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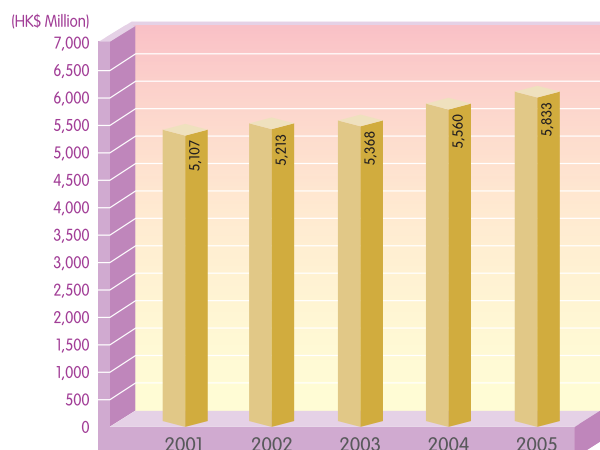
FIVE-YEAR FINANCIAL SUMMARY

TOTAL ADVANCES TO CUSTOMERS / TOTAL CUSTOMERS' DEPOSITS / TOTAL ASSETS

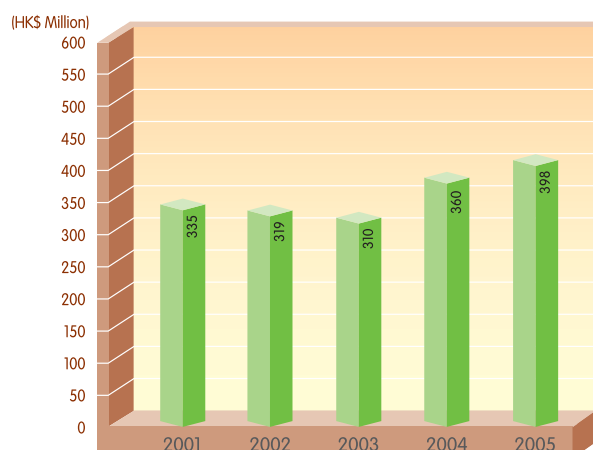


■ Total Advances To Customers
 ■ Total Customers' Deposits
 ■ Total Assets

CAPITAL RESOURCES



PROFIT ATTRIBUTABLE TO SHAREHOLDERS



Board of Directors

Executive Directors

Mr LIU Lit Man, GBS, JP, FIBA
(Executive Chairman)

Dr LIU Lit Mo, LLD, MBE, JP
(Vice Chairman)

Mr LIU Lit Chi
(Managing Director & Chief Executive Officer)

Mr Don Tit Shing LIU
(Deputy Chief Executive Officer)

Mr Wilfred Chun Ning LIU

Mr LAU Wai Man

Mr Frank Shui Sang JIN

Mr Andrew Chiu Wing TSANG

Mr George Har Kar WONG

Non-executive Directors

Mr Timothy George FRESHWATER

Mr Toshiaki ARAI

Mr Andrew LIU

Mr SUN Jiakang

Mr Christopher Kwun Shing LIU

Mr Alfred Cheuk Yu CHOW, JP

Mr WANG Zhi

Independent Non-executive Directors

Dr Robin Yau Hing CHAN, GBS, LLD, JP, EOE

Mr Wanchai CHIRANAKHORN

Mr CHENG Yuk Wo

Senior Managers

Mr Frederick Hoi Kit CHAN

Mr LO Yin Suen

Mr Patrick Siu Cheung WAT

Company Secretary & Legal Counsel

Mr Michael Kin Wah YEUNG

Registered Office

Ground Floor, New World Tower 2
16-18 Queen's Road Central, Hong Kong

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Principal Legal Advisers

Anthony Chiang & Partners

Deacons

K C Ho & Fong

Kwan & Chow

Slaughter and May

Auditors

Deloitte Touche Tohmatsu

Share Registrar and Transfer Office

Computershare Hong Kong Investor Services Limited

Share Listing

The Bank's shares are listed on The Stock Exchange of Hong Kong Limited under Stock Code numbered 1111.

BIOGRAPHICAL DATA ABOUT DIRECTORS AND SENIOR MANAGEMENT

Board of Directors

Executive Directors

Mr LIU Lit Man, GBS, JP, FIBA

aged 76, is the Executive Chairman of the Bank. He joined the Bank in 1950 and has been its 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 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 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 had 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 is 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

aged 68, is the Vice Chairman and an Executive Director of the Bank. He 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 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 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

aged 66, is the Managing Director and Chief Executive Officer of the Bank. He 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

aged 44, is an Executive Director and the Deputy Chief Executive Officer of the Bank. He 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

aged 44, is an Executive Director in charge of the Securities Business Division of the Bank. He holds a Bachelor's degree in Economics from University of Newcastle-upon-Tyne (UK). He joined the Bank in 1993 and became a Director in 1998.

Mr LAU Wai Man

aged 48, 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

aged 48, 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 the 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

aged 48, 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 and 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

aged 53, 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.

Non-executive Directors

Mr Timothy George FRESHWATER

aged 61, was redesignated from independent non-executive director, an office that he had held since April 1997, to 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

aged 52, is 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

aged 50, a member of the Board since 1977, 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.

Mr SUN Jiakang

aged 45, has been a member of the Board since November 2002. He is also the Vice Chairman and Managing Director of COSCO Pacific Limited (“COSCO Pacific”), 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 International WHO’s WHO of Professionals and a visiting professor at Dalian Maritime University. Mr 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 of philosophy (PhD) degree in management from Preston University, USA in 2005. After graduating from university in 1982, Mr Sun joined COSCO Group and had been the Assistant to the President and Spokesman of China Ocean Shipping (Group) Company. For the past 24 years, Mr Sun has committed to shipping management and has accumulated rich experiences in international shipping and logistics operations and has demonstrated excellent management skills. Mr Sun joined COSCO Pacific since September 2002 and is responsible for the overall strategic planning, corporate development, management and administration of COSCO Pacific.

Mr Christopher Kwun Shing LIU

aged 30, 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 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 Alfred Cheuk Yu CHOW, JP

aged 55, 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 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

aged 43, has been a member of the Board since November 2005. He is also a Deputy Managing Director of COSCO Pacific Limited (“COSCO Pacific”). He joined COSCO Pacific in April 2001 and was appointed as an Executive Director of COSCO Pacific in July 2005. He graduated from Jimei Navigation College in 1980. He then further his studies in Shanghai Maritime University and obtained an International Executive Master of Business Administration degree from International School of Management in Paris in 2000. Prior to joining COSCO Pacific, he worked in COSCO Guangzhou in 1980 and gained more than 13 years of working experience in shipping industries there. Since 1993, he had been the Deputy Chief Executive Officer of COSCO (UK) Limited, the Managing Director of Crystal Logistics Ltd and the Managing Director of COSCO France S A. Mr Wang is now responsible for the management and investment of the container terminals and container-related industrial businesses of COSCO Pacific.

Independent Non-executive Directors

Dr Robin Yau Hing CHAN, GBS, LLD, JP, EOE

aged 73, a member of the Board since October 1981, 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

aged 66, an Independent Non-executive Director since September 1998, is the Chairman of 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 from May 1995 to September 1998.

Mr CHENG Yuk Wo

aged 45, 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 and 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 had 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.

Senior Managers**Mr Frederick Hoi Kit CHAN**

aged 45, Senior Manager, is the head of the Finance Department and the Business Development and Coordination Department. He graduated from Imperial College, University of London in Computing Science and obtained a Master of Business Administration degree from Henley Management College, U.K. He is a member of the Institute of Chartered Accountants in England & Wales, a member of the British Computer Society and a fellow of the Hong Kong Institute of Certified Public Accountants. Mr Chan has more than 20 years of experience in the financial services industry and worked for an international accounting firm and major international banks in London and Hong Kong in financial reporting and strategic management before joining the Bank in 2004.

Mr LO Yin Suen

aged 59, is a Senior Manager with over 40 years of banking experience. He joined the Bank in 1960 and is presently in charge of the General Administration Division of the Bank.

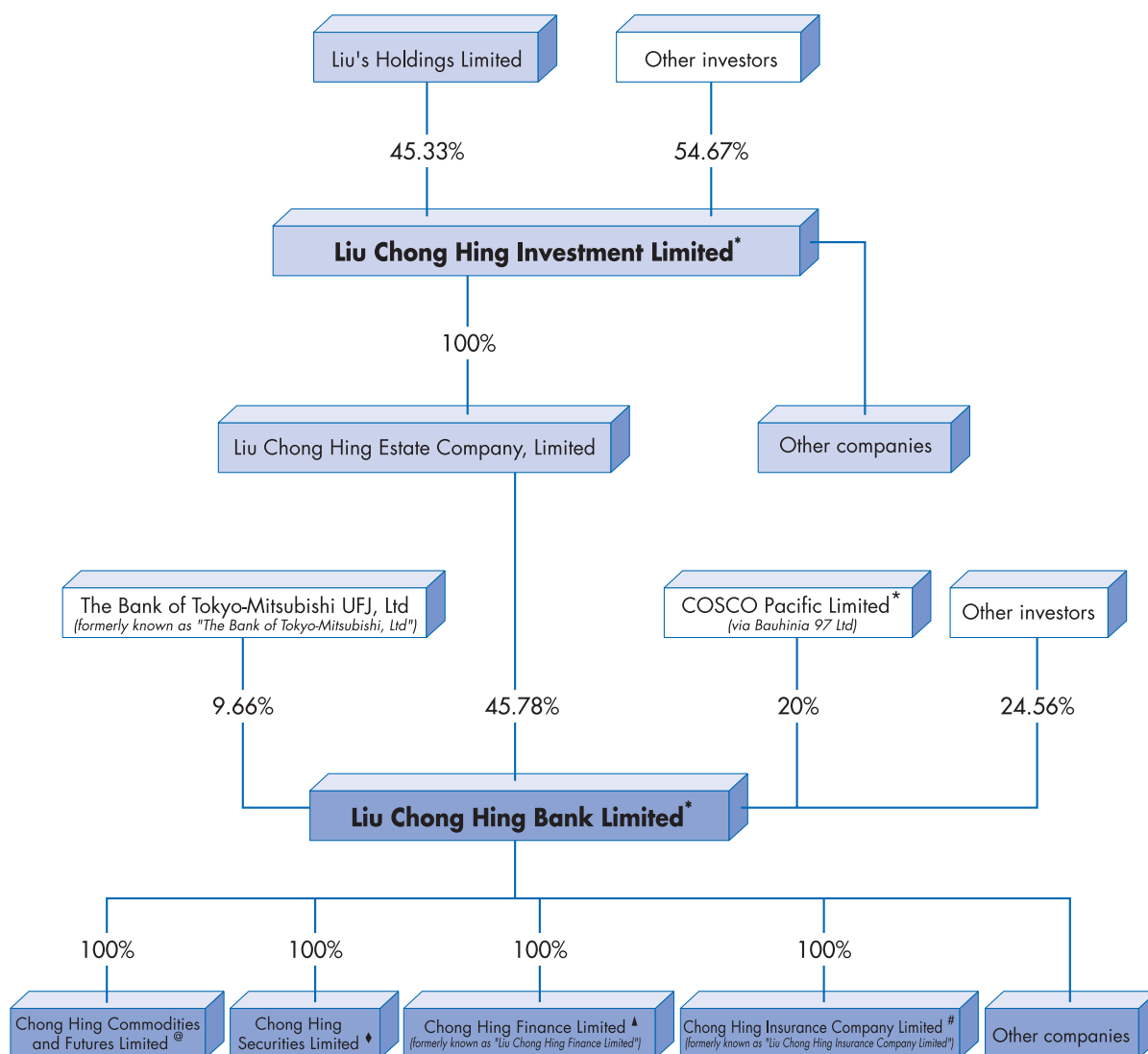
Mr Patrick Siu Cheung WAT

aged 52, Senior Manager, is the head of Operations Division. He holds a Bachelor of Arts degree from the University of Hong Kong in 1975. He has held senior positions in Finance, Business Development, Operations, Internal Control and Quality functions with major US banks in Hong Kong and UK. He has been trained in TQM (Total Quality Management) and as Black Belt in Six Sigma quality programs. Mr Wat is also responsible for change management and productivity improvements since joining the Bank in 2003.

Company Secretary & Legal Counsel**Mr Michael Kin Wah YEUNG**

aged 49, obtained a Bachelor of Arts degree in legal studies, political science and philosophy from Rice University (Texas, USA) in 1980 and a Doctor of Jurisprudence degree from the School of Law of The University of Texas at Austin (Texas, USA) in 1983. Mr Yeung, a United States lawyer, had served as the company secretary of FPB Bank Holding Company Limited (the then Hong Kong-listed banking arm of the First Pacific Group) and South China Morning Post (Holdings) Limited (now known as SCMP Group Limited) before resuming his position as the company secretary of the Bank in 1997.

