Kong	Ordinary	21.0%	21.0%	Reinsurance
Hong Kong Life Insurance Limited	Hong Kong	Ordinary	16.7%	16.7%	Life insurance underwriting
Net Alliance Co., Limited	Hong Kong	Ordinary	15.0%	15.0%	Provision of internet services

18A. LOAN TO A JOINTLY CONTROLLED ENTITY

	THE GROUP		**THE BANK**	
	2005	**2004**	**2005**	**2004**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Loan to a jointly controlled entity	31,000	31,000	31,000	31,000

The loan to a jointly controlled entity, Bank Consortium Holding Limited amounting to HK$31,000,000 (2004: HK$31,000,000) is unsecured, non-interest bearing, and will be repayable on 28 December 2008.

19. INVESTMENT PROPERTIES

	THE GROUP		**THE BANK**	
	2005	**2004**	**2005**	**2004**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
At 1 January	69,360	47,868	51,360	47,868
Additions	–	16,496	–	–
Net increase in fair value	7,500	4,996	7,500	3,492
At 31 December	76,860	69,360	58,860	51,360

Investment properties owned by the Group and by the Bank were revalued at 31 December 2005 on an open market value basis by Vigers Hong Kong Limited, independent professionally qualified valuers.

The investment properties are rented out under operating leases.

The carrying amount of investment properties of the Group and the Bank comprises:

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Leasehold properties				
Held in Hong Kong on long-term lease (over 50 years unexpired)	9,950	9,350	9,950	9,350
Held in Hong Kong on medium-term lease (10 – 50 years unexpired)	48,910	42,010	48,910	42,010
Held outside Hong Kong on medium-term lease (10 – 50 years unexpired)	18,000	18,000	–	–
	76,860	69,360	58,860	51,360

20. PROPERTY AND EQUIPMENT

	THE GROUP				THE BANK		
	Buildings	Equipment	Construction in progress	Total	Buildings	Equipment	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
COST AND VALUATION							
At 1 January 2005							
– as originally stated	613,690	295,284	544,544	1,453,518	613,690	266,052	879,742
– effect of changes in accounting policies	(533,919)	–	(523,100)	(1,057,019)	(533,919)	–	(533,919)
– as restated	79,771	295,284	21,444	396,499	79,771	266,052	345,823
Additions	2,340	23,283	19,010	44,633	2,340	22,190	24,530
Acquired on acquisition of a subsidiary	–	768	–	768	–	–	–
Disposals	(1,600)	(10,690)	–	(12,290)	(1,600)	(9,684)	(11,284)
Currency realignment	–	(2)	–	(2)	–	(2)	(2)
At 31 December 2005	80,511	308,643	40,454	429,608	80,511	278,556	359,067
ACCUMULATED DEPRECIATION							
At 1 January 2005							
– as originally stated	–	188,569	–	188,569	–	166,889	166,889
– effect of changes in accounting policies	17,925	–	–	17,925	17,925	–	17,925
– as restated	17,925	188,569	–	206,494	17,925	166,889	184,814
Provided for the year	1,610	33,995	–	35,605	1,610	29,343	30,953
Eliminated on disposals	(37)	(9,212)	–	(9,249)	(37)	(8,768)	(8,805)
Currency realignment	–	(2)	–	(2)	–	(2)	(2)
At 31 December 2005	19,498	213,350	–	232,848	19,498	187,462	206,960
NET BOOK VALUE							
At 31 December 2005	61,013	95,293	40,454	196,760	61,013	91,094	152,107

	THE GROUP				THE BANK		
	Buildings	Equipment	Construction in progress	Total	Buildings	Equipment	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
COST AND VALUATION							
At 1 January 2004							
– as originally stated	526,594	269,148	529,237	1,324,979	526,594	246,412	773,006
– effect of changes in accounting policies	(458,350)	–	(523,100)	(981,450)	(458,350)	–	(458,350)
– as restated	68,244	269,148	6,137	343,529	68,244	246,412	314,656
Additions	12,027	28,204	15,307	55,538	12,027	27,851	39,878
Acquired on acquisition of a subsidiary	–	6,319	–	6,319	–	–	–
Disposals	(500)	(8,387)	–	(8,887)	(500)	(8,211)	(8,711)
At 31 December 2004	79,771	295,284	21,444	396,499	79,771	266,052	345,823
ACCUMULATED DEPRECIATION							
At 1 January 2004							
– as originally stated	–	159,703	–	159,703	–	143,815	143,815
– effect of changes in accounting policies	16,580	–	–	16,580	16,580	–	16,580
– as restated	16,580	159,703	–	176,283	16,580	143,815	160,395
Provided for the year	1,595	37,189	–	38,784	1,595	31,221	32,816
Eliminated on disposals	(250)	(8,323)	–	(8,573)	(250)	(8,147)	(8,397)
At 31 December 2004	17,925	188,569	–	206,494	17,925	166,889	184,814
NET BOOK VALUE							
At 31 December 2004	61,846	106,715	21,444	190,005	61,846	99,163	161,009

Prior to 1 January 2005, the buildings and leasehold lands included in construction in progress were stated at their revalued amounts. The Group and the Bank have elected to use the cost model, which is allowable under HKAS 16. Under the cost model, the buildings and construction in progress are restated and carried at cost less accumulated depreciation and accumulated impairment losses (if any).

The net book value of buildings and construction in progress shown above comprise:

	THE GROUP				THE BANK	
	Buildings		Construction in progress		Buildings	
	2005	2004	2005	2004	2005	2004
	HK$'000	*HK$'000* (restated)	*HK$'000*	*HK$'000* (restated)	*HK$'000*	*HK$'000* (restated)
Leasehold properties						
Held in Hong Kong on long-term lease (over 50 years unexpired)	12,542	12,922	40,454	21,444	12,542	12,922
Held in Hong Kong on medium-term lease (10-50 years unexpired)	47,568	48,001	–	–	47,568	48,001
Held outside Hong Kong on medium-term lease (10-50 years unexpired)	903	923	–	–	903	923
	61,013	61,846	40,454	21,444	61,013	61,846

In previous years, owner-occupied leasehold land and buildings were included in property and equipment and measured using the revaluation model. In the current year, the Group has applied HKAS 17 "Leases". Under HKAS 17, the land and buildings elements of a lease of land and buildings are apportioned separately for the purposes of lease classified. The apportionment of the values for land and buildings was performed by Vigers Hong Kong Limited, independent professionally qualified valuers.

21. PREPAID LEASE PAYMENTS FOR LAND

The Group's prepaid lease payments comprise:

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
In Hong Kong held on:				
Leases of over 50 years	126,447	126,863	43,409	43,725
Leases of between 10 to 50 years	167,841	172,328	167,841	172,328
Outside Hong Kong held on:				
Leases of between 10 to 50 years	6,681	6,848	6,681	6,848
	300,969	306,039	217,931	222,901

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Net book value at 1 January				
– as originally stated	–	–	–	–
– effect of application of HKAS 17	306,039	311,619	222,901	228,381
– as restated	306,039	311,619	222,901	228,381
Amortisation of prepaid operating lease payment	(5,063)	(5,063)	(4,963)	(4,963)
Disposal	(7)	(517)	(7)	(517)
	300,969	306,039	217,931	222,901
Analysed as:				
Current portion	5,063	5,063	4,963	4,963
Non-current portion	295,906	300,976	212,968	217,938
Total	300,969	306,039	217,931	222,901

The allocation of lease payments between leasehold land and buildings elements was performed by Vigers Hong Kong Limited, independent professionally qualified valuers.

22. DEPOSITS FROM CUSTOMERS

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Demand deposits and current accounts	2,144,820	2,803,982	2,144,820	2,803,982
Savings deposits	6,462,001	8,954,061	6,462,001	8,954,061
Time, call and notice deposits	32,899,471	22,193,588	32,895,315	22,183,307
	41,506,292	33,951,631	41,502,136	33,941,350

Included in the balances is an aggregate amount of approximately HK$318,089,000 (2004: HK$86,297,000) representing deposits of companies having significant influence on the Bank and their subsidiaries placed with the Group and the Bank.

23. SHARE CAPITAL

	2005 & 2004
	HK$'000
Authorised:	
600,000,000 shares of HK$0.50 each	300,000
Issued and fully paid:	
435,000,000 shares of HK$0.50 each	217,500

24. RESERVES

	Share premium	Investment property revaluation reserve	Land and buildings revaluation reserve	Investment revaluation reserve	General reserve	Translation reserve	Regulatory reserve	Retained profits	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
THE BANK									
At 1 January 2005									
– as originally stated	1,542,817	32,836	601,340	110,169	1,378,500	80	–	1,924,145	5,589,887
– effect of changes in accounting policies *(Note 2A)*	–	(5,318)	(248,418)	–	–	–	–	40,780	(212,956)
– as restated	1,542,817	27,518	352,922	110,169	1,378,500	80	–	1,964,925	5,376,931
Effect of initial application of HKAS 39	–	–	–	–	–	–	–	96,390	96,390
Effect of initial application of HKAS 40	–	(27,518)	–	–	–	–	–	27,518	–
Earmark of retained profits as regulatory reserve	–	–	–	–	–	–	103,883	(103,883)	–
As restated on 1 January 2005	1,542,817	–	352,922	110,169	1,378,500	80	103,883	1,984,950	5,473,321
Revaluation gains	–	–	–	44,616	–	–	–	–	44,616
Exchange differences arising from translation of foreign operations	–	–	–	–	–	(207)	–	–	(207)
Net income recognised directly in equity	–	–	–	44,616	–	(207)	–	–	44,409
Transfer between reserves	–	–	(352,922)*	–	–	–	–	352,922	–
Profit for the year	–	–	–	–	–	–	–	351,500	351,500
Reversal of reserves upon disposal	–	–	–	(15,050)	–	–	–	–	(15,050)
Total recognised income for the year	–	–	(352,922)	29,566	–	(207)	–	704,422	380,859
Interim dividend paid	–	–	–	–	–	–	–	(78,300)	(78,300)
Final dividend paid	–	–	–	–	–	–	–	(174,000)	(174,000)
Earmark of retained profits as regulatory reserve	–	–	–	–	–	–	18,954	(18,954)	–
At 31 December 2005	1,542,817	–	–	139,735	1,378,500	(127)	122,837	2,418,118	5,601,880
At 1 January 2004									
– as originally stated	1,542,817	29,344	529,472	57,793	1,378,500	(26)	–	1,829,896	5,367,796
– effect of changes in accounting policies *(Note 2A)*	–	(4,707)	(176,550)	–	–	–	–	35,575	(145,682)
– as restated	1,542,817	24,637	352,922	57,793	1,378,500	(26)	–	1,865,471	5,222,114
Revaluation gains	–	3,492	–	48,675	–	–	–	–	52,167
Deferred taxation arising from revaluation gains	–	(611)	–	–	–	–	–	–	(611)
Exchange differences arising from translation of foreign operations	–	–	–	–	–	106	–	–	106
Net income recognised directly in equity	–	2,881	–	48,675	–	106	–	–	51,662
Profit for the year	–	–	–	–	–	–	–	325,654	325,654
Reversal of reserves upon disposal	–	–	–	3,701	–	–	–	–	3,701
Total recognised income for the year	–	2,881	–	52,376	–	106	–	325,654	381,017
Interim dividend paid	–	–	–	–	–	–	–	(73,950)	(73,950)
Final dividend paid	–	–	–	–	–	–	–	(152,250)	(152,250)
At 31 December 2004	1,542,817	27,518	352,922	110,169	1,378,500	80	–	1,964,925	5,376,931

The Bank's reserves available for distribution to the shareholders as at 31 December 2005 comprised retained profits of HK$2,418,118,000 (2004 (restated): HK$1,964,925,000) and general reserve of HK$1,378,500,000 (2004: HK$1,378,500,000).

The regulatory reserve is set up in compliance with Hong Kong Monetary Authority's requirements and is distributable to shareholders of the Bank subject to consultation with the Hong Kong Monetary Authority. The general reserve is comprised of transfers from previous years' retained profits and inner reserve.

* *Amount represents the revaluation surplus which had been realised on disposal of the relevant land and buildings to a wholly-owned subsidiary several years ago.*

25. DEFERRED TAXATION

The following are the major deferred tax liabilities (assets) recognised and movements thereon during the current and prior reporting year:

	Accelerated tax depreciation	Revaluation of properties	Collectively assessed impairment allowance/ General provisions for bad and doubtful debts	Investment properties	Others	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
THE GROUP						
At 1 January 2005						
– as originally stated	11,246	127,826	(32,893)	–	–	106,179
– effect of changes in accounting policies *(Note 2A)*	(2,622)	(127,826)	–	5,318	–	(125,130)
As restated	8,624	–	(32,893)	5,318	–	(18,951)
Effect of initial application of HKAS 39	–	–	17,868	–	–	17,868
	8,624	–	(15,025)	5,318	–	(1,083)
Charge (credit) to income statement for the year *(Note 11)*	729	–	(7,408)	1,313	–	(5,366)
At 31 December 2005	9,353	–	(22,433)	6,631	–	(6,449)
At 1 January 2004						
– as originally stated	6,225	113,731	(36,310)	–	1,439	85,085
– effect of changes in accounting policies *(Note 2A)*	(984)	(113,731)	–	4,707	–	(110,008)
As restated	5,241	–	(36,310)	4,707	1,439	(24,923)
Charge (credit) to income statement for the year *(Note 11)*	3,151	–	3,417	–	(1,439)	5,129
Acquisition of a subsidiary	232	–	–	–	–	232
Charge to investment property revaluation reserve	–	–	–	611	–	611
At 31 December 2004, as restated	8,624	–	(32,893)	5,318	–	(18,951)
THE BANK						
At 1 January 2005						
– as originally stated	11,014	118,683	(32,882)	–	–	96,815
– effect of changes in accounting policies *(Note 2A)*	(2,622)	(118,683)	–	5,318	–	(115,987)
As restated	8,392	–	(32,882)	5,318	–	(19,172)
Effect of initial application of HKAS 39	–	–	17,868	–	–	17,868
	8,392	–	(15,014)	5,318	–	(1,304)
Charge (credit) to income statement for the year	961	–	(7,413)	1,313	–	(5,139)
At 31 December 2005	9,353	–	(22,427)	6,631	–	(6,443)
At 1 January 2004						
– as originally stated	6,225	104,588	(36,289)	–	1,439	75,963
– effects of changes in accounting policies *(Note 2A)*	(984)	(104,588)	–	4,707	–	(100,865)
As restated	5,241	–	(36,289)	4,707	1,439	(24,902)
Charge (credit) to income statement for the year	3,151	–	3,407	–	(1,439)	5,119
Charge to investment property revaluation reserve	–	–	–	611	–	611
At 31 December 2004, as restated	8,392	–	(32,882)	5,318	–	(19,172)

At the balance sheet date, the Group has unused tax losses of HK$ 3,871,000 (2004: HK$ 6,145,000) available for offset against future profits. No deferred tax assets has been recognised in respect of tax losses since the amount was considered insignificant. The Bank has no tax losses available for offset against future profits.

26. SHARE OPTION SCHEME

The Bank's share option scheme (the "Scheme") was adopted pursuant to a resolution passed on 25 April 2002 for the primary purpose of providing incentives to directors and eligible employees, and will expire on 24 April 2012. Under the Scheme, the Board of Directors of the Bank may grant options to eligible employees, including directors of the Bank and its subsidiaries, to subscribe for shares in the Bank. Additionally, the Bank may, from time to time, grant share options to outside third parties for settlement in respect of goods or services provided to the Bank.

The total number of shares in respect of which options may be granted under the Scheme is not permitted to exceed 10% of the shares of the Bank in issue at the date of approval of the Scheme, without prior approval from the Bank's shareholders. The number of shares in respect of which options may be granted to any individual is not permitted to exceed 1% of the shares of the Bank in issue at any point in time, without prior approval from the Bank's shareholders.

Options granted must be taken up within 28 days of the date of offer, upon payment of HK$10 per option. Options may be exercised at any time from the date of grant of the share option to the fifth anniversary of the date of grant. The exercise price is determined by the Board of Directors of the Bank, and will be the highest of the closing price of the Bank's shares on the date of offer, the average closing price of the shares for the five trading days immediately preceding the date of offer and the nominal value of the shares.

No options have been granted under the above-mentioned scheme since the Scheme was adopted.

27. LOANS TO OFFICERS

The aggregate relevant loans to officers disclosed pursuant to Section 161B(4B) of the Companies Ordinance are as follows:

	THE GROUP AND THE BANK	
	2005	**2004**
	HK$'000	*HK$'000*
Aggregate balance of all relevant loans outstanding at the balance sheet date	100,383	118,514
Maximum aggregate balance of relevant loans during the year	135,511	287,579

The loans have no fixed repayment terms and the applicable interest rate ranges from 0% to prime rate plus 10%. Included in the loans to officers are loans of HK$ 94,208,000 (2004: 109,241,000) with collateral.

28. ACQUISITION OF A SUBSIDIARY

On 27 June 2005, the Group acquired 100% of the issued share capital of Chong Hing Insurance Company Limited (formerly known as "Liu Chong Hing Insurance Company Limited") for consideration of HK$213,369,000, including the legal cost of HK$1,369,000. This acquisition has been accounted for by the acquisition method of accounting. The amount of goodwill arising as a result of the acquisition was HK$110,606,000.

The net assets acquired in the transaction, and the goodwill arising, are as follows:

	Acquiree's carrying amount before combination	Fair value adjustments	2005 Fair value
	HK$'000	*HK$'000*	*HK$'000*
Net assets acquired			
Placements with banks and other financial institutions maturing between one and three months	90,410	–	90,410
Advances and other accounts less impairment	9,473	–	9,473
Available-for-sale securities	26,979	3,259	30,238
Property and equipment	768	–	768
Current tax liabilities	(299)	–	(299)
Other accounts and accruals	(27,827)	–	(27,827)
			102,763
Goodwill arising from acquisition			110,606
Total consideration			213,369
Net cash outflow arising from acquisition:			
Cash consideration			213,369
Cash and cash equivalents acquired			(90,410)
Net outflow of cash and cash equivalents in respect of the purchase of a subsidiary			122,959

The goodwill arising in the acquisition of Chong Hing Insurance Company Limited is attributable to the anticipated profitability of the acquired business and the anticipated future operating synergy from the combination.

The subsidiary acquired during the year contributed HK$6,515,000 to the Group's operating income, and a profit of HK$914,000 to the Group's profit from operations for the period between the date of acquisition and the balance sheet date.

If the acquisition had been completed on 1 January 2005, total Group's operating income for the year would have been HK$978,187,000 and profit for the year would have been HK$399,091,000. The proforma information is for illustrative purposes only and is not necessarily an indication of revenue and results of operations of the Group that actually would have been achieved had the acquisition been completed on 1 January 2005, nor is it intended to be a projection of future results.

In prior year, the Group acquired 66.7% of the issued share capital of Card Alliance Company Limited and a shareholder's loan of HK$7,500,000 for consideration of HK$7,965,000. This acquisition has been accounted for by the acquisition method of accounting. The amount of negative goodwill arising as a result of the acquisition was HK$641,000 and is included in advances and other accounts.

	HK$'000
Net assets acquired	
Placements with banks and other financial institutions maturing between one and twelve months	8,387
Advances and other accounts less provision	3,326
Fixed assets	6,319
Deferred tax liabilities	(232)
Other accounts and accruals	(1,142)
Shareholder's loan	(15,000)
Share of net assets before acquisition	(552)
	1,106
Negative goodwill arising on acquisition	(641)
	465
Shareholder's loan	7,500
Total consideration	7,965
Satisfied by:	
Cash	7,965
Net cash inflow arising on acquisition:	
Cash consideration	7,965
Cash and cash equivalents acquired	(8,387)
Net inflow of cash and cash equivalents in respect of the purchase of a subsidiary	(422)

29. LIQUIDATION OF A SUBSIDIARY

On 30 December 2005, the Group liquidated its subsidiary, Liu Chong Hing Finance (International) Limited. The amount of net assets of Liu Chong Hing Finance (International) Limited at the date of liquidation were as follows:

	2005
	HK$'000
NET ASSETS LIQUIDATED	
Cash and short term funds	2,824
Other accounts and accruals	(42)
	2,782
Loss on liquidation	(4)
Cash received on liquidation	2,778
NET CASH OUTFLOW ARISING ON LIQUIDATION	
Cash and short-term fund disposed	(2,824)
Cash received on liquidation	2,778
Cash outflow on liquidation	(46)

30. IMPAIRMENT TESTING ON GOODWILL

For the year ended 31 December 2005, the management has reviewed goodwill as set out in note 28 for impairment. The review comprised a comparison of the carrying amount and value in use of the acquired subsidiary (the smallest cash-generating unit) to which the goodwill has been allocated. The acquired subsidiary is involved in insurance business. Value in use is derived at by discounting the expected future cash flows over a 40-year period at 9% discount rate. Management's financial model assumes an overall growth in gross written premium of 10.3% per annum during the first 5 years, 7.4% per annum from years 6 to 10 and 5.5% per annum from years 11 to 30. The financial model, which has a projection horizon of 40 years, assumes no premium growth beyond year 30.

No impairment loss has been recognised in respect of goodwill for the year ended 31 December 2005 as their value in use exceeds the carrying amount.

31. CONTINGENT LIABILITIES AND COMMITMENTS

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Contingent liabilities and commitments – contractual amounts				
Direct credit substitutes	972,847	1,023,725	972,847	1,023,725
Trade – related contingencies	371,150	351,095	371,150	351,095
Other commitments				
With an original maturity of under one year or which are unconditionally cancellable	4,270,086	3,998,729	4,269,273	3,998,087
With an original maturity of one year and over	3,626,057	3,108,000	3,626,057	3,107,572
Capital commitments	369,588	50,291	369,588	50,291
	9,609,728	8,531,840	9,608,915	8,530,770
Derivatives notional amounts				
– Exchange rate contracts	111,566	135,335	111,566	135,335
– Interest rate swap contracts	657,654	387,760	657,654	387,760

Included under "Other commitments" are non-cancellable operating leases commitments in respect of rented premises. At the balance sheet date, the Group had commitments for future minimum lease payments under these non-cancellable operating leases which fall due as follows:

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Within one year	31,506	37,080	30,693	36,438
In the second to fifth years inclusive	16,574	41,422	16,574	40,994
Over five years	–	979	–	979
	48,080	79,481	47,267	78,411

Operating lease payments represent rental payable by the Group for certain of its office properties. Leases are negotiated for an average term of three years and rentals are fixed.

Included under "capital commitments" are as follows:

	THE GROUP		THE BANK	
	2005	2004	2005	2004
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Capital expenditure contracted for but not provided in the financial statements in respect of:				
– property and equipment	133,110	24,532	133,110	24,532
– investment in fund	236,478	25,759	236,478	25,759
	369,588	50,291	369,588	50,291

The replacement costs and credit risk weighted amounts of the above contingent liabilities, commitments and derivatives exposures are as follows:

	THE GROUP				THE BANK			
	2005		2004		2005		2004	
	Replace-ment cost	Credit risk weighted amount	Replace-ment cost	Credit risk weighted amount	Replace-ment cost	Credit risk weighted amount	Replace-ment cost	Credit risk weighted amount
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Contingent liabilities and commitments	N/A	2,820,689	N/A	2,272,921	N/A	2,820,689	N/A	2,272,921
Exchange rate contracts	451	514	1,015	1,461	451	514	1,015	1,461
Interest rate contracts	45,607	17,490	8,972	3,941	45,607	17,490	8,972	3,941
	46,058	2,838,693	9,987	2,278,323	46,058	2,838,693	9,987	2,278,323

The derivative financial instruments including exchange rate contracts and interest rate contracts have been recognised on balance sheet at fair value.

Replacement cost is the cost of replacing all contracts that have a positive value when marked to market (should the counterparty default on its obligations) and is obtained by marking contracts to market. Replacement cost is a close approximation of the credit risk for these contracts at the balance sheet dates.

At the balance sheet date, the Group and the Bank as lessor had contracted with tenants for the following future minimum lease payments:

	THE GROUP AND THE BANK	
	2005	2004
	HK$'000	*HK$'000*
Within one year	500	1,821
In the second to fifth years inclusive	–	524
	500	2,345

32. RETIREMENT BENEFITS SCHEME

At the balance sheet date, the Group had two retirement schemes in operation, a non-contributory defined benefit scheme which is registered under the Occupational Retirement Scheme Ordinance (the "ORSO Scheme") in 1995 and a Mandatory Provident Fund Scheme (the "MPF Scheme") established under the Mandatory Provident Fund Ordinance in December 2000. Employees who were members of the ORSO Scheme prior to the establishment of the MPF Scheme were either staying within the ORSO Scheme or switching to the MPF Scheme, whereas all new employees joining the Group on or after December 2000 are required to join the MPF Scheme. Most of the employees enrolled in the MPF Scheme in replacement of the ORSO Scheme (the "participating members"). The assets of the schemes are held separately from those of the Group, in funds under the control of trustees. As a result, retirement benefits accruing subsequent to the establishment of the MPF Scheme are covered therefrom, as far as the ORSO Scheme members participating in the MPF Scheme are concerned. The ORSO Scheme continues to provide retirement benefits to non-participating members and those retirement benefits accrued prior to MPF Scheme to the participating members.