Member of the Liu's family



* Listed on The Stock Exchange of Hong Kong Limited

@ Registered with The Hong Kong Futures Exchange Limited as a participant

♦ Registered with The Stock Exchange of Hong Kong Limited as a participant

▲ Licensed under the Banking Ordinance as a deposit-taking company

Licensed under the Insurance Companies Ordinance as an insurance company

SHARE TRADING SUMMARY

Trading of shares in Liu Chong Hing Bank Limited*, a constituent stock of the Hang Seng Composite Index Series, on The Stock Exchange of Hong Kong Limited (“HKSE”) during 2005

| Month | Unit Price (HK\$) (average for the month) | | | | Monthly Turnover | | Hang Seng Index# (average for the month) |
|----------------------|--|--------|--------|--------|------------------|------------|---|
| | Open | High | Low | Close | Number of Shares | HK\$ | Close |
| January | 11.617 | 11.681 | 11.588 | 11.626 | 3,249,172 | 37,704,600 | 13,644.43 |
| February | 11.888 | 11.938 | 11.832 | 11.906 | 4,010,919 | 47,774,000 | 13,913.70 |
| March | 12.167 | 12.214 | 12.119 | 12.174 | 7,622,000 | 92,590,300 | 13,773.60 |
| April | 11.813 | 11.885 | 11.778 | 11.848 | 3,156,058 | 37,668,600 | 13,661.22 |
| May | 11.558 | 11.593 | 11.473 | 11.508 | 5,511,056 | 62,398,500 | 13,825.04 |
| June | 11.548 | 11.600 | 11.511 | 11.570 | 3,641,426 | 42,236,000 | 13,995.50 |
| July | 11.938 | 12.008 | 11.895 | 11.975 | 7,107,722 | 85,342,400 | 14,462.97 |
| August | 12.239 | 12.287 | 12.193 | 12.243 | 4,926,912 | 60,099,800 | 15,127.99 |
| September | 11.945 | 11.981 | 11.929 | 11.945 | 3,707,300 | 44,330,000 | 15,191.75 |
| October | 11.898 | 11.953 | 11.874 | 11.930 | 3,749,783 | 44,746,200 | 14,644.16 |
| November | 11.905 | 11.943 | 11.893 | 11.923 | 1,489,699 | 17,750,000 | 14,760.98 |
| December | 12.255 | 12.303 | 12.198 | 12.263 | 1,819,865 | 22,263,000 | 15,064.89 |
| Average for the year | 11.898 | 11.949 | 11.857 | 11.909 | 4,165,992 | 49,575,283 | 14,338.85 |

| | | | |
|-----------------------|--|---------------|------------------------------|
| * Authorized | : 600,000,000 shares | Par value | : HK\$0.500 per share |
| Issued and fully-paid | : 435,000,000 shares | Board lot | : 1,000 shares |
| HKSE stock code | : 1111 | | |
| Year high | : HK\$12.450 (1, 2, 3, 4, 5, 8, 9 & 10 August & 16 December) | Historic high | : HK\$27.600 (15 July 1997) |
| Year low | : HK\$11.150 (26 May) | Historic low | : HK\$3.650 (24 August 1998) |

| | | | |
|-------------|--------------------------|---------------|-----------------------------|
| # Year high | : 15,508.57 (16 August) | Historic high | : 18,397.57 (28 March 2000) |
| Year low | : 13,320.53 (24 January) | Base value | : 100.00 (31 July 1964) |

| | |
|---|---|
| 17 August 2005 | Interim results for the first half of 2005 announced. |
| 30 August 2005 | Interim Report 2005 despatched. |
| 12 through 16 September 2005 (both days inclusive) | Register of Members closed for the purpose of ascertaining dividend entitlements. |
| 22 September 2005 | Interim dividend for 2005 of HK\$0.18 per share paid. |
| 10 March 2006 | Final results for the year of 2005 announced. |
| 31 March 2006 | Annual Report 2005 will be despatched. |
| 19 through 21 April 2006 (both days inclusive) | Register of Members will be closed for the purpose of ascertaining dividend entitlements. |
| 26 April 2006 | 2006 Annual General Meeting will be held. |
| 27 April 2006 | If approved by shareholders at the 2006 Annual General Meeting, the final dividend for 2005 of HK\$0.42 per share will be paid. |

NOTICE OF ANNUAL GENERAL MEETING

NOTICE IS HEREBY GIVEN THAT the annual general meeting of the shareholders of Liu Chong Hing Bank Limited (the “Bank”) for the year of 2006 will be held in The Harbour Room on Level 3 of The Ritz-Carlton at 3 Connaught Road Central, Hong Kong on Wednesday, 26 April 2006 at 11 am for the purposes of conducting the following items of ordinary and special business:

Ordinary business

- (1) To receive and adopt the Financial Statements and the Reports of the Directors and Auditors for the year ended 31 December 2005.
- (2) To declare the final dividend for the year ended 31 December 2005.
- (3) To re-elect directors and fix their and the other directors’ remuneration.
- (4) To re-appoint auditors and authorise the directors to fix the auditors’ remuneration.

Special business

As special business, to consider and, if thought fit, pass, with or without modification, the following ordinary resolutions:

- (5) **THAT**
 - (a) the exercise by the directors during the Relevant Period of all the powers of the Bank to purchase Shares, subject to and in accordance with all applicable laws, be and is hereby generally and unconditionally approved;
 - (b) the aggregate nominal amount of Shares which may be purchased on The Stock Exchange of Hong Kong Limited or any other stock exchange recognised for this purpose by the Securities and Futures Commission of Hong Kong and The Stock Exchange of Hong Kong Limited under the Hong Kong Code on Share Repurchases pursuant to the approval in paragraph (a) above shall not exceed 10 per cent of the aggregate nominal amount of Shares in issue at the date of the passing of this resolution, and the said approval be and is hereby limited accordingly; and
 - (c) for the purpose of this resolution:

“Relevant Period” means the period from the passing of this resolution until whichever is the earliest of:

 - (i) the conclusion of the next annual general meeting of the Bank;
 - (ii) the expiration of the period within which the next annual general meeting of the Bank is required by law to be held; or
 - (iii) the revocation or variation of the authority given under this resolution by ordinary resolution of the shareholders in general meeting.
- “Shares” means shares of all classes in the capital of the Bank including, without limitation, shares of HK\$0.50 each of the Bank.

NOTICE OF ANNUAL GENERAL MEETING

(6) **THAT**

(a) subject to paragraph (c), the exercise by the directors of the Bank during the Relevant Period of all the powers of the Bank to allot, issue and deal with additional shares in the capital of the Bank and to make or grant offers, agreements and options which might require the exercise of such powers be and is hereby generally and unconditionally approved;

(b) the approval in paragraph (a) shall authorise the directors of the Bank during the Relevant Period to make or grant offers, agreements and options which would or might require the exercise of such power after the end of the Relevant Period;

(c) the aggregate nominal amount of share capital allotted or agreed conditionally or unconditionally to be allotted (whether pursuant to an option or otherwise) by the directors of the Bank pursuant to the approval in paragraph (a), otherwise than pursuant to (i) any Rights Issue, (ii) any scrip dividend or similar arrangement providing for the allotment and issue of shares in lieu of the whole or part of a dividend on shares of the Bank in accordance with the Articles of Association of the Bank, or (iii) any exercise of options granted under the share option scheme of the Bank adopted on 25 April 2002, shall not exceed the aggregate of:

(aa) 20 per cent of the aggregate nominal amount of the shares in the capital of the Bank in issue at the date of the passing of this resolution; and

(bb) (if the directors are so authorised by a separate ordinary resolution of the shareholders of the Bank) the nominal amount of any share capital of the Bank repurchased by the Bank subsequent to the passing of this resolution,

and the said approval be and is hereby limited accordingly; and

(d) for the purpose of this resolution:

“Relevant Period” means the period from the passing of this resolution until whichever is the earliest of:

(i) the conclusion of the next annual general meeting of the Bank;

(ii) the expiration of the period within which the next annual general meeting of the Bank is required by law to be held; or

(iii) the revocation or variation of the authority given under this resolution by ordinary resolution of the shareholders in general meeting.

“Rights Issue” means an offer of shares open for a period fixed by the directors of the Bank to holders of shares of the Bank or any class thereof on the register on a fixed record date in proportion to their then holdings of such shares or class thereof (subject to such exclusion or other arrangements as the directors of the Bank may deem necessary or expedient in relation to fractional entitlements or having regard to any restrictions or obligations under the laws of, or the requirements of any recognised regulatory body or any stock exchange in, any territory outside Hong Kong).

NOTICE OF ANNUAL GENERAL MEETING

- (7) **THAT** the directors of the Bank be and are hereby authorised to exercise the powers of the Bank referred to in paragraph (a) of the resolution set out as Resolution 6 in the notice convening this meeting in respect of the share capital of the Bank referred to in sub-paragraph (bb) of paragraph (c) of that resolution.

Any other ordinary business

- (8) To transact any other ordinary business.

By Order of the Board
Michael K W Yeung
Company Secretary

10 March 2006

Notes:

- i. A shareholder entitled to attend and vote at the annual general meeting in question is entitled to appoint a proxy to attend and vote in his stead. A proxy does not have to be a shareholder of the Bank. Proxy forms are to be lodged with the registered office of the Bank (currently situated at Ground Floor, New World Tower 2, 16-18 Queen's Road Central, Hong Kong) not later than 48 hours before the time for the holding of the annual general meeting in question or any adjournment thereof.
- ii. The Register of Members of the Bank will be closed from Wednesday, 19 April 2006 to Friday, 21 April 2006 (both days inclusive), during which period no transfer of shares can be registered. In order to qualify for the final dividend in question, all transfer documents, together with the relevant share certificates, must be lodged for registration with the Bank's Share Registrar and Transfer Office, Computershare Hong Kong Investor Services Limited of 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong, not later than 4 pm on Tuesday, 18 April 2006.
- iii. The Bank's Annual Report 2005 includes an Explanatory Statement on Resolutions 5 through 7 in question, information on the retiring directors to be re-elected at the 2006 annual general meeting, and the procedures for demanding and conducting a poll.



Mr Liu Lit Man GBS, JP, FIBA

Executive Chairman

Economic Review

Despite a slackening growth rate compared with that of 2004, the global economy still continued to grow in 2005, as demonstrated especially by the outstanding performance in both the American and the Japanese economies. The US economy benefited mainly from the sharp increase in personal consumption and the long-term interest rates which have continued to stay rather low. The real estate market continued to prosper. The Japanese economy rebounded from the trough primarily because internal demand increased substantially and the banks' bad debt crisis was resolved.

Moreover, the deflationary situation that has plagued Japan for years is beginning to ease off. As to the performance of the euro zone, its growth rate has been rather slow because of problems with the abrupt surge of the euro, the increase in oil prices, the slackening of internal demand, etc. Overall growth, however, has been steady. The global economy is improving as a whole alongside the good performance of these three major economies. The economies of such developing countries as China and India have grown rapidly for many consecutive years and their growth rates are still leading the pack. Surges in oil prices have improved the Russian economy as well as the economies of countries as such those in West Africa. In short, the outlook for the global economy is generally optimistic.

The Hong Kong economy continued to perform well last year. Its gross domestic product, which grew more than generally expected at the outset, increased to 7.3 percent thanks to increases in exports and personal consumption. With the improvement of the economy, the number of unemployed people gradually dropped to below 200,000, a 4-year new low. Investment and consumption sentiments continued to improve bit by bit. Hong Kong registered a slight inflation rate of nearly 2 percent at the end of last year after a long period of deflation. However, frequent new highs in oil prices and successive interest rate increases by banks to mirror those in the United States have cast a shadow on the interest rate-sensitive industries. It is, therefore, inevitable that the stock and the property markets showed signs of slackening in the second half of last year.

As to the banking industry, fierce competition is still ever-increasing. Although the interest rate-hiking cycle started in the United States in mid-2004, banks in Hong Kong have put off raising interest rates for some time because of the rather high account balances in the banking system brought about by the perpetual huge influx of funds into Hong Kong speculating on the appreciation of the renminbi. It was not until March 2005 that Hong Kong formally began its interest rate-hiking cycle, a 9-month lag compared with that in the United States. Interest expenses of borrowers were thus temporarily lessened. Banks' lending activities are normally bound to benefit from the recovery of the economy. However, for the first

EXECUTIVE CHAIRMAN'S STATEMENT

half of last year, other than mortgage business generated by the active property market, the general demand for other commercial and industrial loans showed no conspicuous increase. The various initial public offerings of new shares have also generated some short-term fund raising and margin financing activities. Considering the amount of surplus liquidity, this is not much help because real profit is minimal.