The Group operates the ORSO Scheme for qualifying employees. Under the ORSO Scheme, the employees are entitled to retirement benefits varying between 0 and 100 percent of total contributions made by the Group on attainment of a retirement age of 55. Upon retirement, the employees are entitled to monthly pension until death varying between 0 and 50 percent of final salary depending on years of service completed at the time of retirement. Under the MPF Scheme, the employee contributes 5% of the relevant payroll to the MPF Scheme while the Group contributes from 5% to 10% of the relevant payroll to the MPF Scheme depending on the years of service completed.

The most recent actuarial valuation of the ORSO Scheme was carried out as at 31 December 2004 by the qualified actuaries of Watson Wyatt Hong Kong Limited. The accrued liabilities and future costs were measured using the Projected Unit Credit method. The main actuarial assumptions used were as follows:

Discount rate	4% per annum
Expected return on Scheme assets	5% per annum
Expected rate of salary increase	3% per annum

At the date of the latest formal independent actuarial valuation made at 31 December 2004, the market value of the Scheme assets was HK$166,305,000 which was sufficient to cover the Aggregate Vested Liability and Aggregate Past Service Liability on that date. The Bank carries out actuarial valuation with sufficient regularity and determines that the valuation made on 31 December 2004 does not differ materially from 31 December 2005, had a valuation been done on the later date.

33. MAJOR NON-CASH TRANSACTIONS

During the year, the Group has written off approximately HK$121,517,000 (2004: HK$ 178,893,00) advances to customers to the impairment allowances/provisions against advances and other accounts.

34. RELATED PARTY TRANSACTIONS

During the year, the Group and the Bank entered into the following transactions with related parties:

	Purchase of a subsidiary		Interest, commission and rental income		Interest and rental expenses	
	2005	**2004**	**2005**	**2004**	**2005**	**2004**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Investing enterprises having significant influence on the Bank and their subsidiaries	212,000	–	7,899	7,062	13,915	11,851
Associate and jointly controlled entities	–	–	6,555	13,720	8,423	6,019
Directors and their associates	–	–	36,127	17,659	14,172	3,629

The above transactions were carried out at market rates.

At the balance sheet date, the Group and the Bank had the following outstanding balances with related parties:

	Amounts owed by related parties		Amounts owed to related parties	
	2005	**2004**	**2005**	**2004**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Investing enterprises having significant influence on the Bank and subsidiaries	139,478	225,503	318,089	86,297
Jointly controlled entities	31,000	31,000	188,594	217,284
Directors and their associates	1,255,108	1,049,225	537,559	602,839

The above outstanding balances bear interest at rates similar to those made available to non-related parties.

During the year, the Bank entered into the following transactions with subsidiaries:

	Interest, commission and rental income		Interest and rental expenses	
	2005	**2004**	**2005**	**2004**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Subsidiaries	479	850	15,928	6,036

The above transactions were carried out at market rates.

At the balance sheet date, the Bank had the following outstanding balances with subsidiaries:

	Amounts owed by		Amounts owed to	
	2005	**2004**	**2005**	**2004**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Subsidiaries	33,305	14,546	426,081	420,563

The above outstanding balances bear interest at rates similar to those made available to non-related parties.

Compensation of key management personnel

The remuneration of directors and other members of key management during the year was as follows:

	THE GROUP AND THE BANK	
	2005	**2004**
	HK$'000	*HK$'000*
Short-term benefits	40,636	40,567

The remuneration of directors and key management is reviewed by Remuneration Committee having regarding to the performance of individuals and market trends.

AUDITORS' REPORT

Deloitte.
德勤

TO THE MEMBERS OF LIU CHONG HING BANK LIMITED
(incorporated in Hong Kong with limited liability)

We have audited the financial statements on pages F-81 to F-119 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, in accordance with section 141 of the 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 Statements of Auditing Standards 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 financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Bank and the Group, 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 financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Bank and the Group as at 31 December 2004 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Ordinance.

DELOITTE TOUCHE TOHMATSU
Certified Public Accountants
Hong Kong

3 March 2005

CONSOLIDATED INCOME STATEMENT

	Note	2004 HK$'000	2003 HK$'000
Interest income		990,813	1,034,173
Interest expense		(341,316)	(363,995)
Net interest income		649,497	670,178
Other operating income	5	268,053	213,840
Operating income		917,550	884,018
Operating expenses	6	(462,341)	(463,154)
Operating profit before provisions and disposal of long-term assets		455,209	420,864
Charge for bad and doubtful debts		(51,175)	(62,803)
Net losses from disposal of property and equipment		(43)	(2,664)
Net gains from disposal of other securities and an associate	7	3,863	22,192
Provision for impairment loss in respect of other securities		–	(7,809)
Profit from operations		407,854	369,780
Share of results of jointly controlled entities		11,319	(2,000)
Profit from ordinary activities before taxation		419,173	367,780
Taxation	9	(70,170)	(56,305)
Net profit for the year		349,003	311,475
Dividends	10	247,950	217,500
Earnings per share, basic and diluted	11	HK$0.80	HK$0.72

CONSOLIDATED BALANCE SHEET

	Note	2004 HK$'000	2003 HK$'000
ASSETS			
Cash and short-term funds	*12*	13,606,947	12,001,888
Placements with banks and other financial institutions maturing between one and twelve months		1,544,695	1,243,771
Trading securities	*13*	234,663	220,969
Advances and other accounts	*14*	20,246,034	20,081,543
Held-to-maturity securities	*13*	3,388,300	3,104,561
Certificates of deposit held	*15*	1,309,515	1,292,407
Other securities	*13*	377,847	319,947
Interest in an associate	*17*	–	396,448
Interests in jointly controlled entities	*18*	68,875	66,238
Investment properties	*19*	69,360	47,868
Property and equipment	*20*	1,264,949	1,165,276
TOTAL ASSETS		42,111,185	39,940,916
LIABILITIES			
Deposits and balances of banks and other financial institutions		1,559,633	1,035,392
Deposits from customers	*21*	33,951,631	32,591,590
Other accounts and provisions		279,129	271,327
Deferred taxation	*24*	106,179	85,085
Taxation		11,187	13,114
Total liabilities		35,907,759	33,996,508
CAPITAL RESOURCES			
Share capital	*22*	217,500	217,500
Reserves		5,985,926	5,726,908
Shareholders' funds		6,203,426	5,944,408
TOTAL LIABILITIES AND CAPITAL RESOURCES		42,111,185	39,940,916

BALANCE SHEET

	Note	2004 HK$'000	2003 HK$'000
ASSETS			
Cash and short-term funds	*12*	13,606,940	12,001,888
Placements with banks and other financial institutions maturing between one and twelve months		1,544,695	1,243,771
Trading securities	*13*	234,508	220,575
Advances and other accounts	*14*	20,136,354	19,917,649
Held-to-maturity securities	*13*	3,388,300	3,104,561
Certificates of deposit held	*15*	1,309,515	1,292,407
Other securities	*13*	347,141	297,054
Interests in subsidiaries	*16*	595,265	550,031
Interest in an associate	*17*	–	392,883
Interests in jointly controlled entities	*18*	87,500	96,630
Investment properties	*19*	51,360	47,868
Property and equipment	*20*	712,853	629,191
TOTAL ASSETS		42,014,431	39,794,508
LIABILITIES			
Deposits and balances of banks and other financial institutions		1,559,633	1,035,392
Deposits from customers	*21*	33,941,350	32,574,185
Amounts due to subsidiaries		420,563	385,100
Other accounts and provisions		179,512	128,803
Deferred taxation	*24*	96,815	75,963
Taxation		9,171	9,769
Total liabilities		36,207,044	34,209,212
CAPITAL RESOURCES			
Share capital	*22*	217,500	217,500
Reserves	*23*	5,589,887	5,367,796
Shareholders' funds		5,807,387	5,585,296
TOTAL LIABILITIES AND CAPITAL RESOURCES		42,014,431	39,794,508

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Goodwill	Investment property revaluation reserve	Land and buildings revaluation reserve	Investment revaluation reserve	General reserve	Translation reserve	Dividend reserve	Retained profits	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
THE GROUP											
At 1 January 2003	217,500	1,542,817	(182)	29,344	582,694	9,259	1,388,500	5,307	152,250	1,870,905	5,798,394
Revaluation movements	–	–	–	–	–	65,214	–	–	–	–	65,214
Currency re-alignment	–	–	–	–	–	–	–	(2,721)	–	–	(2,721)
Deferred taxation arising from the change in tax rate *(Note 24)* ...	–	–	–	–	(10,454)	–	–	–	–	–	(10,454)
Net (losses) gains not recognised in the income statement	–	–	–	–	(10,454)	65,214	–	(2,721)	–	–	52,039
Net profit for the year	–	–	–	–	–	–	–	–	–	311,475	311,475
Dividends paid	–	–	–	–	–	–	–	–	(152,250)	(65,250)	(217,500)
Proposed dividend	–	–	–	–	–	–	–	–	152,250	(152,250)	–
At 1 January 2004	217,500	1,542,817	(182)	29,344	572,240	74,473	1,388,500	2,586	152,250	1,964,880	5,944,408
Revaluation movements	–	–	–	4,996	92,576	52,616	–	–	–	–	150,188
Currency re-alignment	–	–	–	–	–	–	–	953	–	–	953
Deferred taxation arising from revaluation movements *(Note 24)*	–	–	–	–	(15,967)	–	–	–	–	–	(15,967)
Reversal of deferred taxation arising from disposal *(Note 24)*	–	–	–	–	1,006	–	–	–	–	–	1,006
Net gains not recognised in the income statement	–	–	–	4,996	77,615	52,616	–	953	–	–	136,180
Reversal of reserves upon disposal	–	–	–	–	(5,747)	3,600	–	(3,565)	–	5,747	35
Net profit for the year	–	–	–	–	–	–	–	–	–	349,003	349,003
Dividends paid	–	–	–	–	–	–	–	–	(152,250)	(73,950)	(226,200)
Proposed dividend	–	–	–	–	–	–	–	–	174,000	(174,000)	–
At 31 December 2004	217,500	1,542,817	(182)	34,340	644,108	130,689	1,388,500	(26)	174,000	2,071,680	6,203,426

Included in the "Translation reserve" of the Group was a surplus of Nil (2003: HK$3,565,000) being the Bank's share of translation reserve of an associate. Other than that, there is no other reserve retained by the associate.

The retained profits of the Group included accumulated losses of HK$18,625,000 (2003: HK$30,392,000) retained by the jointly controlled entities of the Group.

CONSOLIDATED CASH FLOW STATEMENT

	2004	2003
	HK$'000	*HK$'000*
OPERATING ACTIVITIES		
Profit from operations	407,854	369,780
Adjustments for:		
Decrease in interest receivable and other accounts	158,981	75,957
Increase (decrease) in other accounts and provisions	6,660	(118,855)
Net losses from disposal of property and equipment	43	2,664
Net gains from disposal of other securities and an associate	(3,863)	(22,192)
Provision for impairment loss in respect of other securities	–	7,809
Decrease in provisions against advances and other accounts	(127,718)	(44,050)
Decrease in interest in suspense	(94,672)	(16,217)
Dividend income on equity securities	(53,429)	(6,788)
Depreciation	48,974	45,586
Interest income on certificates of deposit held	(13,101)	(24,586)
Interest income on investment in securities	(87,200)	(65,929)
Operating cash flows before movements in working capital	242,529	203,179
Decrease in placements with banks and other financial institutions (with original maturity over three months)	77,645	163,425
Decrease (increase) in bills receivable	126,369	(9,776)
Increase in trade bills	(20,011)	(14,713)
Increase in other advances to customers	(208,627)	(510,241)
Decrease in advances to banks and other financial institutions	157	623
Increase in trading securities	(13,694)	(34,975)
Increase in deposits from customers	1,360,041	99,338
Exchange adjustments	953	(2,567)
Cash generated from (used in) operations	1,565,362	(105,707)
Hong Kong Profits Tax paid	(62,594)	(20,195)
Overseas tax paid	(3,602)	(2,438)
NET CASH FROM (USED IN) OPERATING ACTIVITIES	1,499,166	(128,340)

CONSOLIDATED CASH FLOW STATEMENT *(Continued)*

	Note	2004 HK$'000	2003 HK$'000
INVESTING ACTIVITIES			
Interest received on certificates of deposit held		12,307	26,338
Interest received on investments in securities		91,709	57,002
Dividends received on equity securities		53,429	6,788
Purchase of held-to-maturity securities		(2,135,374)	(1,743,536)
Purchase of certificates of deposit held		(744,651)	(356,322)
Purchase of other securities		(98,627)	(27,567)
Purchase of property and equipment		(55,538)	(42,925)
Purchase of investment properties		(16,496)	–
Purchase of a subsidiary	*27*	422	–
Repayment from (advances to) an associate		261,817	(33,825)
Repayment from jointly controlled entities		630	795
Proceeds from disposal of an associate		132,000	–
Proceeds from disposal of other securities		99,872	43,529
Proceeds from redemption of held-to-maturity securities		1,851,635	196,119
Proceeds from redemption of certificates of deposit held		727,543	401,683
Proceeds from disposal of property and equipment		5,743	349
NET CASH FROM (USED IN) INVESTING ACTIVITIES		186,421	(1,471,572)
FINANCING ACTIVITY			
Ordinary dividend paid		(226,200)	(217,500)
CASH USED IN FINANCING ACTIVITY		(226,200)	(217,500)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		1,459,387	(1,817,412)
CASH AND CASH EQUIVALENTS AT 1 JANUARY		12,132,622	13,950,034
CASH AND CASH EQUIVALENTS AT 31 DECEMBER, represented			
Cash and balances with banks and other financial institutions		560,601	744,527
Money at call and short notice		12,548,402	10,745,214
Exchange fund bills		497,944	512,147
Placements with banks and other financial institutions (with original maturity within three months)		1,544,695	1,166,126
Deposits and balances of banks and other financial institutions (with original maturity within three months)		(1,559,633)	(1,035,392)
		13,592,009	12,132,622

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2004

1. GENERAL

The Bank is a listed public limited company incorporated in Hong Kong and is engaged in the provision of banking and related financial services.