Results Announcement

The Bank's results for 2005 show a rather satisfactory improvement. For the financial year of 2005, on an audited, consolidated basis, profit attributable to shareholders amounted to HK\$397.983 million, an increase of 10.59 percent over that for the year before. Total customers' deposits soared 22.25 percent to HK\$41.506 billion. Total loans to customers (after accounting for impairment allowances for bad and doubtful debts as well as interest accrued) increased 21.36 percent to HK\$24.306 billion. On 31 December 2005, the Bank's loan portfolios were made up as follows: property developments and investments (30.71 percent), personal real estate purchases (17.27 percent), financial and securities concerns (6.39 percent), trade finance (2.69 percent), wholesale and retail trade (2.34 percent), manufacturing, transportation and other businesses (22.69 percent), loans outside Hong Kong (12.37 percent), and others (5.54 percent). Adjusted capital adequacy ratio dropped 19.25 percent to 15.19 percent at the end of 2005, while average liquidity ratio for 2005 decreased 6.13 percent to 49.13 percent. Loan-to-deposit ratio increased 1.35 percent to 50.88 percent. During the period in question, the Bank's loan portfolios grew considerably, while customers' deposits also increased admirably. Loan-to-deposit ratio has therefore remained more or less the same. Total assets, having increased 20.82 percent to HK\$49.974 billion, have already exceeded the minimum asset requirement for setting up branches in the mainland under the Mainland and Hong Kong Closer Economic Partnership Arrangement. Shareholders' funds (after final dividend), compared with the restated shareholders' funds for the previous year, increased 4.9 percent to HK\$5.65 billion. The local economy continued to grow last year and most sectors have started to recover. The pace of growth of the economy has, however, been affected by the triggering off of the interest rate-hiking cycle

as well as the persistent fierce competition among the banks. The results of the performance of the Bank may therefore be regarded as satisfactory because, under the circumstances, they still manage to sustain a good



A more spacious San Po Kong Branch after renovation

momentum. Your board has recommended paying the final dividend of HK\$0.42 per share for the financial year of 2005 to shareholders whose names appear in the Register of Members at the close of business on Friday, 21 April 2006. Total dividends for the financial year of 2005 (including the interim dividend of HK\$0.18 per share paid earlier) amounted to HK\$0.60 per share.

Profit Analysis

On an audited, consolidated basis, net interest income rose 15.91 percent from that of 2004 to HK\$752.852 million in 2005. Interest spread increased 0.04 percent to 1.65 percent. After accounting for the other operating income, which amounted to HK\$217.129 million, total operating income was HK\$969.981 million and total operating expenditure was HK\$493.129 million. Cost-to-income ratio rose 2.03 percent to 50.84 percent. Operating profit before provisions and disposal of long-term assets increased 3.59 percent to HK\$476.852 million. In order to maintain good credit quality, the Bank made impairment allowances for bad and doubtful debts in the amount of HK\$67.807 million for 2005, an increase of 32.50 percent against those made for 2004. After accounting for the impairment allowances for bad and doubtful debts as well as the charge for taxation, profit attributable to shareholders amounted to HK\$397.983 million (an increase of 10.59 percent), translating into earnings of HK\$0.91 per share. Net asset value per share (after final dividend), compared with the restated net asset value per share for the previous year, rose 4.9 percent to HK\$12.99.



New face of Happy Valley Branch after renovation

Additional Branches

For the past few years, the Bank has slowed down its plan to open more branches because the economic environment was cloudy. With the current stabilization of the economy and the upturn of the market, the Bank will actively develop its branch network. It is expected that eight to ten additional branches will be opened within the year. The Bank will also continue to provide its staff with professional training while further enhancing its management to improve service quality and develop new products to broaden its customer base.

New Headquarters

The Bank's head office building at 24 Des Voeux Road Central, which is being redeveloped, will be topped out in March this year. It is expected that the Bank will be able to move its operations back to the new head office building by the end of this year. Quality service will then be continually provided to the community by the Bank with fresh looks.

Directorate Changes

Mr Andrew Chiu Wing Tsang and Mr George Har Kar Wong, senior managers of the Bank, were both appointed executive directors by the board on 17 August 2005. Mr Liu Guoyuan resigned as a non-executive director of the Bank on 16 November 2005 for personal reasons. Mr Wang Zhi was appointed a non-executive director of the Bank on that same day.

EXECUTIVE CHAIRMAN'S STATEMENT

Economic Prospects

It is expected that the growth of the Hong Kong economy this year will continue to be dependent on external trade and driven by internal consumption. The movement of the interest rates would, after all, be the decisive factor for economic performance. Although the new chairman has assumed his office at the United States Federal Reserve Board, he has yet to express a clear stance on monetary policy directions. Recent economic data from the United States signal mixed messages. The expectation that the interest rate-hiking cycle will peak soon is generally believed to be unrealizable for now. Interest rates will hover at high levels for a longer period of time. Besides, repercussions from such other unfavourable factors as stubbornly high oil prices and the yet-to-be fully accomplished warfare against terrorism continue to exist. It is expected that, for the first half of this year, the economy can only stroll along and take a wait-and-see attitude.

The local political and economic arenas are rather harmonious at the moment. The early resolution of the fiscal deficit problem, the timely launching of the various major public projects, the engaged cooperation between Hong Kong and Guangzhou, and the endless supportive measures made available to Hong Kong by the mainland are all conducive to improving Hong Kong's employment situation and long-term economic development.

After a round of consolidations, some new life has recently been breathed into the property market. Developers have seized upon the opportunity by launching their new property developments packaged with various preferential terms in tandem with the massive offers made by the banks to cut mortgage interest rates. This has a certain stimulating effect on the turnover of the property market. On the other hand, the market for initial public offerings of new shares is very active this year, attracting large numbers of mainland enterprises, state-owned or otherwise, to the territory. This is conducive to the development of the stock market and it is expected that more than HK\$200 billion may be raised. With the opening of the Hong Kong Disneyland in September last year, the local tourism industry has witnessed the coming to Hong Kong large numbers of visitors from both the mainland and foreign countries. Moreover, the prosperity of the tourism industry benefited such other industries as the hotel, restaurant, entertainment and retail businesses. The prospects for the tourism industry are expected to be even brighter this year.

The prospects for the banking industry this year are still laden with numerous hidden worries. On the whole, however, Hong Kong has its many blessings, backed up by the tremendous support of the motherland and the diversity of the international market. There are indeed endless business opportunities and progress can be strove for when such opportunities are seized upon in a timely manner.

Finally, on behalf of your board, I would like to wholeheartedly thank our customers, friends and shareholders for their long-standing trust in and support for the Bank, not to mention my fellow directors for the exercise of their wise judgment and all of our staff members for their dedication.

By Order of the Board

Liu Lit Man

Executive Director

10 March 2006

DIRECTORS' REPORT

The directors have pleasure in submitting their annual report and the audited financial statements for the year ended 31 December 2005.

PRINCIPAL ACTIVITIES

The Bank is engaged in the provision of banking and related financial services. The principal activities of its subsidiaries are set out in note 17 to the financial statements.

BUSINESS

The Group's total operating income (net of interest expense) is analysed and reported by significant business classes as follows:

| | 2005 HK\$'000 | 2004 HK\$'000 |
|--|-----------------------|-----------------------|
| Corporate and retail banking | 491,035 | 499,088 |
| Treasury and foreign exchange activities | 364,499 | 273,910 |
| Other business activities | <u>114,447</u> | <u>144,552</u> |
| | <u><u>969,981</u></u> | <u><u>917,550</u></u> |

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.

MAJOR CUSTOMERS

The directors believe that the five largest customers of the Group accounted for less than 30% of the total of interest income and other operating income of the Group for the year.

RESULTS AND STATE OF AFFAIRS

The results of the Group for the year ended 31 December 2005 are set out in the consolidated income statement on page 39.

The state of affairs of the Group and the Bank as at 31 December 2005 are set out in the balance sheets on pages 40 and 41 respectively.

DIVIDENDS

An interim dividend of HK\$0.18 per share amounting to HK\$78,300,000 was paid to the shareholders during the year. The directors now recommend the payment of a final dividend for the year ended 31 December 2005 of HK\$0.42 per share amounting to HK\$182,700,000 to the shareholders on the Register of Members on 21 April 2006 and the retention of the remaining profit for the year.

SHARE CAPITAL

Details of the Bank's share capital are set out in note 23 to the financial statements. There was no movement in the Bank's share capital during the year.

RESERVES

Movements in the reserves of the Group and the Bank during the year are set out in the consolidated statement of changes in equity on page 42 and note 24 to the financial statements respectively.

INVESTMENT PROPERTIES

The Group's investment properties were revalued at 31 December 2005. The net increase in fair value arising on the revaluation, which has been credited directly to the income statement, amounted to HK\$7,500,000. Details of the investment properties of the Group and the Bank are set out in note 19 to the financial statements.

PROPERTY AND EQUIPMENT

Details of the movements in the property and equipment of the Group and the Bank are set out in note 20 to the financial statements.

SHARE OPTION SCHEME

The Bank's share option scheme (the "Scheme") was adopted pursuant to a resolution passed on 25 April 2002. Particulars of the Scheme are set out in note 26 to the financial statements. No options have been granted under the above-mentioned scheme since the Scheme was adopted.

DIRECTORS' REPORT

DIRECTORS

The directors of the Bank at the date of this report are:

Executive Directors

| | |
|-------------------------------|--|
| Mr LIU Lit Man, GBS, JP, FIBA | <i>(Executive Chairman)</i> |
| Dr LIU Lit Mo, LLD, MBE, JP | <i>(Vice Chairman)</i> |
| Mr LIU Lit Chi | <i>(Managing Director and Chief Executive Officer)</i> |
| Mr Don Tit Shing LIU | <i>(Deputy Chief Executive Officer)</i> |
| Mr Wilfred Chun Ning LIU | |
| Mr LAU Wai Man | |
| Mr Frank Shui Sang JIN | |
| Mr Andrew Chiu Wing TSANG | |
| Mr George Har Kar WONG | |

Non-executive Directors

| |
|-------------------------------|
| Mr Timothy George FRESHWATER |
| Mr Toshiaki ARAI |
| Mr Andrew LIU |
| Mr SUN Jiakang |
| Mr Christopher Kwun Shing LIU |
| Mr Alfred Cheuk Yu CHOW, JP |
| Mr WANG Zhi |

Independent Non-executive Directors

| |
|---|
| Dr Robin Yau Hing CHAN, GBS, LLD, JP, EOE |
| Mr Wanchai CHIRANAKHORN |
| Mr CHENG Yuk Wo |

DIRECTORS - continued

Mr Andrew Chiu Wing Tsang, Mr George Har Kar Wong (both were appointed executive directors on 17 August 2005) and Mr Wang Zhi (who was appointed a non-executive director on 16 November 2005) shall retire and offer themselves for re-election at the forthcoming annual general meeting in accordance with Article 85 of the Bank's Articles of Association.

Article 101 of the Bank's Articles of Association stipulates that, among other things, one-third of the directors for the time being, who have been longest in office since their last election, shall be subject to retirement by rotation and re-election at each annual general meeting. Accordingly, Mr Liu Lit Man, Mr Timothy George Freshwater, Mr Sun Jiakang, Mr Christopher Kwun Shing Liu and Mr Alfred Cheuk Yu Chow shall retire and offer themselves for re-election at the forthcoming annual general meeting.

DIRECTORS' SERVICE CONTRACTS

No director proposed for re-election at the forthcoming annual general meeting has a service contract, which is not determinable by the Bank within one year without payment of compensation, other than statutory compensation.

DIRECTORS' REPORT

DIRECTORS' (INCLUDING THE CHIEF EXECUTIVE OFFICER'S) INTERESTS AND SHORT POSITIONS IN SECURITIES

As at 31 December 2005, the interests and short positions of the directors (including the chief executive officer) in the securities and underlying securities of the Bank and its associated corporations (under Part XV of the Securities and Futures Ordinance (the "SFO")), as recorded in the register required to be kept under Section 352 of the SFO, were as follows:

Interests in securities

| Director's name | Number of ordinary shares in the Bank | | | | Percentage of issued share capital |
|----------------------|---------------------------------------|-------------------|---|-----------------|------------------------------------|
| | Personal interests | Spousal interests | Corporate interests | Total interests | |
| Liu Lit Man | 3,447,928 | — | 239,145,628 <i>Note (1)</i> | 242,593,556 | 55.76863 |
| Liu Lit Mo | 1,009,650 | — | 239,145,628 <i>Note (1)</i> | 240,155,278 | 55.20811 |
| Liu Lit Chi | 313,248 | — | 241,408,839 <i>Notes (1) & (2)</i> | 241,722,087 | 55.56830 |
| Don T S Liu | 15,000 | — | — | 15,000 | 0.00345 |
| Robin Y H Chan | 48,400 | — | 1,018,000 <i>Note (3)</i> | 1,066,400 | 0.24515 |
| Timothy G Freshwater | 396 | — | — | 396 | 0.00009 |
| Andrew Liu | 60,000 | — | — | 60,000 | 0.01379 |

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 Company, Limited ("Liu Chong Hing Estate"), in which each of Messrs Liu Lit Man, Liu Lit Mo and Liu Lit Chi is deemed under the SFO to be interested through Liu's Holdings Limited, a private company holding approximately 45 percent 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, Ltd ("Bank of Tokyo-Mitsubishi"). Pursuant to an agreement in 1994, Bank of Tokyo-Mitsubishi 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 Bank of Tokyo-Mitsubishi 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.
- (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 Y H Chan's directions or instructions.

DIRECTORS' (INCLUDING THE CHIEF EXECUTIVE OFFICER'S) INTERESTS AND SHORT POSITIONS IN SECURITIES - continued

Other interests and short positions in securities

Under the SFO, other than those interests disclosed above, as at 31 December 2005, none of the directors (including the chief executive officer), nor their respective associates, had any other interests (nor any short positions) in any securities (nor in any underlying securities) in the Bank and its associated corporations. Moreover, as at 31 December 2005, none of the directors (including the chief executive officer), nor their respective spouses and children under 18 years of age, had been granted any rights to subscribe for the securities in the Bank and its associated corporations, much less had any such rights exercised.