2. POTENTIAL IMPACT ARISING FROM THE RECENTLY ISSUED ACCOUNTING STANDARDS

In 2004, the Hong Kong Institute of Certified Public Accountants (the “HKICPA”) issued a number of new or revised Hong Kong Accounting Standards (“HKASs”) and Hong Kong Financial Reporting Standards (“HKFRSs”) (herein collectively referred to as “new HKFRSs”) which are effective for accounting periods beginning on or after 1 January 2005. The Group has not early adopted these new HKFRSs in the financial statements for the year ended 31 December 2004.

The Group has commenced considering the potential impact of these new HKFRSs but is not yet in a position to determine whether these HKFRSs would have a significant impact on how its results of operations and financial position are prepared and presented. These HKFRSs may result in changes in the future as to how the results and financial position are prepared and presented.

3. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared under the historical cost convention as modified for the revaluation of certain properties and investments in securities.

The financial statements have been prepared in accordance with accounting principles generally accepted in Hong Kong. The principal accounting policies adopted are set out below:

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Bank and its subsidiaries made up to 31 December each year.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Goodwill

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group’s interest in the fair value of the identifiable assets and liabilities of a subsidiary, associate or jointly controlled entity at the date of acquisition.

Goodwill arising on acquisitions prior to 1 January 2001 continues to be held in reserves, and will be charged to the income statement at the time of disposal of the relevant subsidiary, associate or jointly controlled entity, or at such time as the goodwill is determined to be impaired.

Goodwill arising on acquisitions after 1 January 2001 is capitalised and amortised on a straight-line basis over its useful economic life. Goodwill arising on the acquisition of an associate or a jointly controlled entity is included within the carrying amount of the associate or jointly controlled entity. Goodwill arising on the acquisition of subsidiaries is presented separately in the balance sheet.

Negative goodwill

Negative goodwill represents the excess of the Group's interest in the fair value of the identifiable assets and liabilities of a subsidiary at the date of acquisition over the cost of acquisition.

Negative goodwill is presented as a deduction from assets. To the extent that such negative goodwill is attributable to losses or expenses anticipated at the date of acquisition, it is released to income in the period in which those losses or expenses arise. The remaining negative goodwill is recognised as income on a straight-line basis over the remaining average useful life of the identifiable acquired depreciable assets. To the extent that such negative goodwill exceeds the aggregate fair value of the acquired identifiable non-monetary assets, it is recognised in income immediately.

Investments in subsidiaries

Investments in subsidiaries are included in the Bank's balance sheet at cost less any identified impairment loss.

Interest in an associate

The consolidated income statement includes the Group's share of the post-acquisition results of its associate for the year. In the consolidated balance sheet, interest in an associate is stated at the Group's share of the net assets of the associate, less any identified impairment loss.

The results of associate are accounted for by the Bank on the basis of dividends received and receivable during the year. In the Bank's balance sheet, investment in an associate is stated at cost, as reduced by any identified impairment loss.

Interests in jointly controlled entities

Joint venture arrangements which involve the establishment of a separate entity in which each venturer has an interest are referred to as jointly controlled entities.

The Group's interests in jointly controlled entities are included in the consolidated balance sheet at the Group's share of the net assets of the jointly controlled entities less any identified impairment loss. The Group's share of the post-acquisition results of its jointly controlled entities is included in the consolidated income statement.

The Bank's investments in jointly controlled entities are stated at cost, as reduced by any identified impairment loss. The results of jointly controlled entities are accounted for by the Bank on the basis of dividends received and receivable.

Advances and other accounts

Advances to customers, banks and other financial institutions and accrued interest and other accounts are stated in the balance sheet after deducting provision for estimated losses.

Provision for bad and doubtful debts is made, having regard to both specific and general risks.

The specific element of the provision relates to those loans that have been individually reviewed and specifically identified as bad or doubtful. Factors which are considered include expected cashflows, financial condition of the borrower and current economic conditions. The general element of the provision relates to those losses that, although not yet specifically identified, are known from experience to be present in the Group's portfolio of loans and advances. In determining the level of the provision required, management considers numerous factors including, but not limited to, domestic and international economic conditions, the composition of the loan portfolio and prior loan loss experience.

Provisions are applied to write off advances when all security has been realised and further recoveries are considered unlikely.

Loans with a specific due date are classified as overdue when the principal or interest is overdue and remains unpaid as at the year-end date. Loans repayable by regular instalments are treated as overdue when an instalment payment is overdue and remains unpaid as at the year-end date. Loans repayable on demand are categorised as overdue either when a demand for repayment has been served on the borrower but repayment has not been made in accordance with the instruction or, the loan has remained continuously outside the approved limit that was advised to the borrower for more than three months.

Rescheduled advances refer to those loans that have been restructured or renegotiated due to the deterioration in the financial position of the borrower or the inability of the borrower to meet the original repayment schedule. Rescheduled advances which have been overdue over three months under the revised repayment terms are classified as overdue advances and not as rescheduled advances.

Assets held through repossession of collateral for realisation continue to be treated as securities for loans and advances. In this regard, provision has been made on the shortfall between the carrying amount of the loans and advances and the expected net sales proceeds from realisation of the repossessed assets.

Foreign currencies

Transactions in foreign currencies are initially recorded at the rates of exchange prevailing on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are re-translated at the rates prevailing on the balance sheet date. Profits and losses arising on exchange are included in net profit or loss for the period.

On consolidation, the assets and liabilities of the Group's overseas branches and subsidiaries are translated at the exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised as income or as expenses in the period in which the operation is disposed of.

Revenue recognition

Interest income is recognised in the income statement as it accrues, except in the case of doubtful debts where interest is credited to a suspense account which is netted in the balance sheet against the relevant balances. Doubtful debts are those debts where there is reasonable doubt about the ultimate collectibility of principal or interest; or against which a specific provision has been made; or where contractual payments of principal and/or interest are more than 3 months in arrears and where the net realisable value of the security is insufficient to cover payment of principal and accrued interest.

Interest income ceases to be accrued or is placed into suspense account for those debts where the contractual payments of principal and/or interest are more than 12 months in arrears, irrespective of the net realisable value of collateral.

When interest has been placed in suspense or has ceased to be accrued, accrual of interest to the income statement is resumed only if all arrears of principal and interest from the borrower have been cleared and it is probable that the customer is capable of fully servicing his obligations for the foreseeable future.

Fees and commission income are accounted for in the period when receivable, 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 on an appropriate basis over the relevant period.

Dividend income from investments in securities is recognised when the Group's right to receive payment has been established.

Property and equipment

Property and equipment are stated at cost or valuation less depreciation and accumulated impairment losses.

Land and buildings are stated in the balance sheet at their revalued amount, being the fair value at the date of revaluation less any subsequent accumulated depreciation and any subsequent impairment losses. Revaluations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the balance sheet date.

Any revaluation increase arising on revaluation of land and buildings is credited to the revaluation reserve, except to the extent that it reverses a revaluation decrease of the same asset previously recognised as an expense, in which case the increase is credited to the income statement to the extent of the decrease previously charged. A decrease in net carrying amount arising on revaluation of an asset is dealt with as an expense to the extent that it exceeds the balance, if any, on the revaluation reserve relating to a previous revaluation of that asset. On the subsequent sale or retirement of a revalued asset, the attributable revaluation surplus is transferred to retained profits.

Construction in progress is carried at cost, less any identified impairment loss. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

Depreciation is provided to write off the cost or valuation of items of property and equipment over their estimated useful lives and after taking into account their estimated residual value, using the straight line method, at the following rates per annum:

Leasehold land	Over the term of the lease
Buildings	Over the shorter of the term of the lease or 2%
Equipment	10% – 20%

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the income statement.

Investment properties

Investment properties are completed properties which are held for their investment potential, any rental income being negotiated at arm's length.

Investment properties are stated at their open market value based on independent professional valuations at the balance sheet date. Any revaluation increase or decrease arising on the revaluation of investment properties is credited or charged to the investment property revaluation reserve unless the balance of this reserve is insufficient to cover a revaluation decrease, in which case the excess of the revaluation decrease over the balance on the investment property revaluation reserve is charged to the income statement. Where a decrease has previously been charged to the income statement and a revaluation increase subsequently arises, this increase is credited to the income statement to the extent of the decrease previously charged.

On disposal of an investment property, the balance on the investment property revaluation reserve attributable to that property is transferred to the income statement.

No depreciation is provided on investment properties except where the unexpired term of the relevant lease is 20 years or less.

Impairment

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately, unless the relevant asset is carried at a revalued amount under another Standard, in which case the impairment loss is treated as revaluation decrease under that Standard.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, such that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount under another Standard, in which case the reversal of the impairment loss is treated as a revaluation increase under that Standard.

Leased assets

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards of ownership of the assets concerned to the lessees.

Amounts due from lessees under finance leases are recorded as advances and other accounts at the amount of the Group's net investment in the leases.

Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Group's net investment outstanding in respect of the leases.

Initial direct costs are dealt with as an expense in the year in which they arise.

All other leases are classified as operating leases and the rental income is recognised on a straight line basis over the lease term.

Investments in securities

Investments in securities are recognised on a trade-date basis and are initially measured at cost.

At subsequent reporting dates, debt securities that the Group has the expressed intention and ability to hold to maturity (held-to-maturity securities) are measured at amortised cost, less any impairment loss recognised to reflect irrecoverable amounts. The annual amortisation of any discount or premium on the acquisition of a held-to-maturity security is aggregated with other investment income receivable over the term of the instrument so that the revenue recognised in each period represents a constant yield on the investment.

All securities other than held-to-maturity debt securities are measured at subsequent reporting dates at fair value.

Where securities are held for trading purposes, unrealised gains and losses are included in net profit or loss for the period. For other securities, unrealised gains and losses are dealt with in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in net profit or loss for the period.

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes income statement items that are never taxable or deductible.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and 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. Such assets and liabilities are not recognised if the temporary difference arises from goodwill (or negative goodwill) or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associate, and interests in jointly controlled entities, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited to the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Operating leases

Rental costs under operating leases are charged to the income statement on a straight line basis over the lease term.

Financial derivative products

Financial derivative products, which include forward contracts, interest rate swaps and similar derivative products, are recognised on a trade-date basis and are initially measured at cost. Financial derivative products outstanding at the year end, except for those designated as hedges, are valued at fair value, with unrealised gains and losses included in the income statement. Gains and losses related to those derivative products that are designated as hedges are dealt with in accordance with the accounting treatment applicable to the position hedged and there is no offsetting of assets and liabilities until the position is closed. To qualify as a hedge, the derivative is expected to be effective in reducing the price or interest rate risk of the asset, liability or anticipated transaction to which it is linked and be designated as a hedge at inception of the derivative contract. Accordingly, changes in the market value of the derivative are expected to be highly correlated with changes in the market value of the underlying hedged item at inception of the hedge and over the life of the hedge contract. The financial derivative products of the Group are mainly used for hedging purposes.

Fiduciary assets

The assets of staff retirement benefits scheme and assets held in trust in a fiduciary capacity are not assets of the Group and accordingly are not included in the financial statements.

Retirement benefit costs

Payments to the Mandatory Provident Fund Scheme are charged as expenses as they fall due.

For defined benefit retirement schemes, the cost of providing benefits is determined using the projected unit credit method with actuarial valuations being carried out every three years. Actuarial gains and losses which exceed 10% of the greater of the present value of the Group's pension obligations and the fair value of plan assets are amortised over the expected average remaining working lives of the participating employees. Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the amended benefits become vested. Any asset resulting from this calculation is limited to unrecognised actuarial losses and past service cost, plus the present value of available refunds and reductions in the future contributions to the plan.

The amount recognised in the balance sheet represents the present value of the defined benefit obligation as adjusted for unrecognised actuarial gains and losses and unrecognised past service cost, and as reduced by the fair value of plan assets. Any asset resulting from this calculation is limited to unrecognised actuarial losses and past service cost, plus the present value of available refunds and reductions in the future contributions to the plan.

4. BUSINESS AND GEOGRAPHICAL SEGMENTS

(a) Business segments

For management purposes, the Group is currently organised into two operating divisions - corporate and retail banking, and treasury and foreign exchange activities. These divisions are the basis on which the Group reports its primary segment information.

Principal activities are as follows:

The corporate and retail banking services provided by the Group are principally lending and trade finance facilities, consumer financing, overdraft facilities, mandatory provident fund services, provision of fixed deposits, current and savings accounts, credit card, insurance and personal wealth management services . The Group also provides fully automated telephone and internet banking services to its customers. Other financial services offered include remittance and money exchange, safe deposit boxes, auto pay and direct debit services.

Treasury activities mainly comprise inter-bank placement and deposit transactions, management of overall interest rate risk and liquidity of the Group and centralised cash management. Income from foreign exchange activities is generated from services provided to customers in the form of foreign exchange trading and forward contracts.

Other business activities of the Group include investment holding, securities trading, stockbroking, futures broking, other investment advisory services and property investment.

(i) Segment information about these businesses for the year ended 31 December 2004 is presented below:

INCOME STATEMENT

	Corporate and retail banking	Treasury and foreign exchange activities	Other business activities	Eliminations	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Interest income from external customers	631,115	359,698	–	–	990,813
Interest expense to external customers	(333,967)	(7,349)	–	–	(341,316)
Inter-segment income *(Note)*	106,001	–	–	(106,001)	–
Inter-segment expense *(Note)*	–	(106,001)	–	106,001	–
Net income	403,149	246,348	–	–	649,497
Other operating income	95,939	27,562	144,552	–	268,053
Operating income	499,088	273,910	144,552	–	917,550
Charge for bad and doubtful debts	(51,175)	–	–	–	(51,175)
Net (losses) gains from disposal of property and equipment	(122)	–	79	–	(43)
Net gains from disposal of other securities and an associate	–	–	3,863	–	3,863
Operating expenses	(289,261)	(19,094)	(27,695)	–	(336,050)
Segment profit	158,530	254,816	120,799	–	534,145
Unallocated corporate expenses					(126,291)
Profit from operations					407,854
Share of results of jointly controlled entities			11,319		11,319
Profit from ordinary activities before taxation					419,173
Taxation					(70,170)
Net profit for the year					349,003

Notes: Inter-segment pricing is charged at prevailing customer deposits interest rates.

BALANCE SHEET

	Corporate and retail banking	Treasury and foreign exchange activities	Other business activities	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Assets				
Segment assets	21,078,497	19,649,998	686,045	41,414,540
Interests in jointly controlled entities	–	–	68,875	68,875
Unallocated corporate assets				627,770
Consolidated total assets				42,111,185
Liabilities				
Segment liabilities	33,988,496	1,522,769	–	35,511,265
Unallocated corporate liabilities				396,494
Consolidated total liabilities				35,907,759

OTHER INFORMATION

	Corporate and retail banking	Treasury and foreign exchange activities	Other business activities	Unallocated	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Capital additions	31,600	103	373	23,462	55,538
Depreciation	25,371	647	4,268	18,688	48,974

(ii) Segment information about these businesses for the year ended 31 December 2003 is presented below:

INCOME STATEMENT

	Corporate and retail banking	Treasury and foreign exchange activities	Other business activities	Eliminations	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Interest income from external customers	669,630	364,543	–	–	1,034,173
Interest expense to external customers	(357,850)	(6,145)	–	–	(363,995)
Inter-segment income *(Note)*	121,776	–	–	(121,776)	–
Inter-segment expense *(Note)*	–	(121,776)	–	121,776	–
Net income	433,556	236,622	–	–	670,178
Other operating income	89,546	34,270	90,024	–	213,840
Operating income	523,102	270,892	90,024	–	884,018
Charge for bad and doubtful debts	(62,803)	–	–	–	(62,803)
Net losses from disposal of property and equipment	(2,140)	(126)	(398)	–	(2,664)
Net gains from disposal of other securities	–	–	22,192	–	22,192
Provision for impairment loss in respect of other securities	–	–	(7,809)	–	(7,809)
Operating expenses	(280,402)	(20,337)	(28,858)	–	(329,597)
Segment profit	177,757	250,429	75,151	–	503,337
Unallocated corporate expenses					(133,557)
Profit from operations					369,780
Share of results of jointly controlled entities			(2,000)		(2,000)
Profit from ordinary activities before taxation					367,780
Taxation					(56,305)
Net profit for the year					311,475

Notes: Inter-segment pricing is charged at prevailing customer deposits interest rates.

BALANCE SHEET

	Corporate and retail banking	Treasury and foreign exchange activities	Other business activities	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Assets				
Segment assets	20,852,733	17,458,133	597,169	38,908,035
Interest in an associate	–	–	396,448	396,448
Interests in jointly controlled entities	–	–	66,238	66,238
Unallocated corporate assets				570,195
Consolidated total assets				39,940,916
Liabilities				
Segment liabilities	32,629,660	997,322	–	33,626,982
Unallocated corporate liabilities				369,526
Consolidated total liabilities				33,996,508

OTHER INFORMATION

	Corporate and retail banking	Treasury and foreign exchange activities	Other business activities	Unallocated	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Capital additions	14,371	765	929	26,860	42,925
Depreciation	25,993	512	4,904	14,177	45,586

(b) Geographical segments

Geographical segmentation is analysed based on the locations of the principal operations of the branches and subsidiary companies responsible for reporting the results or booking the assets. For both years 2003 and 2004, more than 90% of the Group's revenue and profit from ordinary activities before taxation were generated by assets booked by the principal operations of the branches and subsidiary companies located in Hong Kong. More than 90% of assets were located in Hong Kong and the balance of the assets were extended to branches outside Hong Kong, mainly in Mainland China and America.

Details of geographical segmentation are set out in note 3 of the unaudited supplementary financial information.

5. OTHER OPERATING INCOME

	2004	2003
	HK$'000	*HK$'000*
Fees and commission income		
Securities dealings	53,064	43,038
Credit lines	14,151	16,361
Trade finance	13,383	13,835
Credit card services	15,520	13,013
Agency services	23,241	15,950
Others	10,452	9,627
Total fees and commission income	129,811	111,824
Less: Fees and commission expense	(3,197)	(2,140)
Net fees and commission income	126,614	109,684
Dividend income		
Listed investments	6,899	5,192
Unlisted investments	46,530	1,596
Net gains from dealing in foreign currencies	27,562	34,269
Net gains from disposal of trading securities	562	–
Gross rents from properties	4,349	4,621
Less: Outgoings	(592)	(4,577)
Net rental income	3,757	44
Safe deposit box rentals	22,310	21,946
Other banking services income	33,259	29,725
Others	560	11,384
	268,053	213,840

6. OPERATING EXPENSES

	2004	2003
	HK$'000	*HK$'000*
Auditors' remuneration	2,004	2,187
Staff costs		
Salaries and other costs	225,979	218,588
Retirement benefits scheme contributions	17,249	16,581
Total staff costs	243,228	235,169
Depreciation	48,974	45,586
Premises and equipment expenses, excluding depreciation		
Rentals and rates for premises	40,741	38,737
Others	12,622	12,671
Other operating expenses	114,772	128,804
	462,341	463,154

7. NET GAINS FROM DISPOSAL OF OTHER SECURITIES AND AN ASSOCIATE

The amounts include gains on disposal of an associate of HK$934,000 (2003: Nil). In accordance with the Share and Debt Purchase Agreement dated 16 March 2004 between the Bank and Liu Chong Hing Investment Limited, the Bank sold to Liu Chong Hing Investment Limited the entire share capital and the shareholder's loan made to Alain Limited at a consideration of HK$132 million. As it is considered as a connected transaction under the Listing Rules, the Bank and Liu Chong Hing Investment Limited made a joint announcement.

8. DIRECTORS' AND EMPLOYEES' EMOLUMENTS

	2004			2003		
	Executive	**Others**	**Total**	**Executive**	**Others**	**Total**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Directors						
Fees	373	570	943	360	576	936
Other emoluments:						
Salaries and other benefits	20,703	81	20,784	19,024	362	19,386
Contributions to retirement benefits scheme	1,252	–	1,252	1,260	–	1,260
Total emoluments	22,328	651	22,979	20,644	938	21,582

The above amounts include directors' fees of HK$180,000 (2003: HK$265,000) paid to independent non-executive directors.

Emoluments of the directors were within the following bands:

	2004 Number of directors	**2003 Number of directors**
Nil – HK$1,000,000	13	13
HK$1,000,001 – HK$1,500,000	1	–
HK$1,500,001 – HK$2,000,000	3	4
HK$2,000,001 – HK$2,500,000	1	1
HK$2,500,001 – HK$3,000,000	–	–
HK$3,000,001 – HK$3,500,000	–	–
HK$3,500,001 – HK$4,000,000	–	–
HK$4,000,001 – HK$4,500,000	–	–
HK$4,500,001 – HK$5,000,000	–	–
HK$5,000,001 – HK$5,500,000	–	1
HK$5,500,001 – HK$6,000,000	1	1
HK$6,000,001 – HK$6,500,000	–	–
HK$6,500,001 – HK$7,000,000	1	–

Employees

The five highest paid employees for 2004 and 2003 were all directors.

9. TAXATION

	2004	2003
	HK$'000	*HK$'000*
The tax charge comprises:		
Hong Kong Profits Tax		
– current year	58,818	61,315
– under(over)provision in prior years	2,455	(2,057)
	61,273	59,258
Overseas taxation	2,996	2,045
Deferred tax *(Note 24)*		
– current year	5,901	(2,010)
– attributable to change in tax rate	–	(2,988)
	5,901	(4,998)
	70,170	56,305

Hong Kong Profits Tax is calculated at 17.5% (2003: 17.5%) of the estimated assessable profit for the year.

Taxation arising in other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions. The tax charge for the year can be reconciled to the Group's profit per the income statement as follows:

	2004	2003
	HK$'000	*HK$'000*
Profit before taxation	419,173	367,780
Tax at the domestic income tax rate of 17.5% (2003: 17.5%)	73,355	64,361
Tax effect of expenses not deductible for tax purpose	6,815	2,973
Tax effect of income not taxable for tax purpose	(12,433)	(5,927)
Tax effect of tax losses not recognised	–	173
Under(over)provision in prior years	2,455	(2,057)
Effect of different tax rates of subsidiaries operating in other jurisdictions	(47)	(230)
Decrease in opening deferred tax liability resulting from an increase in applicable tax rate	–	(2,988)
Others	25	–
Tax charge for the year	70,170	56,305

10. DIVIDENDS

	2004	2003
	HK$'000	*HK$'000*
Ordinary shares:		
Interim dividend paid - HK$0.17 (2003: HK$0.15) per share	73,950	65,250
Final dividend proposed - HK$0.40 (2003: HK$0.35) per share	174,000	152,250
	247,950	217,500

A final dividend of HK$0.40 (2003: HK$0.35) per share has been proposed by the directors and is subject to approval by the shareholders at the forthcoming general meeting.

11. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the profit attributable to shareholders of HK$349,003,000 (2003: HK$311,475,000) and on 435,000,000 (2003: 435,000,000) ordinary shares in issue during the year.

12. CASH AND SHORT-TERM FUNDS

	THE GROUP		THE BANK	
	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Cash and balances with banks and other financial institutions	560,601	744,527	560,594	744,527
Money at call and short notice	12,548,402	10,745,214	12,548,402	10,745,214
Exchange fund bills	497,944	512,147	497,944	512,147
	13,606,947	12,001,888	13,606,940	12,001,888

13. INVESTMENTS IN SECURITIES

	Trading securities		Held-to-maturity securities		Other securities		Total	
	2004	2003	2004	2003	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
THE GROUP								
Equity securities:								
Listed in Hong Kong	155	394	–	–	157,678	114,044	157,833	114,438
Listed overseas	–	–	–	–	5,650	5,441	5,650	5,441
Unlisted	–	–	–	–	214,519	200,462	214,519	200,462
	155	394	–	–	377,847	319,947	378,002	320,341
Debt securities:								
Unlisted	234,508	220,575	3,388,300	3,104,561	–	–	3,622,808	3,325,136
Total:								
Listed in Hong Kong	155	394	–	–	157,678	114,044	157,833	114,438
Listed overseas	–	–	–	–	5,650	5,441	5,650	5,441
Unlisted	234,508	220,575	3,388,300	3,104,561	214,519	200,462	3,837,327	3,525,598
	234,663	220,969	3,388,300	3,104,561	377,847	319,947	4,000,810	3,645,477
Market value of listed securities:								
Listed in Hong Kong	155	394	–	–	157,678	114,044	157,833	114,438
Listed overseas	–	–	–	–	5,650	5,441	5,650	5,441
	155	394	–	–	163,328	119,485	163,483	119,879

	Trading securities		Held-to-maturity securities		Other securities		Total	
	2004	2003	2004	2003	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
THE BANK								
Equity securities:								
Listed in Hong Kong	–	–	–	–	126,972	91,151	126,972	91,151
Listed overseas	–	–	–	–	5,650	5,441	5,650	5,441
Unlisted	–	–	–	–	214,519	200,462	214,519	200,462
	–	–	–	–	347,141	297,054	347,141	297,054
Debt securities:								
Unlisted	234,508	220,575	3,388,300	3,104,561	–	–	3,622,808	3,325,136
Total:								
Listed in Hong Kong	–	–	–	–	126,972	91,151	126,972	91,151
Listed overseas	–	–	–	–	5,650	5,441	5,650	5,441
Unlisted	234,508	220,575	3,388,300	3,104,561	214,519	200,462	3,837,327	3,525,598
	234,508	220,575	3,388,300	3,104,561	347,141	297,054	3,969,949	3,622,190
Market value of listed securities:								
Listed in Hong Kong	–	–	–	–	126,972	91,151	126,972	91,151
Listed overseas	–	–	–	–	5,650	5,441	5,650	5,441
	–	–	–	–	132,622	96,592	132,622	96,592

Certain held-to-maturity federal notes of approximately HK$23,510,000 (2003: Certificates of deposit: HK$23,293,000) held by the San Francisco Branch of the Bank, have been pledged to the State of California of the United States of America in compliance with the requirements of the California Financial Code.