SUBSTANTIAL SHAREHOLDERS' INTERESTS AND SHORT POSITIONS IN SECURITIES

As at 31 December 2005, the register maintained under Section 336 of the SFO showed that, other than the interests disclosed above in respect of certain directors (including the chief executive officer), the following parties had interests and short positions in the securities and underlying securities in the Bank:

| Name | Capacity | Number of ordinary shares | Percentage of issued share capital |
|---|--------------------------------------|---|--|
| Liu Chong Hing Estate Company, Limited | Beneficial owner | 199,145,628 <i>Notes (1) and (3)</i> | 45.78 |
| Liu Chong Hing Investment Limited | Interest of a controlled corporation | 199,145,628 <i>Notes (1) and (3)</i> | 45.78 |
| Liu's Holdings Limited | Interest of a controlled corporation | 199,145,628 <i>Notes (1) and (3)</i> | 45.78 |
| Bauhinia 97 Ltd | Beneficial owner | 87,000,000 <i>Note (2)</i> | 20.00 |
| COSCO Pacific Limited | Interest of a controlled corporation | 87,000,000 <i>Note (2)</i> | 20.00 |
| COSCO Pacific Investment Holdings Limited | Interest of a controlled corporation | 87,000,000 <i>Note (2)</i> | 20.00 |
| China COSCO Holdings Company Limited | Interest of a controlled corporation | 87,000,000 <i>Note (2)</i> | 20.00 |
| China Ocean Shipping (Group) Company | Interest of a controlled corporation | 87,000,000 <i>Note (2)</i> | 20.00 |
| The Bank of Tokyo-Mitsubishi, Ltd | Beneficial owner | 42,000,000 <i>Note (3)</i> | 9.66 |
| Mitsubishi UFJ Financial Group, Inc (formerly known as "Mitsubishi Tokyo Financial Group, Inc") | Interest of a controlled corporation | 42,000,000 <i>Note (3)</i> | 9.66 |
| Third Avenue Management LLC | Investment manager | 26,241,000 <i>Note (4)</i> | 6.03 |

SUBSTANTIAL SHAREHOLDERS' INTERESTS AND SHORT POSITIONS IN SECURITIES - continued

Notes:

- (1) These interests are the same as those of certain directors (including the chief executive officer) disclosed above under the heading "DIRECTORS' (INCLUDING THE CHIEF EXECUTIVE OFFICER'S) INTERESTS AND SHORT POSITIONS IN SECURITIES" Note (1)(i). Liu Chong Hing Estate Company, Limited ("Liu Chong Hing Estate") is a wholly-owned subsidiary of Liu Chong Hing Investment Limited, a public company listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). Liu's Holdings Limited, a private company, had interest in about 45 percent 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 percent 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 52.18 percent interest in COSCO Pacific Limited ("COSCO Pacific"). Both COSCO Holdings and COSCO Pacific are public companies listed on the 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.
- (3) The Bank of Tokyo-Mitsubishi, Ltd ("Bank of Tokyo-Mitsubishi") 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 Bank of Tokyo-Mitsubishi.

Pursuant to an agreement in 1994, Bank of Tokyo-Mitsubishi 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 Bank of Tokyo-Mitsubishi 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.

Other than those interests and short positions in the securities and underlying securities in the Bank as disclosed above under Section 336 of the SFO, the Bank had not been notified of any other interests and short positions in its securities and underlying securities as at 31 December 2005.

DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE

Other than those interests disclosed above under the heading "CONNECTED TRANSACTIONS", no contracts of significance to which the Bank or any of its subsidiaries was a party and in which a director of the Bank had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

CONNECTED TRANSACTIONS

The connected transactions between the Group, Liu Chong Hing Investment Limited and its subsidiaries ("Liu Chong Hing Investment Group") and COSCO Pacific Limited, its subsidiaries, its holding companies and/or its fellow subsidiaries ("COSCO Group") during the year are as follows:

- A. The Bank handled routine banking transactions for the members of the Liu Chong Hing Investment Group. Services provided by the Bank are cheque clearing, current, savings and deposit accounts, remittances, and other banking facilities.
- B. Members of the Group provided securities and futures brokerage, nominee and data processing services to members of the Liu Chong Hing Investment Group.
- C. Liu Chong Hing Investment Limited through its wholly-owned subsidiary, Liu Chong Hing Property Management and Agency Limited, provided property management, property consultancy and property maintenance services to the Bank.
- D. The Bank leased office premises of the Western Harbour Centre, a property owned by the Liu Chong Hing Investment Group. On the other hand, Liu Chong Hing Investment Limited subleased office premises of the Liu Chong Hing Bank Building from the Bank.
- E. The Bank and its subsidiaries provided banking and related financial services to the COSCO Group including cheque clearing, current and savings accounts and fixed deposits in a number of currencies, foreign exchange, remittances, stockbroking and nominee services. The Bank also provided loan facilities to the COSCO Group on a bilateral basis or through participating in syndicated loans.
- F. In accordance with a conditional Sale and Purchase Agreement dated 3 March 2005 between the Bank and Liu Chong Hing Investment Limited (which then had a beneficial shareholding interest of about 45.46 percent in the Bank), the Bank had agreed to acquire from Liu Chong Hing Investment Limited the entire issued and fully paid-up share capital of its then wholly-owned subsidiary, Chong Hing Insurance Company Limited (then known as "Liu Chong Hing Insurance Company Limited"), for a total cash consideration of HK\$212 million. The purpose of the transaction is to improve the operation efficiency of both the Bank and Liu Chong Hing Investment Limited. Particulars of the transaction, a discloseable and connected transaction for the Bank under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, were published in both the local newspapers on 15 March 2005 and the Bank's circular dated 4 April 2005. The transaction was completed on 27 June 2005 and Chong Hing Insurance Company Limited became a wholly-owned subsidiary of the Bank on that day.

CONNECTED TRANSACTIONS - continued

Messrs Liu Lit Man, Liu Lit Mo, Liu Lit Chi, Don Tit Shing Liu, Robin Yau Hing Chan, Timothy George Freshwater and Andrew Liu are interested, directly or indirectly, in the respective share capitals of Liu Chong Hing Investment Limited and/or the Bank.

The independent non-executive directors confirm that the transaction has been entered into by the Bank in the ordinary course of its business, on normal commercial terms, and in accordance with the terms which are fair and reasonable and in the interests of the shareholders of the Bank as a whole.

Pursuant to Rule of the Rules Governing the Listing Securities on the Stock Exchange of Hong Kong Limited, the board of directors engaged the auditors of the Bank to perform certain agreed upon procedures in respect of the continuing connected transactions of the Group. The auditors have reported their factual findings on these procedures to the board of directors. The independent non-executive directors have reviewed the continuing connected transactions and the report of the auditors and have confirmed that the transactions have been entered into by the Bank in the ordinary course of its business, on normal commercial terms, and in accordance with the terms of the agreement governing such transactions that are fair and reasonable and in the interests of the shareholders of the Bank as a whole.

DECLARATION OF INTERESTS

No directors (other than the independent non-executive directors and Mr Toshiaki Arai, a non-executive director) are interested in any business which may or may not compete, either directly or indirectly, with the business of the Bank.

Mr Toshiaki Arai is the Director, Regional Head for Hong Kong and General Manager of The Bank of Tokyo-Mitsubishi UFJ, Limited, Hong Kong Branch.

ARRANGEMENT TO PURCHASE SHARES OR DEBENTURES

Other than the share option scheme disclosed in note 26 to the financial statements, at no time during the year was the Bank or any of its subsidiaries a party to any arrangements to enable the directors of the Bank to acquire benefits by means of the acquisition of shares in, or debentures of, the Bank or any other body corporate.

PURCHASE, SALE OR REDEMPTION OF THE BANK'S LISTED SECURITIES

Neither the Bank nor any of its subsidiaries purchased, sold or redeemed any of the Bank's listed securities during the year.

DONATIONS

During the year, the Group made charitable and other donations amounting to approximately HK\$910,000 (2004: HK\$1,081,000).

COMPLIANCE WITH THE SUPERVISORY POLICY MANUAL FD-1 “FINANCIAL DISCLOSURE BY LOCALLY INCORPORATED AUTHORISED INSTITUTIONS”

The Bank has fully complied with the Supervisory Policy Manual “Financial Disclosure by Locally Incorporated Authorised Institutions” which was issued by the Hong Kong Monetary Authority.

EMOLUMENT POLICY

The Bank has set up a Remuneration Committee, responsibilities of which include the reviewing and approving the performance-based remuneration packages payable to directors and senior management, if any, by reference to the Bank’s corporate goals and objectives.

SUFFICIENCY OF PUBLIC FLOAT

The Group has maintained a sufficient public float throughout the year ended 31 December 2005.

AUDITORS

Messrs Deloitte Touche Tohmatsu shall retire at the conclusion of the Bank’s forthcoming annual general meeting. Being eligible, they shall offer themselves for re-appointment as the Bank’s auditors at that meeting.

On behalf of the Board

Liu Lit Man

Executive Chairman

10 March 2006

Corporate Governance Practices

The board of directors of the Bank (the “Board”) is well aware that maintaining good corporate governance standards is important to the effective and efficient operation of the Bank. The Board has therefore adopted and implemented various measures to ensure that a high standard of corporate governance practices is maintained. The directors confirm that, for the financial year ended 31 December 2005, the Bank has complied with the Code on Corporate Governance Practices as set out in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “Corporate Governance Code”) except, under the Bank’s Articles of Association, one-third (or, if the quotient resulting from the division of the number of directors by three is not a whole number, the number nearest one-third) of the directors for the time being, who have been longest in office since their last election, shall be subject to retirement by rotation and re-election at each annual general meeting. As between persons who became directors on the same day, those to retire shall (unless they otherwise agree between themselves) be determined by drawing lots. And as to those persons additionally appointed as directors or appointed as directors to fill casual vacancies by the Board, they shall hold office only until the next following annual general meeting and shall then be eligible for re-election (but not to be taken into account in determining the directors or the number of directors who are to retire by rotation) at that annual general meeting. The directors consider the Bank’s practice to be an appropriate alternative to that recommended under A.4.1 and A.4.2 of the Corporate Governance Code in respect of the appointment of non-executive directors for a specific term and the retirement by rotation of directors.

Board and Senior Management Oversight and Risk Management

The Bank, an authorized institution under the Banking Ordinance, is under the supervision of the Hong Kong Monetary Authority. Board and senior management oversight and risk management are key to attaining good standards of corporate governance practices in a banking environment. The Board oversees the Group’s policies, procedures and controls of measuring, monitoring and controlling risks arising from the banking and related financial service businesses. The day-to-day supervision of major functional areas is delegated to various specialised committees comprising directors and senior management members of the Bank. The unaudited supplementary financial information regarding corporate governance, risk management and other financial information disclosed pursuant to the Supervisory Policy Manual FD-1 “Financial Disclosure By Locally Incorporated Authorised Institutions” issued by the Hong Kong Monetary Authority provides a detailed report on the Board and senior management oversight and the risk management process.

Directors’ Securities Transactions

The Bank has adopted a code for securities transactions by directors with terms no less exacting than those set out in the Model Code for Securities Transactions by Directors of Listed Issuers under Appendix 10 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “Model Securities Transactions Code”). After specific enquiry by the Bank, all of the directors confirmed that, for the financial year ended 31 December 2005, they had complied with the required standards as set out in both the Model Securities Transactions Code and the Bank’s own code in question.

CORPORATE GOVERNANCE REPORT

Board of Directors

The Board is composed of the following directors. During the year of 2005, six board meetings were held and the attendance of each director is set out as follows:

| Name of Director | Number of Board Meetings Attended | Attendance Rate |
|--|--|------------------------|
| Executive Directors | | |
| Mr LIU Lit Man, GBS, JP, FIBA <i>(Executive Chairman)</i> | 6 / 6 | 100% |
| Dr LIU Lit Mo, LLD, MBE, JP <i>(Vice Chairman)</i> | 6 / 6 | 100% |
| Mr LIU Lit Chi <i>(Managing Director and Chief Executive Officer)</i> | 6 / 6 | 100% |
| Mr Don Tit Shing LIU <i>(Deputy Chief Executive Officer)</i> | 6 / 6 | 100% |
| Mr Wilfred Chun Ning LIU | 3 / 6 | 50% |
| Mr LAU Wai Man | 6 / 6 | 100% |
| Mr Frank Shui Sang JIN | 6 / 6 | 100% |
| Mr Andrew Chiu Wing TSANG | 2 / 2 | 100% |
| Mr George Har Kar WONG | 2 / 2 | 100% |
| Non-executive Directors | | |
| Mr Timothy George FRESHWATER | 4 / 6 | 66.67% |
| Mr Toshiaki ARAI | 4 / 6 | 66.67% |
| Mr Andrew LIU | 3 / 6 | 50% |
| Mr SUN Jiakang | 6 / 6 | 100% |
| Mr Christopher Kwun Shing LIU | 5 / 6 | 83.33% |
| Mr Alfred Cheuk Yu CHOW, JP | 6 / 6 | 100% |
| Mr WANG Zhi | 0 / 1 | 0% |
| Independent Non-executive Directors | | |
| Dr Robin Yau Hing CHAN, GBS, LLD, JP, EOE | 5 / 6 | 83.33% |
| Mr Wanchai CHIRANAKHORN | 5 / 6 | 83.33% |
| Mr CHENG Yuk Wo | 6 / 6 | 100% |

CORPORATE GOVERNANCE REPORT

The Board, constituted in accordance with the Bank's Articles of Associations for the time being in force, is the ultimate governing body of the Bank responsible for setting the Bank's strategic goals and policies; monitoring management performance against the achievement of such goals and the compliance with such policies; filling senior management positions and reviewing succession plans for such positions; ensuring that a proper system of internal controls exists; and accounting for the Bank's operations.