Investments in securities are analysed and reported by issuing entities as follows:

	Trading securities		Held-to-maturity securities		Other securities		Total	
	2004	2003	2004	2003	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
THE GROUP								
Central governments and central banks	–	–	50,024	–	–	–	50,024	–
Public sectors entities	–	–	29,762	–	41,380	33,859	71,142	33,859
Banks and other financial institutions	35	40	1,915,305	1,548,459	16,457	10,899	1,931,797	1,559,398
Corporate entities	120	354	1,392,514	1,456,008	82,111	55,600	1,474,745	1,511,962
Others	234,508	220,575	695	100,094	237,899	219,589	473,102	540,258
	234,663	220,969	3,388,300	3,104,561	377,847	319,947	4,000,810	3,645,477
THE BANK								
Central governments and central banks	–	–	50,024	–	–	–	50,024	–
Public sectors entities	–	–	29,762	–	39,896	33,370	69,658	33,370
Banks and other financial institutions	–	–	1,915,305	1,548,459	13,658	8,647	1,928,963	1,557,106
Corporate entities	–	–	1,392,514	1,456,008	79,068	54,575	1,471,582	1,510,583
Others	234,508	220,575	695	100,094	214,519	200,462	449,722	521,131
	234,508	220,575	3,388,300	3,104,561	347,141	297,054	3,969,949	3,622,190

14. ADVANCES AND OTHER ACCOUNTS

	THE GROUP		THE BANK	
	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Advances to customers				
Bills receivable	410,792	537,161	410,792	537,161
Trade bills	89,366	69,355	89,366	69,355
Other advances to customers	19,790,061	19,578,749	19,784,832	19,566,981
	20,290,219	20,185,265	20,284,990	20,173,497
Interest receivable	86,900	122,020	86,893	121,970
Provisions for bad and doubtful debts				
– General	(201,876)	(215,730)	(201,818)	(214,608)
– Specific	(101,391)	(215,255)	(101,391)	(214,474)
Interest in suspense	(45,931)	(140,603)	(45,931)	(140,528)
	20,027,921	19,735,697	20,022,743	19,725,857
Advances to banks and other financial institutions	58,212	58,369	58,212	58,369
	20,086,133	19,794,066	20,080,955	19,784,226
Other accounts	159,901	287,477	55,399	133,423
	20,246,034	20,081,543	20,136,354	19,917,649

Included in the "Advances to customers" of the Group and the Bank are aggregate amounts of approximately HK$225,503,000 (2003: HK$284,274,000) due from companies having significant influence on the Bank and their subsidiaries.

Included in the "Advances to banks and other financial institutions" is an amount of approximately HK$58,212,000 (2003: HK$58,369,000) placed as reserve funds with the financial institutions in the People's Republic of China by the Shantou Branch of the Bank in compliance with the requirements of Regulations Governing Foreign Financial Institutions of the People's Republic of China.

Provisions against advances and other accounts:

	THE GROUP				THE BANK			
	Specific	General	Total	Suspended interest	Specific	General	Total	Suspended interest
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Balance at 1 January 2004	215,255	215,730	430,985	140,603	214,474	214,608	429,082	140,528
New provisions	105,170	–	105,170	–	105,168	–	105,168	–
Amounts released	(41,142)	(12,853)	(53,995)	–	(41,142)	(12,796)	(53,938)	–
Net charge to income statement	64,028	(12,853)	51,175	–	64,026	(12,796)	51,230	–
Interest suspended during the year	–	–	–	40,142	–	–	–	40,142
Interest recovered during the year	–	–	–	(19,952)	–	–	–	(19,952)
Exchange difference	–	6	6	–	–	6	6	–
Amounts written off	(177,892)	(1,007)	(178,899)	(114,862)	(177,109)	–	(177,109)	(114,787)
Balance at 31 December 2004	101,391	201,876	303,267	45,931	101,391	201,818	303,209	45,931
Balance at 1 January 2003	272,699	202,336	475,035	156,820	272,281	201,127	473,408	156,820
New provisions	83,440	45,434	128,874	–	83,077	45,453	128,530	–
Amounts released	(34,287)	(31,784)	(66,071)	–	(34,287)	(31,716)	(66,003)	–
Net charge to income statement	49,153	13,650	62,803	–	48,790	13,737	62,527	–
Interest suspended during the year	–	–	–	54,940	–	–	–	54,865
Interest recovered during the year	–	–	–	(32,764)	–	–	–	(32,764)
Exchange difference	–	(11)	(11)	–	–	(11)	(11)	–
Amounts written off	(106,597)	(245)	(106,842)	(38,393)	(106,597)	(245)	(106,842)	(38,393)
Balance at 31 December 2003	215,255	215,730	430,985	140,603	214,474	214,608	429,082	140,528

Details of the advances to customers on which interest is being placed in suspense or has ceased to be accrued are as follows:

	THE GROUP		THE BANK	
	2004	**2003**	**2004**	**2003**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Gross advances to customers	790,980	972,840	790,980	971,308
Less: Specific provisions	(95,142)	(202,599)	(95,142)	(201,818)
	695,838	770,241	695,838	769,490
Percentage of such advances to total advances	3.9%	4.8%	3.9%	4.8%
Market value of collateral pledged	704,626	775,624	704,626	775,624
Interest in suspense	45,931	140,603	45,931	140,528

The specific provisions were made after taking into account the value of collateral in respect of such advances to customers.

There are no advances to banks and other financial institutions on which interest is being placed in suspense or has ceased to be accrued.

Advances to customers of the Group include receivables under finance leases as follows:

	Minimum lease payments		Present value of minimum lease payments	
	2004	**2003**	**2004**	**2003**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Within one year	818	4,382	721	4,302
In the second to fifth year inclusive	1,104	2,581	1,023	2,088
	1,922	6,963	1,744	6,390
Less: unearned finance income	(178)	(573)	–	–
Present value of minimum lease payments receivable	1,744	6,390	1,744	6,390
Analysed as:				
Non-current finance lease receivables (recoverable after 12 months)			1,023	2,088
Current finance lease receivables (recoverable within 12 months)			721	4,302
			1,744	6,390

15. CERTIFICATES OF DEPOSIT HELD

All the certificates of deposit are held-to-maturity and are unlisted.

16. INTERESTS IN SUBSIDIARIES

	2004	**2003**
	HK$'000	*HK$'000*
Unlisted shares, at cost	580,719	547,715
Amounts due from subsidiaries	14,546	2,316
	595,265	550,031

The amounts due from subsidiaries are unsecured, non-interest bearing and, in the opinion of the directors, are not repayable within one year.

Details of all the subsidiaries are as follows:

Name of company	Place of incorporation/ operation	Issued and fully paid ordinary share capital	Percentage of issued share capital directly held	Principal activities
Liu Chong Hing (Management) Limited	Hong Kong	HK$100,000	100%	Provision of property management services
Liu Chong Hing (Nominees) Limited	Hong Kong	HK$100,000	100%	Provision of nominee services
Liu Chong Hing Finance Limited	Hong Kong	HK$25,000,000	100%	Deposit-taking
Liu Chong Hing Data Processing Limited	Hong Kong	HK$100,000	100%	Provision of electronic data processing services
Liu Chong Hing Finance (International) Limited	Republic of Vanuatu/ Hong Kong	AU$200,000	100%	Inactive
Liu Chong Hing Banking Corporation, Cayman	Cayman Islands/ Hong Kong	US$65,000,000	100%	General merchant banking
Chong Hing Securities Limited	Hong Kong	HK$10,000,000	100%	Stockbroking
Chong Hing Commodities and Futures Limited	Hong Kong	HK$5,000,000	100%	Investment holding and commodities and futures broking
Right Way Investments Limited	Bermuda/ Hong Kong	US$12,000	100%	Property investment
Gallbraith Limited	Hong Kong	HK$16,550,000	100%	Property investment
Card Alliance Company Limited *(Note 27)*	Hong Kong	HK$18,000,000	100%	Credit card management

None of the subsidiaries had any debt security subsisting at the end of the year or at any time during the year.

17. INTEREST IN AN ASSOCIATE

	THE GROUP		THE BANK	
	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Unlisted shares, at cost	–	–	–	5
Share of net assets	–	3,570	–	–
	–	3,570	–	5
Amount due from an associate	–	392,878	–	392,878
	–	396,448	–	392,883

On 16 March 2004, the Bank disposed of the entire interest in an associate, being 47.37% of the issued ordinary share capital of Alain Limited, a private limited company incorporated in Hong Kong.

The balance of advances to the associate was fully repaid in March 2004.

18. INTERESTS IN JOINTLY CONTROLLED ENTITIES

	THE GROUP		THE BANK	
	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Unlisted shares, at cost	–	–	56,500	57,500
Share of net assets	37,875	27,108	–	–
	37,875	27,108	56,500	57,500
Loans to jointly controlled entities	31,000	39,130	31,000	39,130
	68,875	66,238	87,500	96,630

As at 31 December 2004, the Bank had interests in the following jointly controlled entities:

Name of company	Place of incorporation and operation	Class of share held	Ownership interest	Proportion of voting power	Nature of business
Bank Consortium Holding Limited	Hong Kong	Ordinary	13.3%	14.3%	Investment holding and provision of trustee, administration and custodian services for retirement schemes
BC Reinsurance Limited	Hong Kong	Ordinary	10.5%	10.5%	Reinsurance
Hong Kong Life Insurance Limited	Hong Kong	Ordinary	11.7%	11.7%	Life insurance underwriting
Net Alliance Co., Limited	Hong Kong	Ordinary	15%	15%	Provision of internet services

The loans to jointly controlled entities are unsecured, non-interest bearing and, in the opinion of the directors, not repayable within one year. A loan to Bank Consortium Holding Limited amounting to HK$31,000,000 (2003: HK$31,000,000) is on fixed terms and will be repayable on 28 December 2008.

19. INVESTMENT PROPERTIES

	THE GROUP		THE BANK	
	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
At 1 January 2004	47,868	47,868	47,868	47,868
Additions	16,496	–	–	–
Surplus on revaluation	4,996	–	3,492	–
At 31 December 2004	69,360	47,868	51,360	47,868

Investment properties owned by the Group and by the Bank were revalued at 31 December 2004 on an open market value basis by Vigers Hong Kong Limited, independent professionally qualified valuers.

The investment properties are rented out under operating leases.