The day-to-day operations of the Bank are mainly managed by various specialised committees, as well as different divisions and departments reporting to the Managing Director and Chief Executive Officer, while the Board remains ultimately responsible for the Bank's operations and affairs.

Board meetings are usually scheduled a year in advance. At least 7 days' notice of board meetings is normally given to directors. The Executive Chairman sets the agenda for board meetings. The views of the directors, as expressed in the board meetings, on matters brought to their attention are duly minuted. Minutes of every board meeting are circulated to all directors comment before they are confirmed at the next board meeting.

Directors are entitled to have access to board papers and any other related materials, and may seek external professional advice, as they see fit, so as to keep themselves abreast of the latest relevant development of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") and other applicable rules and regulations with an eye to ensuring better compliance and meeting better corporate governance standards.

The Bank has received, from each of the independent non-executive directors an annual confirmation of his independence pursuant to Rule 3.13 of the Listing Rules. The Bank considers all of its independent non-executive directors to be independent.

As to the nomination of candidates for appointment to the Board, instead of having a nomination committee in place, any director is entitled to recommend for the consideration and, if thought fit, approval of the Board suitable candidates who can contribute to the Bank, discharge their responsibilities in the interests of the Bank and its shareholders as a whole, and meet the requirements of The Stock Exchange of Hong Kong Limited and the Hong Kong Monetary Authority for appointment as directors.

Chairman and Chief Executive Officer

Mr Liu Lit Man is the Executive Chairman of the Bank and Mr Liu Lit Chi is its Managing Director and Chief Executive Officer. The roles and responsibilities of the Executive Chairman and the Managing Director and Chief Executive Officer are separate. They are assumed by two different individuals. The Executive Chairman is responsible for the management of the Board, while the Managing Director and Chief Executive Officer is charged with the responsibilities to manage the day-to-day business of the Bank.

Auditors' Remuneration

The remuneration paid and payable to the Group's auditors, Messrs. Deloitte Touche Tohmatsu, for 2005 amounted to:

| | HKD |
|---|-------------------------|
| Audit services | 2,525,000 |
| Tax, information technology and regulatory consulting | 435,694 |
| Corporate finance | <u>380,000</u> |
| Total | <u><u>3,340,694</u></u> |

Remuneration Committee

The Remuneration Committee comprises two independent non-executive directors and one non-executive director appointed by the Board.

The Remuneration Committee reviews and makes recommendations to the Board 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. The terms of reference of the Remuneration Committee sets out its roles.

The Remuneration Committee meets at least twice a year. During the year of 2005, two meetings were held and the attendance of each member is set out as follows:

| Name of Member | Number of Committee Meetings Attended | Attendance Rate |
|--|--|------------------------|
| Mr Wanchai CHIRANAKHORN <i>(Chairman)</i> | 2 / 2 | 100% |
| Mr CHENG Yuk Wo | 2 / 2 | 100% |
| Mr Alfred Cheuk Yu CHOW, JP | 2 / 2 | 100% |

The Remuneration Committee is provided with sufficient resources to discharge its duties and the following is a summary of the work of the Remuneration Committee during 2005:

- (i) discussion and review of the current remuneration policy and structure applicable to the directors and senior management;
- (ii) discussion and review of the directors' fees;
- (iii) discussion and review of the remuneration of the senior management; and
- (iv) discussion and review of benefits in kind, including medical and other protections, club memberships, and the eligibility for the use of Bank-owned motor vehicles, provided to the directors and senior management.

The emolument payable to directors will depend on their respective contractual terms under employment contracts, if any, and as recommended by the Remuneration Committee. Details of the directors' remuneration are set out in note 10 to the financial statements.

Audit Committee

The Audit Committee comprises two independent non-executive directors and one non-executive director who possess the appropriate professional expertise and experience in financial management and business. The Audit Committee is chaired by Mr Cheng Yuk Wo and the other members are Mr Wanchai Chiranakhorn and Mr Alfred Cheuk Yu Chow.

Under its terms of reference, the Audit Committee is required, among other things, to oversee the relationship with the external auditors, to advise the Board on the appointment and retention of the external auditors, to review the external auditors' independence and objectivity, to oversee the relationship with the external auditors, to review the half-yearly and annual reports and accounts, to review the external auditors' management letter, to hold meetings with the Hong Kong Monetary Authority, 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.

CORPORATE GOVERNANCE REPORT

The Audit Committee shall meet at least twice a year. During the year of 2005, the Audit Committee held five meetings and record of individual attendance of members is set out as follows:

| Name of Member | Number of Committee | |
|--------------------------------------|----------------------------|------------------------|
| | Meetings Attended | Attendance Rate |
| Mr CHENG Yuk Wo <i>(Chairman)</i> | 5 / 5 | 100% |
| Mr Wanchai CHIRANAKHORN | 5 / 5 | 100% |
| Mr Alfred Cheuk Yu CHOW, JP | 5 / 5 | 100% |

To discharge its responsibilities, the Audit Committee performed the following major reviews in 2005:

Financial Statements

The Audit Committee met with the external auditors and the executive director in charge of Finance and Treasury Management Division to discuss the accounts for the year ended 31 December 2004 and for the six months ended 30 June 2005. The Audit Committee reviewed and discussed with the external auditors to ensure that the Bank's financial statements had been prepared in accordance with the accounting principles generally accepted in Hong Kong.

Relationship with the External Auditors

The Audit Committee reviewed the independence and objectivity of the external auditors, the scope of audit services and related audit fees payable to the external auditors for the Board's approval. Moreover, the Audit Committee met and discussed with the external auditors on their audit strategy and assessment of the sufficiency of the internal control of the Bank.

Internal Control Review

The Audit Committee also reviewed the internal control issues and the internal audit function of the Bank, covering the annual audit plan, the staffing and resources of Internal Audit Department, the audit findings and recommendations raised in the internal audits undertaken, and the implementation status of related audit recommendations.



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 39 to 110 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

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CONSOLIDATED INCOME STATEMENT

| | <i>Note</i> | 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 |

Approved and authorised for issue by the Board of Directors on 10 March 2006 and signed on its behalf by:

Liu Lit Man, *Executive Chairman*

Liu Lit Mo, *Vice Chairman-Executive Director*

Frank S S Jin, *Executive Director*

Michael K W Yeung, *Company Secretary*

| | <i>Note</i> | 2005 HK\$'000 | 2004 HK\$'000 (restated) |
|---|-------------|-------------------|--------------------------------|
| Assets | | | |
| Cash and short-term funds | 14 | 11,761,605 | 13,606,940 |
| Placements with banks and other financial institutions maturing between one and twelve months | | 2,029,416 | 1,544,695 |
| Trading securities | 15 | – | 234,508 |
| Financial assets at fair value through profit or loss | 15 | 854,205 | – |
| Available-for-sale securities | 15 | 676,491 | – |
| Held-to-maturity securities | 15 | 9,192,906 | 3,388,300 |
| Other securities | 15 | – | 347,141 |
| Certificates of deposit held | 15 | – | 1,309,515 |
| Advances and other accounts | 16 | 24,427,040 | 20,136,354 |
| Investments in subsidiaries | 17 | 792,484 | 580,719 |
| Amounts due from subsidiaries | 17A | 33,305 | 14,546 |
| Interests in jointly controlled entities | 18 | 56,500 | 56,500 |
| Loan to a jointly controlled entity | 18A | 31,000 | 31,000 |
| Investment properties | 19 | 58,860 | 51,360 |
| Property and equipment | 20 | 152,107 | 161,009 |
| Prepaid lease payments for land | 21 | 217,931 | 222,901 |
| Deferred tax assets | 25 | 6,443 | 19,172 |
| Total assets | | <u>50,290,293</u> | <u>41,704,660</u> |
| Liabilities | | | |
| Deposits and balances of banks and other financial institutions | | 2,263,504 | 1,559,633 |
| Deposits from customers | 22 | 41,502,136 | 33,941,350 |
| Amounts due to subsidiaries | | 426,081 | 420,563 |
| Other accounts and accruals | | 247,827 | 179,512 |
| Current tax liabilities | | 31,365 | 9,171 |
| Total liabilities | | <u>44,470,913</u> | <u>36,110,229</u> |
| Shareholders' equity | | | |
| Share capital | 23 | 217,500 | 217,500 |
| Reserves | 24 | 5,601,880 | 5,376,931 |
| Shareholders' funds | | <u>5,819,380</u> | <u>5,594,431</u> |
| Total liabilities and shareholders' equity | | <u>50,290,293</u> | <u>41,704,660</u> |

Approved and authorised for issue by the Board of Directors on 10 March 2006 and signed on its behalf by:

Liu Lit Man, *Executive Chairman*

Liu Lit Mo, *Vice Chairman-Executive Director*

Frank S S Jin, *Executive Director*

Michael K W Yeung, *Company Secretary*

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2005

| | Share capital HK\$'000 | Share premium HK\$'000 | Goodwill HK\$'000 | Investment property revaluation reserve HK\$'000 | Land and buildings revaluation reserve HK\$'000 | Investment revaluation reserve HK\$'000 | General reserve HK\$'000 | Translation reserve HK\$'000 | Regulatory reserve HK\$'000 | Retained profits HK\$'000 | Total 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

| | 2005 HK\$'000 | 2004 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 |

CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 December 2005

| | 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 |

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).

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

(a) Application of Hong Kong Financial Reporting Standards - continued

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:

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

(a) Application of Hong Kong Financial Reporting Standards - continued

Business combinations - continued

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:

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

(a) Application of Hong Kong Financial Reporting Standards - continued

Financial instruments - continued

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.

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

(a) Application of Hong Kong Financial Reporting Standards - continued

Financial instruments - continued

Debt and equity securities - continued

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.

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

(a) Application of Hong Kong Financial Reporting Standards - continued

Financial instruments - continued

Advances to customers - continued

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.

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

(a) Application of Hong Kong Financial Reporting Standards - continued

Financial instruments - continued

Derivatives and hedging - continued

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 (<i>Note 21</i>) | (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 | <u>17,432</u> | <u>10,854</u> |

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 | <u>17,432</u> | <u>10,854</u> |

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

THE GROUP

| | As at 31 December 2004 (originally stated) | | | | As at HK (SIC) 31 December 2004 | | | | As at 1 January 2005 | |
|---|--|-----------------|------------------|----------------|---------------------------------------|------------|---------------|----------|----------------------------|----------|
| | HKAS 16 | HKAS 17 | HK (SIC) INT-21 | 2004 | HKFRS 3 | HKAS 39 | HKAS 40 | 2005 | | |
| | HK\$'000 | 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 | <u>26,436,000</u> | <u>(19,077)</u> | <u>(619,488)</u> | <u>(5,210)</u> | <u>25,792,225</u> | <u>641</u> | <u>96,390</u> | <u>-</u> | <u>25,889,256</u> | - |
| 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 | <u>2,924,128</u> | <u>(19,077)</u> | <u>(619,488)</u> | <u>(5,210)</u> | <u>2,280,353</u> | <u>641</u> | <u>96,390</u> | <u>-</u> | <u>2,377,384</u> | - |

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 HK\$'000 | Adjustments HK\$'000 | As restated 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 | <u>2,718,714</u> | <u>(576,403)</u> | <u>2,142,311</u> |

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

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

THE BANK

| | As at 31 December 2004 (originally stated) | | | | As at 31 December 2004 | | | As at 1 January 2005 |
|---|--|---------------------|--------------------------------|---------------------|------------------------------|----------|-------------------|----------------------------|
| | HKAS 16 HK\$'000 | HKAS 17 HK\$'000 | HK (SIC) INT-21 HK\$'000 | HKAS 39 HK\$'000 | HKAS 40 HK\$'000 | | HK\$'000 | |
| Trading securities | 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 | - | - | 585,061 | - | - | 3,973,361 | |
| Other securities | 347,141 | - | - | (347,141) | - | - | - | |
| Certificates of deposit held | 1,309,515 | - | - | (1,309,515) | - | - | - | |
| Advances and other accounts | 20,136,354 | - | - | 109,649 | - | - | 20,246,003 | |
| Property and equipment | 712,853 | 3,316 | (555,160) | - | - | - | 161,009 | |
| Prepaid lease payments for land | - | - | 222,901 | - | - | - | 222,901 | |
| Other accounts and accruals | (179,512) | - | - | (149) | - | - | (179,661) | |
| Deferred tax (liabilities) assets | (96,815) | (192) | (5,210) | 19,172 | (17,868) | - | 1,304 | |
| Total effects on assets and liabilities | <u>25,852,344</u> | <u>3,124</u> | <u>(5,210)</u> | <u>96,390</u> | <u>-</u> | <u>-</u> | <u>25,735,778</u> | |
| Retained profits | 1,924,145 | 2,171 | 108 | (7,493) | 27,518 | - | 1,984,950 | |
| Investment property revaluation reserve | 32,836 | - | (5,318) | - | (27,518) | - | - | |
| Land and buildings revaluation reserve | 601,340 | 953 | - | - | - | - | 352,922 | |
| Regulatory reserve | - | - | - | 103,883 | - | - | 103,883 | |
| Total effects on equity | <u>2,558,321</u> | <u>3,124</u> | <u>(5,210)</u> | <u>96,390</u> | <u>-</u> | <u>-</u> | <u>2,441,755</u> | |

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 HK\$'000 | Adjustments HK\$'000 | As restated 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 | <u>2,388,712</u> | <u>(145,682)</u> | <u>2,243,030</u> |

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

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.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Goodwill - continued

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.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Interests in jointly controlled entities - continued

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.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

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.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

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.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

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.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

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.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Financial instruments - continued

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.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Financial instruments - continued

Financial assets - continued

Loans and receivables - continued

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.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Financial instruments - continued

Financial assets - continued

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.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Financial instruments - continued

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.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Reposessed assets

Collateral reposessed 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 reposessed 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.