The carrying amount of investment properties of the Group and the Bank comprises:

	THE GROUP		THE BANK	
	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Leasehold properties				
Held in Hong Kong on long-term lease (over 50 years unexpired)	9,350	10,332	9,350	10,332
Held in Hong Kong on medium-term lease (10 – 50 years unexpired)	42,010	37,536	42,010	37,536
Held outside Hong Kong on medium-term lease (10 – 50 years unexpired)	18,000	–	–	–
	69,360	47,868	51,360	47,868

20. PROPERTY AND EQUIPMENT

	THE GROUP				THE BANK		
	Land and buildings	Equipment	Construction in progress	Total	Land and buildings	Equipment	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
COST OR VALUATION							
At 1 January 2004	526,594	269,148	529,237	1,324,979	526,594	246,412	773,006
Additions	12,027	28,204	15,307	55,538	12,027	27,851	39,878
Acquired on acquisition of a subsidiary	–	6,319	–	6,319	–	–	–
Surplus on revaluation	92,576	–	–	92,576	92,576	–	92,576
Elimination of accumulated depreciation	(11,785)	–	–	(11,785)	(11,785)	–	(11,785)
Disposals	(5,722)	(8,387)	–	(14,109)	(5,722)	(8,211)	(13,933)
At 31 December 2004	613,690	295,284	544,544	1,453,518	613,690	266,052	879,742
Comprising							
At cost	–	295,284	544,544	839,828	–	266,052	266,052
At professional valuation 2004	613,690	–	–	613,690	613,690	–	613,690
	613,690	295,284	544,544	1,453,518	613,690	266,052	879,742
DEPRECIATION							
At 1 January 2004	–	159,703	–	159,703	–	143,815	143,815
Provided for the year	11,785	37,189	–	48,974	11,785	31,221	43,006
Eliminated on disposals	–	(8,323)	–	(8,323)	–	(8,147)	(8,147)
Eliminated on revaluation	(11,785)	–	–	(11,785)	(11,785)	–	(11,785)
At 31 December 2004	–	188,569	–	188,569	–	166,889	166,889
NET BOOK VALUE							
At 31 December 2004	613,690	106,715	544,544	1,264,949	613,690	99,163	712,853
At 31 December 2003	526,594	109,445	529,237	1,165,276	526,594	102,597	629,191

The net book values of land and buildings and construction in progress shown above comprise:

	THE GROUP				THE BANK	
	Land and buildings		Construction in progress		Land and buildings	
	2004	2003	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Leasehold properties						
Held in Hong Kong on long-term lease (over 50 years unexpired)	182,000	173,807	544,544	529,237	182,000	173,807
Held in Hong Kong on medium-term lease (10 – 50 years unexpired)	423,200	345,415	–	–	423,200	345,415
Held outside Hong Kong on medium-term lease (10 – 50 years unexpired)	8,490	7,372	–	–	8,490	7,372
	613,690	526,594	544,544	529,237	613,690	526,594

Land and buildings owned by the Group and by the Bank were revalued at 31 December 2004 on an open market value basis by Vigers Hong Kong Limited, independent professionally qualified valuers.

If land and buildings had not been revalued, they would have been included in the financial statements of the Group and the Bank at historical cost less accumulated depreciation of HK$291,430,000 (2003: HK$287,449,000).

21. DEPOSITS FROM CUSTOMERS

	THE GROUP		THE BANK	
	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Demand deposits and current accounts	2,803,982	2,029,869	2,803,982	2,029,869
Savings deposits	8,954,061	7,568,026	8,954,061	7,568,026
Time, call and notice deposits	22,193,588	22,993,695	22,183,307	22,976,290
	33,951,631	32,591,590	33,941,350	32,574,185

Included in the balances is an aggregate amount of approximately HK$86,297,000 (2003: HK$39,935,000) representing deposits of companies having significant influence on the Bank and their subsidiaries placed with the Group and the Bank.

22. SHARE CAPITAL

	2004 & 2003
	HK$'000
Authorised:	
600,000,000 shares of HK$0.50 each	300,000
Issued and fully paid:	
435,000,000 shares of HK$0.50 each	217,500

23. RESERVES

	Share premium	Investment property revaluation reserve	Land and buildings revaluation reserve	Investment revaluation reserve	General reserve	Translation reserve	Dividend reserve	Retained profits	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
THE BANK									
At 1 January 2003	1,542,817	29,344	539,142	(2,207)	1,378,500	265	152,250	1,597,075	5,237,186
Revaluation movements	–	–	–	60,000	–	–	–	–	60,000
Currency re-alignment	–	–	–	–	–	(291)	–	–	(291)
Deferred taxation arising from the change in tax rate *(Note 24)*	–	–	(9,670)	–	–	–	–	–	(9,670)
Net (losses) gains not recognised in the income statement	–	–	(9,670)	60,000	–	(291)	–	–	50,039
Profit for the year	–	–	–	–	–	–	–	298,071	298,071
Dividends paid	–	–	–	–	–	–	(152,250)	(65,250)	(217,500)
Proposed dividend	–	–	–	–	–	–	152,250	(152,250)	–
At 31 December 2003	1,542,817	29,344	529,472	57,793	1,378,500	(26)	152,250	1,677,646	5,367,796
Revaluation movements	–	3,492	92,576	48,675	–	–	–	–	144,743
Currency re-alignment	–	–	–	–	–	106	–	–	106
Deferred taxation arising from revaluation movements *(Note 24)*	–	–	(15,967)	–	–	–	–	–	(15,967)
Reversal of deferred taxation arising from disposal *(Note 24)*	–	–	1,006	–	–	–	–	–	1,006
Net gains not recognised in the income statement	–	3,492	77,615	48,675	–	106	–	–	129,888
Reversal of reserves upon disposal	–	–	(5,747)	3,701	–	–	–	5,747	3,701
Profit for the year	–	–	–	–	–	–	–	314,702	314,702
Dividends paid	–	–	–	–	–	–	(152,250)	(73,950)	(226,200)
Proposed dividend	–	–	–	–	–	–	174,000	(174,000)	–
At 31 December 2004	1,542,817	32,836	601,340	110,169	1,378,500	80	174,000	1,750,145	5,589,887

The Bank's reserves available for distribution to the shareholders as at 31 December 2004 comprised retained profits of HK$1,750,145,000 (2003: HK$1,677,646,000), general reserve of HK$1,378,500,000 (2003: HK$1,378,500,000) and dividend reserve of HK$174,000,000 (2003: HK$152,250,000).

24. DEFERRED TAXATION

The following are the major deferred tax liabilities and assets recognised and movements thereon during the current and prior reporting periods:

	Accelerated tax depreciation	Revaluation of properties	General provisions for bad and doubtful debts	Others	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
THE GROUP					
At 1 January 2003	5,207	104,069	(32,706)	3,059	79,629
Charge (credit) to income statement for the year *(Note 9)*	530	(95)	(538)	(1,907)	(2,010)
Effect of change in tax rate:					
Charge to land and buildings revaluation reserve for the year	–	10,454	–	–	10,454
Charge (credit) to income statement for the year *(Note 9)*	488	(697)	(3,066)	287	(2,988)
Balance at 1 January 2004	6,225	113,731	(36,310)	1,439	85,085
Charge (credit) to income statement for the year *(Note 9)*	4,789	(866)	3,417	(1,439)	5,901
Charge to land and buildings revaluation reserve for the year	–	15,967	–	–	15,967
Acquisition of a subsidiary	232	–	–	–	232
Credit to equity for the year	–	(1,006)	–	–	(1,006)
At 31 December 2004	11,246	127,826	(32,893)	–	106,179
THE BANK					
At 1 January 2003	5,207	95,710	(32,673)	3,059	71,303
Charge (credit) to income statement for the year	530	(95)	(552)	(1,907)	(2,024)
Effect of change in tax rate:					
Charge to land and buildings revaluation reserve for the year *(Note 23)*	–	9,670	–	–	9,670
Charge (credit) to income statement for the year	488	(697)	(3,064)	287	(2,986)
Balance at 1 January 2004	6,225	104,588	(36,289)	1,439	75,963
Charge (credit) to income statement for the year	4,789	(866)	3,407	(1,439)	5,891
Charge to land and buildings revaluation reserve for the year *(Note 23)*	–	15,967	–	–	15,967
Credit to equity for the year *(Note 23)*	–	(1,006)	–	–	(1,006)
At 31 December 2004	11,014	118,683	(32,882)	–	96,815

25. SHARE OPTION SCHEME

The Bank's share option scheme (the "Scheme") was adopted pursuant to a resolution passed on 25 April 2002 for the primary purpose of providing incentives to directors and eligible employees, and will expire on 24 April 2012. Under the Scheme, the Board of Directors of the Bank may grant options to eligible employees, including directors of the Bank and its subsidiaries, to subscribe for shares in the Bank. Additionally, the Bank may, from time to time, grant share options to outside third parties for settlement in respect of goods or services provided to the Bank.

The total number of shares in respect of which options may be granted under the Scheme is not permitted to exceed 10% of the shares of the Bank in issue at the date of approval of the Scheme, without prior approval from the Bank's shareholders. The number of shares in respect of which options may be granted to any individual is not permitted to exceed 1% of the shares of the Bank in issue at any point in time, without prior approval from the Bank's shareholders.

Options granted must be taken up within 28 days of the date of offer, upon payment of HK$10 per option. Options may be exercised at any time from the date of grant of the share option to the fifth anniversary of the date of grant. The exercise price is determined by the Board of Directors of the Bank, and will be the highest of the closing price of the Bank's shares on the date of offer, the average closing price of the shares for the five trading days immediately preceding the date of offer and the nominal value of the shares.

No options have been granted under the above-mentioned scheme since the Scheme was adopted.

26. LOANS TO OFFICERS

The aggregate relevant loans to officers disclosed pursuant to Section 161B(4B) of the Companies Ordinance are as follows:

	THE GROUP AND THE BANK	
	2004	**2003**
	HK$'000	*HK$'000*
Aggregate balance of all relevant loans outstanding at the balance sheet date	118,514	105,554
Maximum aggregate balance of relevant loans during the year	287,579	135,502

27. ACQUISITION OF A SUBSIDIARY

On 6 May 2004, the Group acquired 66.7% of the issued share capital of Card Alliance Company Limited and a shareholder's loan of HK$7,500,000 for consideration of HK$7,965,000. This acquisition has been accounted for by the acquisition method of accounting. The amount of negative goodwill arising as a result of the acquisition was HK$641,000 and is included in advances and other accounts.

	HK$'000
Net assets acquired	
Placements with banks and other financial institutions maturing between one and twelve months	8,387
Advances and other accounts less provision	3,326
Fixed assets	6,319
Deferred tax liabilities	(232)
Other accounts and provisions	(1,142)
Shareholder's loan	(15,000)
Share of net assets before acquisition	(552)
	1,106
Negative goodwill arising on acquisition	(641)
	465
Shareholder's loan	7,500
Total consideration	7,965
Satisfied by:	
Cash	7,965
Net cash inflow arising on acquisition:	
Cash consideration	7,965
Cash and cash equivalents acquired	(8,387)
Net inflow of cash and cash equivalents in respect of the purchase of a subsidiary	(422)

The subsidiary acquired during the year contributed HK$1,957,000 to the Group's turnover, and a loss of HK$5,483,000 to the Group's profit from operations.

28. OFF-BALANCE SHEET EXPOSURES

	THE GROUP		THE BANK	
	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Contingent liabilities and commitments – contractual amounts				
Direct credit substitutes	1,023,725	829,984	1,023,725	829,984
Trade – related contingencies	351,095	256,126	351,095	256,126
Other commitments				
With an original maturity of under one year or which are unconditionally cancellable	3,998,729	3,643,812	3,998,087	3,643,170
With an original maturity of one year and over	3,108,000	3,192,101	3,107,572	3,191,031
Forward assets purchases	50,291	165,981	50,291	165,981
	8,531,840	8,088,004	8,530,770	8,086,292

Included under "Other commitments" are non-cancellable operating leases commitments in respect of rented premises. At the balance sheet date, the Group had commitments for future minimum lease payments under these non-cancellable operating leases which fall due as follows:

	THE GROUP		THE BANK	
	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Within one year	37,080	33,708	36,438	33,066
In the second to fifth year inclusive	41,422	49,676	40,994	48,606
Over five years	979	816	979	816
	79,481	84,200	78,411	82,488

Operating lease payments represent rental payable by the Group for certain of its office properties. Leases are negotiated for an average term of three years and rentals are fixed.

Included under "Forward assets purchases" are capital commitments as follows:

	THE GROUP		THE BANK	
	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Capital expenditure contracted for but not provided in the financial statements in respect of:				
– property and equipment	24,532	14,734	24,532	14,734
– investment in fund	25,759	151,247	25,759	151,247
	50,291	165,981	50,291	165,981

	THE GROUP		THE BANK	
	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Derivatives – notional amounts				
Forward exchange rate contracts				
– hedging	135,335	19,046	135,335	19,046
Interest rate swap contracts				
– hedging	387,760	611,758	387,760	611,758

The replacement costs and credit risk weighted amounts of the above off-balance sheet exposures are as follows:

	THE GROUP				THE BANK			
	2004		2003		2004		2003	
	Replace-ment cost	Credit risk weighted amount	Replace-ment cost	Credit risk weighted amount	Replace-ment cost	Credit risk weighted amount	Replace-ment cost	Credit risk weighted amount
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Contingent liabilities and commitments	N/A	2,272,921	N/A	2,181,804	N/A	2,272,921	N/A	2,181,804
Exchange rate contracts	1,015	1,461	120	125	1,015	1,461	120	125
Interest rate contracts	8,972	3,941	694	1,683	8,972	3,941	694	1,683
	9,987	2,278,323	814	2,183,612	9,987	2,278,323	814	2,183,612

The above amounts do not take into account the effect of bilateral netting arrangements.