4. CRITICAL ACCOUNTING JUDGEMENT AND KEY SOURCE OF ESTIMATION UNCERTAINTY - continued

(a) Impairment allowances on loans and advances - continued

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.

5. BUSINESS AND GEOGRAPHICAL SEGMENTS - continued

(a) Business segments - continued

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

INCOME STATEMENT

| | Corporate and retail banking HK\$'000 | Treasury and foreign exchange activities HK\$'000 | Other business activities HK\$'000 | Eliminations HK\$'000 | Consolidated 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 (<i>Note</i>) | 333,259 | – | – | (333,259) | – |
| Inter-segment expense (<i>Note</i>) | – | (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 |

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

5. BUSINESS AND GEOGRAPHICAL SEGMENTS - continued**(a) Business segments - continued**

- (i) Segment information about these businesses as at 31 December 2005 is presented below: -
continued

BALANCE SHEET

| | Corporate and retail banking HK\$'000 | Treasury and foreign exchange activities HK\$'000 | Other business activities HK\$'000 | Consolidated 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 | | | | <u>49,973,752</u> |
| Liabilities | | | | |
| Segment liabilities | 42,035,905 | 1,733,891 | 92,061 | 43,861,857 |
| Unallocated corporate liabilities | | | | 278,759 |
| Consolidated total liabilities | | | | <u>44,140,616</u> |

OTHER INFORMATION

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

5. BUSINESS AND GEOGRAPHICAL SEGMENTS - continued

(a) Business segments - continued

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

INCOME STATEMENT

| | Corporate and retail banking HK\$'000 | Treasury and foreign exchange activities HK\$'000 | Other business activities HK\$'000 | Eliminations HK\$'000 | Consolidated 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 | <u>162,662</u> | <u>254,816</u> | <u>125,754</u> | <u>–</u> | <u>543,232</u> |
| Unallocated corporate expenses | | | | | (125,296) |
| Profit from operations | | | | | 417,936 |
| Share of results of jointly controlled entities | | | <u>11,319</u> | | <u>11,319</u> |
| Profit before taxation | | | | | 429,255 |
| Taxation | | | | | <u>(69,398)</u> |
| Profit for the year | | | | | <u>359,857</u> |

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

5. BUSINESS AND GEOGRAPHICAL SEGMENTS - continued**(a) Business segments - continued**

(ii) Segment information about these businesses as at 31 December 2004 is presented below: - continued

BALANCE SHEET

| | Corporate and retail banking HK\$'000 | Treasury and foreign exchange activities HK\$'000 | Other business activities HK\$'000 | Consolidated 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 | | | | <u>41,361,231</u> |
| Liabilities | | | | |
| Segment liabilities | 33,988,496 | 1,522,769 | 99,159 | 35,610,424 |
| Unallocated corporate liabilities | | | | 191,156 |
| Consolidated total liabilities | | | | <u>35,801,580</u> |

OTHER INFORMATION

| | Corporate and retail banking HK\$'000 | Treasury and foreign exchange activities HK\$'000 | Other business activities HK\$'000 | Unallocated HK\$'000 | Consolidated 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.

6. FINANCIAL RISK MANAGEMENT - continued

Strategy in using financial instruments - continued

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.

6. FINANCIAL RISK MANAGEMENT - continued

Credit risk - continued

(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 extend 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.

6. FINANCIAL RISK MANAGEMENT - continued

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 (<i>Note 16</i>) | 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 | <u>35,524,529</u> | <u>9,388,599</u> | <u>132,713</u> | <u>4,927,911</u> | <u>49,973,752</u> |
| 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 | <u>29,919,474</u> | <u>9,251,921</u> | <u>74,005</u> | <u>4,895,216</u> | <u>44,140,616</u> |
| Net on-balance sheet position | <u>5,605,055</u> | <u>136,678</u> | <u>58,708</u> | <u>32,695</u> | <u>5,833,136</u> |
| Off-balance sheet notional position | <u>151,629</u> | <u>(129,072)</u> | <u>(4,004)</u> | <u>(18,553)</u> | <u>–</u> |

6. FINANCIAL RISK MANAGEMENT - continued**Foreign exchange risk - continued****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 (<i>Note 16</i>) | 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 | <u>29,612,889</u> | <u>7,515,680</u> | <u>113,610</u> | <u>4,119,052</u> | <u>41,361,231</u> |
| 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 | <u>24,201,194</u> | <u>7,477,852</u> | <u>45,138</u> | <u>4,077,396</u> | <u>35,801,580</u> |
| Net on-balance sheet position | <u>5,411,695</u> | <u>37,828</u> | <u>68,472</u> | <u>41,656</u> | <u>5,559,651</u> |
| Off-balance sheet notional position | <u>57,235</u> | <u>(25,522)</u> | <u>–</u> | <u>(31,713)</u> | <u>–</u> |

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

6. FINANCIAL RISK MANAGEMENT - continued

Foreign exchange risk - continued

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 (<i>Note 16</i>) | 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 | <u>35,841,071</u> | <u>9,388,600</u> | <u>132,713</u> | <u>4,927,909</u> | <u>50,290,293</u> |
| 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 | <u>30,249,771</u> | <u>9,251,921</u> | <u>74,005</u> | <u>4,895,216</u> | <u>44,470,913</u> |
| Net on-balance sheet position | <u>5,591,300</u> | <u>136,679</u> | <u>58,708</u> | <u>32,693</u> | <u>5,819,380</u> |
| Off-balance sheet notional position | <u>151,629</u> | <u>(129,072)</u> | <u>(4,004)</u> | <u>(18,553)</u> | <u>–</u> |
| 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 (<i>Note 16</i>) | 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 | <u>29,956,318</u> | <u>7,515,680</u> | <u>113,610</u> | <u>4,119,052</u> | <u>41,704,660</u> |
| 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 | <u>24,509,842</u> | <u>7,477,852</u> | <u>45,138</u> | <u>4,077,397</u> | <u>36,110,229</u> |
| Net on-balance sheet position | <u>5,446,476</u> | <u>37,828</u> | <u>68,472</u> | <u>41,655</u> | <u>5,594,431</u> |
| Off-balance sheet notional position | <u>57,235</u> | <u>(25,522)</u> | <u>–</u> | <u>(31,713)</u> | <u>–</u> |

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

6. FINANCIAL RISK MANAGEMENT - continued

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 HK\$'000 | 3 - 12 months HK\$'000 | 1 - 5 years HK\$'000 | Over 5 years HK\$'000 | Non- interest bearing HK\$'000 | Total 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 | | <u>43,313,646</u> | <u>1,769,744</u> | <u>2,575,273</u> | <u>13,235</u> | <u>2,301,854</u> | <u>49,973,752</u> |
| 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 | | <u>39,670,212</u> | <u>1,676,101</u> | <u>267,837</u> | - | <u>2,526,466</u> | <u>44,140,616</u> |
| Total interest sensitivity gap | | <u>3,643,434</u> | <u>93,643</u> | <u>2,307,436</u> | <u>13,235</u> | <u>(224,612)</u> | <u>5,833,136</u> |
| 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 | | <u>36,525,257</u> | <u>1,913,420</u> | <u>756,135</u> | <u>52,081</u> | <u>2,114,338</u> | <u>41,361,231</u> |
| 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 | | <u>31,121,063</u> | <u>1,501,642</u> | <u>73,000</u> | - | <u>3,105,875</u> | <u>35,801,580</u> |
| Total interest sensitivity gap | | <u>5,404,194</u> | <u>411,778</u> | <u>683,135</u> | <u>52,081</u> | <u>(991,537)</u> | <u>5,559,651</u> |

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

6. FINANCIAL RISK MANAGEMENT - continued

Cash flow and fair value interest rate risk - continued

THE BANK

| | Effective interest rate % | Up to 3 months HK\$'000 | 3 - 12 months HK\$'000 | 1 - 5 years HK\$'000 | Over 5 years HK\$'000 | Non- interest bearing HK\$'000 | Total 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 (<i>Note 16</i>) | 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 (<i>Note 16</i>) | 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 |

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

6. FINANCIAL RISK MANAGEMENT - continued

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 HK\$'000 | Repayable within 3 months or less (except on those repayable on demand) HK\$'000 | Repayable after 3 months but within 1 year HK\$'000 | Repayable after 1 year but within 5 years HK\$'000 | Repayable after 5 years HK\$'000 | Undated HK\$'000 | Total HK\$'000 |
|---|------------------------------------|--|--|---|--|---------------------|-------------------|
| As at 31 December 2005 | | | | | | | |
| Assets | | | | | | | |
| Cash and short-term funds | <u>1,140,954</u> | <u>10,319,189</u> | <u>99,501</u> | <u>228,835</u> | <u>10,000</u> | <u>-</u> | <u>11,798,479</u> |
| Placements with banks and other financial institutions | <u>-</u> | <u>2,029,416</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>2,029,416</u> |
| Advances to banks and other financial institutions (Note 16) | <u>-</u> | <u>19,209</u> | <u>38,000</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>57,209</u> |
| Advances to customers (Note 16) | <u>1,615,723</u> | <u>4,635,235</u> | <u>3,254,009</u> | <u>8,116,115</u> | <u>6,087,700</u> | <u>587,862</u> | <u>24,296,644</u> |
| Debt securities included in: | | | | | | | |
| - financial assets at fair value through profit or loss | <u>16,024</u> | <u>164,920</u> | <u>54,286</u> | <u>540,598</u> | <u>78,377</u> | <u>-</u> | <u>854,205</u> |
| - available-for-sale securities | <u>-</u> | <u>-</u> | <u>38,388</u> | <u>144,857</u> | <u>95,151</u> | <u>-</u> | <u>278,396</u> |
| - held-to-maturity securities | <u>-</u> | <u>2,741,346</u> | <u>2,298,402</u> | <u>3,849,468</u> | <u>303,690</u> | <u>-</u> | <u>9,192,906</u> |
| | <u>16,024</u> | <u>2,906,266</u> | <u>2,391,076</u> | <u>4,534,923</u> | <u>477,218</u> | <u>-</u> | <u>10,325,507</u> |
| Liabilities | | | | | | | |
| Deposits and balances of banks and other financial institutions | <u>529,613</u> | <u>1,733,891</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>2,263,504</u> |
| Deposits from customers | <u>8,630,741</u> | <u>31,289,581</u> | <u>1,385,276</u> | <u>200,694</u> | <u>-</u> | <u>-</u> | <u>41,506,292</u> |

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

6. FINANCIAL RISK MANAGEMENT - continued

Liquidity risk - continued

THE GROUP

| | Repayable on demand HK\$'000 | Repayable within 3 months or less (except those repayable on demand) HK\$'000 | Repayable after 3 months but within 1 year HK\$'000 | Repayable after 1 year but within 5 years HK\$'000 | Repayable after 5 years HK\$'000 | Undated HK\$'000 | Total HK\$'000 |
|--|---------------------------------------|---|--|---|--|---------------------|-------------------|
| 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 HK\$'000 | Repayable within 3 months or less (except those repayable on demand) HK\$'000 | Repayable after 3 months but within 1 year HK\$'000 | Repayable after 1 year but within 5 years HK\$'000 | Repayable after 5 years HK\$'000 | Undated HK\$'000 | Total 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 |

6. FINANCIAL RISK MANAGEMENT - continued**Liquidity risk - continued****THE BANK**

| | Repayable on demand HK\$'000 | Repayable within 3 months or less (except those repayable on demand) HK\$'000 | Repayable after 3 months but within 1 year HK\$'000 | Repayable after 1 year 5 years but within HK\$'000 | Repayable after 5 years HK\$'000 | Undated HK\$'000 | Total HK\$'000 |
|---|---------------------------------------|---|--|---|--|---------------------|-------------------|
| As at 31 December 2004 | | | | | | | |
| Assets | | | | | | | |
| Cash and short-term funds | <u>699,807</u> | <u>12,712,567</u> | <u>114,931</u> | <u>69,635</u> | <u>10,000</u> | <u>-</u> | <u>13,606,940</u> |
| Placements with banks and other financial institutions | <u>-</u> | <u>1,544,695</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>1,544,695</u> |
| Advances to banks and other financial institutions (Note 16) | <u>-</u> | <u>20,212</u> | <u>38,000</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>58,212</u> |
| Advances to customers (Note 16) | <u>1,401,718</u> | <u>3,450,174</u> | <u>3,163,023</u> | <u>7,025,143</u> | <u>4,787,196</u> | <u>457,736</u> | <u>20,284,990</u> |
| Debt securities included in: | | | | | | | |
| - trading securities | <u>79,282</u> | <u>123,819</u> | <u>31,407</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>234,508</u> |
| - held-to-maturity securities | <u>-</u> | <u>784,141</u> | <u>553,405</u> | <u>1,880,617</u> | <u>170,137</u> | <u>-</u> | <u>3,388,300</u> |
| | <u>79,282</u> | <u>907,960</u> | <u>584,812</u> | <u>1,880,617</u> | <u>170,137</u> | <u>-</u> | <u>3,622,808</u> |
| Certificates of deposit held | <u>-</u> | <u>250,020</u> | <u>394,927</u> | <u>614,568</u> | <u>50,000</u> | <u>-</u> | <u>1,309,515</u> |
| Liabilities | | | | | | | |
| Deposits and balances of banks and other financial institutions | <u>36,865</u> | <u>1,522,768</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>1,559,633</u> |
| Deposits from customers | <u>11,776,084</u> | <u>20,740,749</u> | <u>1,351,508</u> | <u>73,009</u> | <u>-</u> | <u>-</u> | <u>33,941,350</u> |

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.