At the balance sheet date, the Group and the Bank as lessor had contracted with tenants for the following future minimum lease payments:

	THE GROUP AND THE BANK	
	2004	2003
	HK$'000	*HK$'000*
Within one year	1,821	1,200
In the second to fifth year inclusive	524	1,700
	2,345	2,900

Leases are negotiated for an average term of 2 years and rentals are also fixed for an average of 2 years.

29. RETIREMENT BENEFITS SCHEME

At the balance sheet date, the Group had two retirement schemes in operation, a non-contributory defined benefit scheme which is registered under the Occupational Retirement Scheme Ordinance (the "ORSO Scheme") in 1995 and a Mandatory Provident Fund Scheme (the "MPF Scheme") established under the Mandatory Provident Fund Ordinance in December 2000. Employees who were members of the ORSO Scheme prior to the establishment of the MPF Scheme were either staying within the ORSO Scheme or switching to the MPF Scheme, whereas all new employees joining the Group on or after December 2000 are required to join the MPF Scheme. Most of the employees enrolled in the MPF Scheme in replacement of the ORSO Scheme (the "participating members"). The assets of the schemes are held separately from those of the Group, in funds under the control of trustees. As a result, retirement benefits accruing subsequent to the establishment of the MPF Scheme are covered therefrom, as far as the ORSO Scheme members participating in the MPF Scheme are concerned. The ORSO Scheme continues to provide retirement benefits to non-participating members and those retirement benefits accrued prior to MPF Scheme to the participating members.

The Group operates the ORSO Scheme for qualifying employees. Under the ORSO Scheme, the employees are entitled to retirement benefits varying between 0 and 100 percent of total contributions made by the Group on attainment of a retirement age of 55. Upon retirement, the employees are entitled to monthly pension until death varying between 0 and 50 percent of final salary depending on years of service completed at the time of retirement. Under the MPF Scheme, the employee contributes 5% of the relevant payroll to the MPF Scheme while the Group contributes from 5% to 10% of the relevant payroll to the MPF Scheme depending on the years of service completed.

The most recent actuarial valuation of the ORSO Scheme was carried out as at 31 December 2004 by the qualified actuaries of Watson Wyatt Hong Kong Limited. The accrued liabilities and future costs were measured using the Projected Unit Credit method. The main actuarial assumptions used were as follows:

Discount rate	4% per annum
Expected return on Scheme assets	5% per annum
Expected rate of salary increase	3% per annum

At the date of the latest formal independent actuarial valuation made at 31 December 2004, the market value of the Scheme assets was HK$166,305,439 which was sufficient to cover the Aggregate Vested Liability and Aggregate Past Service Liability on that date. The Bank is not required to make any contributions to the Scheme for the next three years following the valuation date. The next formal independent actuarial valuation will be made at 31 December 2007 in accordance with the provisions of the Occupational Retirement Schemes Ordinance.

30. MATURITY PROFILES

The maturity profiles of certain assets and liabilities of the Group and the Bank as at 31 December 2004 are analysed as follows:

	THE GROUP						
	Repayable on demand	Repayable within 3 months or less (except those repayable on demand)	Repayable after 3 months but within 1 year	Repayable after 1 year but within 5 years	Repayable after 5 years	Undated	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Assets							
Cash and short-term funds	699,814	12,712,567	114,931	69,635	10,000	–	13,606,947
Placements with banks and other financial institutions	–	1,544,695	–	–	–	–	1,544,695
Advances to banks and other financial institutions	–	20,212	38,000	–	–	–	58,212
Advances to customers	1,401,718	3,450,550	3,164,119	7,027,496	4,788,574	457,762	20,290,219
Debt securities included in:							
– trading securities	79,282	123,819	31,407	–	–	–	234,508
– held-to-maturity securities	–	784,141	553,405	1,880,617	170,137	–	3,388,300
	79,282	907,960	584,812	1,880,617	170,137	–	3,622,808
Certificates of deposit held	–	250,020	394,927	614,568	50,000	–	1,309,515
Liabilities							
Deposits and balances of banks and other financial institutions	36,865	1,522,768	–	–	–	–	1,559,633
Deposits from customers	11,777,613	20,749,367	1,351,642	73,009	–	–	33,951,631

	THE BANK						
	Repayable on demand	Repayable within 3 months or less (except those repayable on demand)	Repayable after 3 months but within 1 year	Repayable after 1 year but within 5 years	Repayable after 5 years	Undated	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Assets							
Cash and short-term funds	699,807	12,712,567	114,931	69,635	10,000	–	13,606,940
Placements with banks and other financial institutions	–	1,544,695	–	–	–	–	1,544,695
Advances to banks and other financial institutions	–	20,212	38,000	–	–	–	58,212
Advances to customers	1,401,718	3,450,174	3,163,023	7,025,143	4,787,196	457,736	20,284,990
Debt securities included in:							
– trading securities	79,282	123,819	31,407	–	–	–	234,508
– held-to-maturity securities	–	784,141	553,405	1,880,617	170,137	–	3,388,300
	79,282	907,960	584,812	1,880,617	170,137	–	3,622,808
Certificates of deposit held	–	250,020	394,927	614,568	50,000	–	1,309,515
Liabilities							
Deposits and balances of banks and other financial institutions	36,865	1,522,768	–	–	–	–	1,559,633
Deposits from customers	11,776,084	20,740,749	1,351,508	73,009	–	–	33,941,350

The maturity profile of certain assets and liabilities of the Group and the Bank as at 31 December 2003 are analysed as follows:

	THE GROUP						
	Repayable on demand	Repayable within 3 months or less (except those repayable on demand)	Repayable after 3 months but within 1 year	Repayable after 1 year but within 5 years	Repayable after 5 years	Undated	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Assets							
Cash and short-term funds	933,204	10,798,317	175,874	74,499	19,994	–	12,001,888
Placements with banks and other financial institutions	–	1,116,125	127,646	–	–	–	1,243,771
Advances to banks and other financial institutions	–	2,633	41,760	13,976	–	–	58,369
Advances to customers	1,989,555	2,992,788	2,919,657	6,890,735	4,509,465	883,065	20,185,265
Debt securities included in:							
– trading securities	120,572	51,138	41,043	7,822	–	–	220,575
– held-to-maturity securities	–	95,084	235,497	2,655,493	118,487	–	3,104,561
	120,572	146,222	276,540	2,663,315	118,487	–	3,325,136
Certificates of deposit held	–	73,284	504,519	714,604	–	–	1,292,407
Liabilities							
Deposits and balances of banks and other financial institutions	38,070	997,322	–	–	–	–	1,035,392
Deposits from customers	9,680,090	20,670,640	1,916,230	324,630	–	–	32,591,590

	THE BANK						
	Repayable on demand	Repayable within 3 months or less (except those repayable on demand)	Repayable after 3 months but within 1 year	Repayable after 1 year but within 5 years	Repayable after 5 years	Undated	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Assets							
Cash and short-term funds	933,204	10,798,317	175,874	74,499	19,994	–	12,001,888
Placements with banks and other financial institutions	–	1,116,125	127,646	–	–	–	1,243,771
Advances to banks and other financial institutions	–	2,633	41,760	13,976	–	–	58,369
Advances to customers	1,989,555	2,991,232	2,916,379	6,886,424	4,507,787	882,120	20,173,497
Debt securities included in:							
– trading securities	120,572	51,138	41,043	7,822	–	–	220,575
– held-to-maturity securities	–	95,084	235,497	2,655,493	118,487	–	3,104,561
	120,572	146,222	276,540	2,663,315	118,487	–	3,325,136
Certificates of deposit held	–	73,284	504,519	714,604	–	–	1,292,407
Liabilities							
Deposits and balances of banks and other financial institutions	38,070	997,322	–	–	–	–	1,035,392
Deposits from customers	9,678,406	20,656,006	1,915,143	324,630	–	–	32,574,185

31. RELATED PARTY TRANSACTIONS

During the year, the Group entered into the following transactions with related parties:

	Interest, commission and rental income		Interest and rental expenses	
	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Investing enterprises having significant influence on the Bank and their subsidiaries	7,062	8,214	11,851	13,430
Associate and jointly controlled entities	13,720	7,817	6,019	13,519
Directors and their associates	17,659	21,052	3,629	6,122

The above transactions were carried out at market price.

As the balance sheet date, the Group had the following outstanding balances with related parties:

	Amounts owed by related parties		Amounts owed to related parties	
	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Investing enterprises having significant influence on the Bank and their subsidiaries	225,503	284,274	86,297	39,935
Associate and jointly controlled entities	31,000	432,008	217,284	231,061
Directors and their associates	1,049,225	688,347	602,839	538,381

The above outstanding balances bear interest at rates similar to those made available to non-related parties.

APPENDIX A

SUMMARY OF THE EFFECTS OF THE CHANGES IN ACCOUNTING POLICIES FOR THE YEAR ENDED 31 DECEMBER 2003

In 2005, the Group has applied, for the first time, a number of new HKFRSs, HKASs and Interpretations (hereinafter collectively referred to as "**new HKFRSs**") issued by the HKICPA that are effective for accounting periods beginning on or after 1 January 2005. The application of the new HKFRSs has resulted in a change in the presentation of the consolidated income statement and the consolidated balance sheet.

The application of the new HKFRSs has resulted in changes to the Group's accounting policies in the following areas. The results for the year ended 31 December 2003 of the Bank as set out in the "*Summary Financial and Other Information*" are restated accordingly.

(a) Owner-occupied leasehold interest in land

In previous years, owner-occupied leasehold land and buildings were included in property and equipment and were measured using the revaluation model. In 2005, the Group has applied HKAS 17 "*Leases*". Under HKAS 17, the land and buildings elements of a lease of land and buildings are considered separately for the purposes of lease classification, unless the lease payments cannot be allocated reliably between the land and buildings elements, in which case, the entire lease is generally treated as a finance lease. To the extent that the allocation of the lease payments between the land and buildings elements can be made reliably, the leasehold interests in land are reclassified to prepaid lease payments under operating leases, which are carried at cost and amortised over the lease term on a straight-line basis. This change in accounting policy has been applied retrospectively. Comparative figures for 2003 have been restated.

(b) Deferred taxes related to investment properties

In previous years, deferred tax consequences in respect of revalued investment properties were assessed on the basis of the tax consequence that would follow from recovery of the carrying amount of the properties through sale in accordance with the predecessor Interpretation. In 2005, the Group has applied HK(SIC) Interpretation 21 "*Income Taxes – Recovery of Revalued Non-Depreciable Assets*" which removes the presumption that the carrying amount of investment properties is to be recovered through sale. Therefore, the deferred tax consequences of the investment properties are now assessed on the basis that reflect the tax consequences that would follow from the manner in which the Group expects to recover the property at each balance sheet date. In the absence of any specific transitional provisions in HK(SIC) Interpretation 21, this change in accounting policy has been applied retrospectively. Comparative figures for 2003 have been restated.

(c) Change of Accounting Policy for Property and Equipment

In 2005, the Group has elected to use the cost model, which is allowable under HKAS 16, to account for its buildings held for own use, consistent with the measurement basis of the Group's interest in leasehold lands. Under the cost model, the buildings are carried at cost less accumulated depreciation and accumulated impairment losses (if any). In previous years, buildings held for own use are stated in the balance sheet at their revalued amount, being the fair value at the date of revaluation less any subsequent accumulated depreciation and any subsequent accumulated impairment losses. Buildings held under the predecessor standard were measured at open market values, with revaluation surplus or deficits credited or charged to property revaluation reserve unless the balance on this reserve was insufficient to cover a revaluation decrease, in which case the excess of the revaluation decrease over the balance on the revaluation reserve of the buildings was charged to the income statement. Where a decrease had previously been charged to the income statement and a revaluation surplus subsequently arose, that increase was credited to the income statement to the extent of the decrease previously charged.

The Group has applied this change in accounting policy to carry the buildings at cost retrospectively. As a result, the carrying amount of property and equipment and the related deferred tax liabilities for 2003 have been restated.

The effects of the changes in the accounting policies described above on the Bank's consolidated results for the year ended 31 December 2003 are as follows:

	2003
	(HK$ thousands)
Gain on disposal of property and equipment	261
Increase in operating expenses relating to prepaid lease payments for land	(5,068)
Reversal of depreciation of land and buildings	10,944
Decrease in deferred tax assets	(1,386)
	4,751

	As at 31 December 2003 (Originally stated)	**HKAS 16**	**HKAS 17**	**HK (SIC) Int-21**	**As at 31 December 2003 (restated)**
			(HK$ thousands)		
Property and equipment	1,165,276	(15,833)	(982,197)	—	167,246
Prepaid lease payments for land	—	—	311,619	—	311,619
Deferred tax (liabilities) assets	(85,085)	(2,081)	116,688	(4,599)	24,923
Total effects on assets and liabilities	1,080,191	(17,914)	(553,890)	(4,599)	503,788
Reserves	5,726,908	(17,914)	(553,890)	(4,599)	5,150,505
Total effects on equity	5,726,908	(17,914)	(553,890)	(4,599)	5,150,505

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