6. FINANCIAL RISK MANAGEMENT - continued

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 | <u>9,192,906</u> | <u>3,388,300</u> | <u>9,172,671</u> | <u>3,410,258</u> |

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 HK\$'000 | 2004 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 |
| | <u>1,719,338</u> | <u>990,813</u> |
| Interest expense | | |
| Banks and customers | (966,486) | (341,316) |
| Net interest income | <u>752,852</u> | <u>649,497</u> |

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 HK\$'000 | 2004 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 |
| | <u>217,129</u> | <u>268,053</u> |

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

9. OPERATING EXPENSES

| | 2005 HK\$'000 | 2004 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 |
| | <u>493,129</u> | <u>457,214</u> |

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 | | | |
|---------------------------------|-----------------------------|---------------|-------------------------------------|---------------|-----------------------------|---------------|-------------------------------------|---------------|
| | Salaries and other benefits | | Contribution to retirement benefits | Total | Salaries and other benefits | | Contribution to retirement benefits | Total |
| | Fees | benefits | scheme | | Fees | benefits | scheme | |
| | 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 | 22 | 693 | 46 | 761 | 23 | 792 | 52 | 867 |
| 1.1.2005 - 16.7.2005 | | | | | | | | |
| Andrew Chiu Wing Tsang | 15 | 633 | 47 | 695 | - | - | - | - |
| 17.8.2005 - 31.12.2005 | | | | | | | | |
| George Har Kar Wong | 15 | 707 | 39 | 761 | - | - | - | - |
| 17.8.2005 - 31.12.2005 | | | | | | | | |
| Dominic Bing Hoi Lam | - | - | - | - | 30 | 906 | 90 | 1,026 |
| 1.1.2005 - 10.5.2005 | | | | | | | | |
| Total executive directors | <u>372</u> | <u>22,794</u> | <u>1,335</u> | <u>24,501</u> | <u>373</u> | <u>20,703</u> | <u>1,252</u> | <u>22,328</u> |

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

10. DIRECTORS' AND EMPLOYEES' EMOLUMENTS - continued

| | 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 | <u>326</u> | <u>81</u> | <u>-</u> | <u>407</u> | <u>390</u> | <u>81</u> | <u>-</u> | <u>471</u> |
| 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 | <u>238</u> | <u>-</u> | <u>-</u> | <u>238</u> | <u>180</u> | <u>-</u> | <u>-</u> | <u>180</u> |
| Total | <u>936</u> | <u>22,875</u> | <u>1,335</u> | <u>25,146</u> | <u>943</u> | <u>20,784</u> | <u>1,252</u> | <u>22,979</u> |

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.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

11. TAXATION

| | 2005 HK\$'000 | 2004 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 |
| | <u>75,457</u> | <u>61,273</u> |
| Overseas taxation | <u>727</u> | <u>2,996</u> |
| Deferred tax (Note 25) | <u>(5,366)</u> | <u>5,129</u> |
| | <u><u>70,818</u></u> | <u><u>69,398</u></u> |

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 HK\$'000 | 2004 HK\$'000 (restated) |
|---|----------------------|--------------------------------|
| Profit before taxation | <u>468,801</u> | <u>429,255</u> |
| 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 | <u>284</u> | <u>25</u> |
| Tax charge for the year | <u><u>70,818</u></u> | <u><u>69,398</u></u> |

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 | <u>182,700</u> | <u>174,000</u> |
| | <u>261,000</u> | <u>247,950</u> |

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) | <u>0.04</u> | <u>0.03</u> |
| As reported/restated | <u>0.91</u> | <u>0.83</u> |

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 |
| | <u>11,798,479</u> | <u>13,606,947</u> | <u>11,761,605</u> | <u>13,606,940</u> |

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for the year ended 31 December 2005

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 designated at fair value | Held-to-maturity securities | Available-for-sale securities | Total | Trading | 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.

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for the year ended 31 December 2005

15. INVESTMENTS IN SECURITIES/CERTIFICATES OF DEPOSIT HELD - continued

| | THE GROUP | | | | THE BANK | | | |
|--|--------------------|---------------------|------------------|-----------|--------------------|---------------------|------------------|-----------|
| | Held-to- | | Other securities | Total | Held-to- | | Other securities | Total |
| | Trading securities | maturity securities | | | Trading securities | maturity securities | | |
| | 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 |

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

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 |
| | <u>24,296,644</u> | <u>20,290,219</u> | <u>24,293,670</u> | <u>20,284,990</u> |
| 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) |
| | <u>24,306,296</u> | <u>20,027,921</u> | <u>24,303,029</u> | <u>20,022,743</u> |
| Advances to banks and other financial institutions | 57,209 | 58,212 | 57,209 | 58,212 |
| | <u>24,363,505</u> | <u>20,086,133</u> | <u>24,360,238</u> | <u>20,080,955</u> |
| Other accounts | 144,556 | 159,901 | 66,802 | 55,399 |
| | <u>24,508,061</u> | <u>20,246,034</u> | <u>24,427,040</u> | <u>20,136,354</u> |

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.

16. ADVANCES AND OTHER ACCOUNTS - continued

Impairment allowances on advances:

| | THE GROUP | | | | | THE BANK | | | | |
|---------------------------------------|------------|------------|------------|-----------|-----------|------------|------------|------------|-----------|-----------|
| | Individual | Collective | Total | Suspended | Total | Individual | Collective | Total | Suspended | Total |
| | assessment | assessment | assessment | interest | | assessment | assessment | assessment | interest | |
| 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 | Specific | General | Total | Suspended |
| | | | | interest | | | | 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.

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for the year ended 31 December 2005

16. ADVANCES AND OTHER ACCOUNTS - continued

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 | <u>588,148</u> | <u>695,838</u> | <u>588,148</u> | <u>695,838</u> |
| Gross impaired/non-performing loans as a percentage of gross advances to customers | <u>2.65%</u> | <u>3.90%</u> | <u>2.65%</u> | <u>3.90%</u> |
| Market value of collateral pledged | <u>617,345</u> | <u>704,626</u> | <u>617,345</u> | <u>704,626</u> |
| Interest in suspense | <u>–</u> | <u>45,931</u> | <u>–</u> | <u>45,931</u> |

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 |
| | <u>774</u> | <u>1,922</u> | <u>704</u> | <u>1,744</u> |
| Less: Unearned finance income | (70) | (178) | – | – |
| Present value of minimum lease payments receivable | <u>704</u> | <u>1,744</u> | <u>704</u> | <u>1,744</u> |
| Analysed as: | | | | |
| Non-current finance lease receivables (recoverable after 12 months) | | | 377 | 1,023 |
| Current finance lease receivables (recoverable within 12 months) | | | 327 | 721 |
| | | | <u>704</u> | <u>1,744</u> |

17. INVESTMENTS IN SUBSIDIARIES

| | | |
|--------------------------|-----------------------|-----------------------|
| | 2005 | 2004 |
| | HK\$'000 | HK\$'000 |
| Unlisted shares, at cost | <u>792,484</u> | <u>580,719</u> |

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 lending |
| Liu Chong Hing Data Processing Limited | Hong Kong | HK\$100,000 | 100% | Provision of electronic data processing services |
| 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 | <u>33,305</u> | <u>14,546</u> |

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 | <u>65,710</u> | <u>37,875</u> | – | – |
| | <u>65,710</u> | <u>37,875</u> | <u>56,500</u> | <u>56,500</u> |

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 | <u>31,000</u> | <u>31,000</u> | <u>31,000</u> | <u>31,000</u> |

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 | <u>76,860</u> | <u>69,360</u> | <u>58,860</u> | <u>51,360</u> |

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 | – | – |
| | <u>76,860</u> | <u>69,360</u> | <u>58,860</u> | <u>51,360</u> |

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for the year ended 31 December 2005

20. PROPERTY AND EQUIPMENT

| | THE GROUP | | | | THE BANK | | |
|--|-----------|-----------|--------------|-------------|-----------|-----------|-----------|
| | Buildings | Equipment | Construction | | Buildings | Equipment | Total |
| | | | in progress | 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 |

20. PROPERTY AND EQUIPMENT - continued

| | THE GROUP | | | | THE BANK | | |
|--|---------------|----------------|---------------|----------------|---------------|----------------|----------------|
| | Buildings | Equipment | Construction | | Buildings | Equipment | Total |
| | | | in progress | 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 | <u>79,771</u> | <u>295,284</u> | <u>21,444</u> | <u>396,499</u> | <u>79,771</u> | <u>266,052</u> | <u>345,823</u> |
| 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 | <u>17,925</u> | <u>188,569</u> | <u>-</u> | <u>206,494</u> | <u>17,925</u> | <u>166,889</u> | <u>184,814</u> |
| NET BOOK VALUE | | | | | | | |
| At 31 December 2004 | <u>61,846</u> | <u>106,715</u> | <u>21,444</u> | <u>190,005</u> | <u>61,846</u> | <u>99,163</u> | <u>161,009</u> |

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).

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for the year ended 31 December 2005

20. PROPERTY AND EQUIPMENT - continued

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 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| | | (restated) | | (restated) | | (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 |
| | <u>61,013</u> | <u>61,846</u> | <u>40,454</u> | <u>21,444</u> | <u>61,013</u> | <u>61,846</u> |

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 |
| | <u>300,969</u> | <u>306,039</u> | <u>217,931</u> | <u>222,901</u> |

21. PREPAID LEASE PAYMENTS FOR LAND - continued

The Group's prepaid lease payments comprise: - continued

| | 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) |
| | <u>300,969</u> | <u>306,039</u> | <u>217,931</u> | <u>222,901</u> |
| Analysed as: | | | | |
| Current portion | 5,063 | 5,063 | 4,963 | 4,963 |
| Non-current portion | 295,906 | 300,976 | 212,968 | 217,938 |
| Total | <u>300,969</u> | <u>306,039</u> | <u>217,931</u> | <u>222,901</u> |

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 |
| | <u>41,506,292</u> | <u>33,951,631</u> | <u>41,502,136</u> | <u>33,941,350</u> |

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 | <u>300,000</u> |
| Issued and fully paid: | |
| 435,000,000 shares of HK\$0.50 each | <u>217,500</u> |

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

24. RESERVES

| | Share premium HK\$'000 | Investment property revaluation reserve HK\$'000 | Land and buildings revaluation reserve HK\$'000 | Investment revaluation reserve HK\$'000 | General reserve HK\$'000 | Translation reserve HK\$'000 | Regulatory reserve HK\$'000 | Retained profits HK\$'000 | Total 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.

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for the year ended 31 December 2005

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 HK\$'000 | Revaluation of properties HK\$'000 | Collectively assessed impairment allowance/ General provisions for bad and doubtful debts HK\$'000 | Investment properties HK\$'000 | Others HK\$'000 | Total 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) | <u>(2,622)</u> | <u>(127,826)</u> | - | 5,318 | - | <u>(125,130)</u> |
| As restated | 8,624 | - | (32,893) | 5,318 | - | (18,951) |
| Effect of initial application of HKAS 39 | - | - | 17,868 | - | - | 17,868 |
| | <u>8,624</u> | <u>-</u> | <u>(15,025)</u> | <u>5,318</u> | <u>-</u> | <u>(1,083)</u> |
| Charge (credit) to income statement for the year (Note 11) | 729 | - | (7,408) | 1,313 | - | (5,366) |
| At 31 December 2005 | <u>9,353</u> | <u>-</u> | <u>(22,433)</u> | <u>6,631</u> | <u>-</u> | <u>(6,449)</u> |
| 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) | <u>(984)</u> | <u>(113,731)</u> | - | 4,707 | - | <u>(110,008)</u> |
| 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 | <u>8,624</u> | <u>-</u> | <u>(32,893)</u> | <u>5,318</u> | <u>-</u> | <u>(18,951)</u> |
| 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) | <u>(2,622)</u> | <u>(118,683)</u> | - | 5,318 | - | <u>(115,987)</u> |
| As restated | 8,392 | - | (32,882) | 5,318 | - | (19,172) |
| Effect of initial application of HKAS 39 | - | - | 17,868 | - | - | 17,868 |
| | <u>8,392</u> | <u>-</u> | <u>(15,014)</u> | <u>5,318</u> | <u>-</u> | <u>(1,304)</u> |
| Charge (credit) to income statement for the year | 961 | - | (7,413) | 1,313 | - | (5,139) |
| At 31 December 2005 | <u>9,353</u> | <u>-</u> | <u>(22,427)</u> | <u>6,631</u> | <u>-</u> | <u>(6,443)</u> |
| 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) | <u>(984)</u> | <u>(104,588)</u> | - | 4,707 | - | <u>(100,865)</u> |
| 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 | <u>8,392</u> | <u>-</u> | <u>(32,882)</u> | <u>5,318</u> | <u>-</u> | <u>(19,172)</u> |

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 | <u>100,383</u> | <u>118,514</u> |
| Maximum aggregate balance of relevant loans during the year | <u>135,511</u> | <u>287,579</u> |

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 HK\$'000 | Fair value adjustments HK\$'000 | 2005 Fair value 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) |
| | | | <u>102,763</u> |
| Goodwill arising from acquisition | | | <u>110,606</u> |
| Total consideration | | | <u>213,369</u> |
| 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 | | | <u>122,959</u> |

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.

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28. ACQUISITION OF A SUBSIDIARY - continued

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) |
| | <u>1,106</u> |
| Negative goodwill arising on acquisition | (641) |
| | <u>465</u> |
| Shareholder's loan | 7,500 |
| Total consideration | <u>7,965</u> |
| Satisfied by: | |
| Cash | <u>7,965</u> |
| 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 | <u>(422)</u> |

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) |
| | <u>2,782</u> |
| Loss on liquidation | (4) |
| Cash received on liquidation | <u>2,778</u> |
| NET CASH OUTFLOW ARISING ON LIQUIDATION | |
| Cash and short-term fund disposed | (2,824) |
| Cash received on liquidation | <u>2,778</u> |
| Cash outflow on liquidation | <u>(46)</u> |

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 |
| | <u>9,609,728</u> | <u>8,531,840</u> | <u>9,608,915</u> | <u>8,530,770</u> |
| 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 |
| | <u>48,080</u> | <u>79,481</u> | <u>47,267</u> | <u>78,411</u> |

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 |
| | <u>369,588</u> | <u>50,291</u> | <u>369,588</u> | <u>50,291</u> |

31. CONTINGENT LIABILITIES AND COMMITMENTS - continued

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 | |
| | Replacement cost HK\$'000 | Credit risk weighted amount HK\$'000 | Replacement cost HK\$'000 | Credit risk weighted amount HK\$'000 | Replacement cost HK\$'000 | Credit risk weighted amount HK\$'000 | Replacement cost HK\$'000 | Credit risk weighted amount 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 |
| | <u>46,058</u> | <u>2,838,693</u> | <u>9,987</u> | <u>2,278,323</u> | <u>46,058</u> | <u>2,838,693</u> | <u>9,987</u> | <u>2,278,323</u> |

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 HK\$'000 | 2004 HK\$'000 |
| Within one year | 500 | 1,821 |
| In the second to fifth years inclusive | — | 524 |
| | <u>500</u> | <u>2,345</u> |

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.

32. RETIREMENT BENEFITS SCHEME - continued

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\$ 178,893,000) 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 HK\$'000 | 2004 HK\$'000 | 2005 HK\$'000 | 2004 HK\$'000 | 2005 HK\$'000 | 2004 HK\$'000 |
| Investing enterprises having significant influence on the Bank and their subsidiaries | <u>212,000</u> | <u>-</u> | <u>7,899</u> | <u>7,062</u> | <u>13,915</u> | <u>11,851</u> |
| Associate and jointly controlled entities | <u>-</u> | <u>-</u> | <u>6,555</u> | <u>13,720</u> | <u>8,423</u> | <u>6,019</u> |
| Directors and their associates | <u>-</u> | <u>-</u> | <u>36,127</u> | <u>17,659</u> | <u>14,172</u> | <u>3,629</u> |

The above transactions were carried out at market rates.

34. RELATED PARTY TRANSACTIONS - continued

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 HK\$'000 | 2004 HK\$'000 | 2005 HK\$'000 | 2004 HK\$'000 |
| Investing enterprises having significant influence on the Bank and subsidiaries | <u>139,478</u> | <u>225,503</u> | <u>318,089</u> | <u>86,297</u> |
| Jointly controlled entities | <u>31,000</u> | <u>31,000</u> | <u>188,594</u> | <u>217,284</u> |
| Directors and their associates | <u>1,255,108</u> | <u>1,049,225</u> | <u>537,559</u> | <u>602,839</u> |

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 HK\$'000 | 2004 HK\$'000 | 2005 HK\$'000 | 2004 HK\$'000 |
| Subsidiaries | <u>479</u> | <u>850</u> | <u>15,928</u> | <u>6,036</u> |

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 HK\$'000 | 2004 HK\$'000 | 2005 HK\$'000 | 2004 HK\$'000 |
| Subsidiaries | <u>33,305</u> | <u>14,546</u> | <u>426,081</u> | <u>420,563</u> |

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 HK\$'000 | 2004 HK\$'000 |
| Short-term benefits | <u>40,636</u> | <u>40,567</u> |

The remuneration of directors and key management is reviewed by Remuneration Committee having regarding to the performance of individuals and market trends.

The unaudited supplementary financial information regarding corporate governance, risk management and other financial information disclosed pursuant to the Supervisory Policy Manual FD-1 “Financial Disclosure By Locally Incorporated Authorised Institutions” issued by the Hong Kong Monetary Authority is as follows:

1. SPECIALISED COMMITTEES

The Board of Directors of the Bank (the “Board”) is constituted in accordance with the Bank’s Articles of Association and is the ultimate governing body. In order to ensure that matters arising between meetings of the Board are handled properly and timely, the Board delegates the day-to-day supervision of major functional areas to the following specialised committees. These committees are established with clearly defined objectives, authorities, responsibilities and tenure. Written terms of reference are approved by the Board and are up-dated appropriately.

(i) Executive Committee

The Executive Committee comprises all executive directors of the Bank.

It is authorised by the Board to exercise all such powers and do all such acts as may be exercised, done or approved by Board, thus relieving the full Board of detailed review of information and operational activities. The Executive Committee steers the Group’s policy and operational decisions on a day-to-day basis, and attends to matters that require the review and supervision of the Board between regular board meetings. Moreover, it also coordinates the work of other committees as it sees fit.

(ii) Executive Management Committee

Members of the Executive Management Committee, comprising the Managing Director and Chief Executive Officer and certain other executive directors and division heads, are responsible for managing the day-to-day business and the affairs of the Bank group. The Executive Management Committee holds regular meetings twice a week to discuss and formulate operation and management policies, discuss significant daily operational issues, review key business performance, and discuss business opportunities arising from changing market and competitive conditions. In performing its functions, the Executive Management Committee shall act in accordance with the directions and requirements as may from time to time be stipulated by the Board.

(iii) Executive Loans Committee

The Executive Loans Committee comprises all executive directors of the Bank.

The Executive Loans Committee is established to guide and review the operations of, and to delegate proper authorities as it deems appropriate from time to time to the Loans Committee. It also approves large and certain specific new loan applications and applications for renewal and amendment of existing loans, having due regard to the Group’s Lending Policy and the relevant laws and regulations.

1. SPECIALISED COMMITTEES - continued

(iv) Loans Committee

Members of the Loans Committee are appointed by the Board. It comprises senior staff members of the Bank including the executive directors in charge of the Credit Control Division.

The Loans Committee ensures that the Group's Lending Policy is adequate, and issues guidelines from time to time to guide lending activities of the Group. It also directs the Credit Risk Management Department to monitor loans portfolio quality through identifying problems early and taking timely corrective actions such as implementing debt-restructuring schemes and maintaining adequate provisions for loan losses. The Loans Committee members meet regularly to evaluate loan applications and make credit decisions. The monitoring of compliance with statutory lending limits, the assessment and approval of new loan products, the attending to instructions of the Executive Loans Committee are other key functions of the Loans Committee.

(v) The Asset and Liability Management Committee (the "ALCO")

Members of the ALCO are appointed by the Board. It comprises the senior staff members representing major divisions of the Bank.

The ALCO is established to facilitate the oversight of the Board 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. The assessment of 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 also come under other key functions of the ALCO.

(vi) The Risk Management and Compliance Committee (the "RMCC")

Members of the RMCC are appointed by the Board. It comprises senior staff members who are responsible for risk management, compliance issues and operations of the Bank.

The RMCC is established to facilitate the oversight of the Board concerning risk management and compliance issues of the Bank. The RMCC discharges its responsibilities 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. The RMCC also takes charge of coordinating and monitoring the implementation of the recommendations made by the regulators. Regular reports as prepared by the RMCC are submitted to the Board.

1. SPECIALISED COMMITTEES - continued

Details concerning composition and functions of Audit Committee and Remuneration Committee are set out in Corporate Governance Report.

In the opinion of the directors, the Bank has fully complied with the Supervisory Policy Manual CG-1 “Corporate Governance of Locally Incorporated Authorised Institutions” which was issued by the Hong Kong Monetary Authority.

2. RISK MANAGEMENT

The Group has established policies, procedures, and controls for measuring, monitoring and controlling risks arising from the banking and related financial services business. These policies, procedures, and controls are implemented by various committees and departments of the Group and are regularly reviewed by the Board. The internal auditors also play an important role in the risk management process by performing regular, as well as sporadic compliance audits.

The management of assets and liabilities of the Group is conducted under the guidance of the ALCO. The ALCO holds weekly meetings, and more frequent meetings when required, to review and direct the relevant policies, and to monitor the bank-wide positions. The day-to-day management of the liquidity risk, foreign exchange, interest rate and other market risks, and the compliance with the ALCO and RMCC policies are monitored by the Treasury Management and the Finance Departments with the assistance of various qualitative and quantitative analyses.

In addition to complementing the ALCO in the management of assets and liabilities, the RMCC also oversees the implementation of the policies and procedures established for managing the Group’s operational, legal, and reputation risks and compliance requirements.

(i) Capital management

The Group has adopted a policy of maintaining a strong capital base to support its business growth. Capital adequacy ratio has remained well above the statutory minimum ratio of 8% for the past five financial years.

2. RISK MANAGEMENT - continued

(ii) Operational and legal risk

Operational risk is the risk of unexpected losses attributable to human error, systems failures, fraud, or inadequate internal controls and procedures.

Executive directors, department heads, in-house legal counsels, and internal auditors collaborate to manage operational and legal risks through proper human resources policies, delegation of authorities, segregation of duties, and timely and accurate management information. Senior management and the Audit Committee are accountable to the Board for maintaining a strong and disciplined control environment to provide reasonable assurance that the operational and legal risks are prudently managed.

A comprehensive contingency plan is available to ensure that key business functions continue and normal operations are restored effectively and efficiently in the event of business interruption.

(iii) Reputation risk

Reputation risk is the risk to earnings or capital arising from negative public opinion.

Reputation risk is managed by ensuring proper and adequate communications and public relation efforts to foster the reputation of the Group. A risk management mechanism guided by the senior management including executive directors and senior managers has been established to manage the media exposure, handle customers' and other relevant parties' complaints and suggestions, and to ensure that new business activities and agents acting on our behalf do not jeopardise our reputation.

Details of the Group's credit risk, liquidity risk, market risk, foreign exchange risk, and interest rate risk management policies and measures are set out in Note 6 of notes to the financial statements.

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

3. SEGMENTAL INFORMATION

The Group's information concerning geographical analysis has been classified by the location of the principal operations of the branches and subsidiary companies responsible for reporting the results or booking the assets.

| | 2005 | | | | |
|---------------------------------------|--|--|--------------------------------------|---|--|
| | Total operating income HK\$'000 | Profit before taxation HK\$'000 | Total assets HK\$'000 | Total liabilities HK\$'000 | Total contingent liabilities and commitments HK\$'000 |
| Hong Kong | 921,944 | 448,116 | 46,976,330 | 41,530,478 | 9,515,592 |
| Asia Pacific (excluding Hong Kong) | 16,494 | 19,035 | 2,304,042 | 1,989,216 | 45,648 |
| America | 31,543 | 1,650 | 693,380 | 620,922 | 48,488 |
| Total | <u>969,981</u> | <u>468,801</u> | <u>49,973,752</u> | <u>44,140,616</u> | <u>9,609,728</u> |

| | 2004 | | | | |
|---------------------------------------|--|--|--------------------------------------|---|--|
| | Total operating income HK\$'000 | Profit before taxation HK\$'000 | Total assets HK\$'000 | Total liabilities HK\$'000 | Total contingent liabilities and commitments HK\$'000 |
| Hong Kong | 883,083 | 413,009 | 39,393,687 | 34,198,063 | 8,328,022 |
| Asia Pacific (excluding Hong Kong) | 13,103 | 11,051 | 1,353,052 | 1,055,994 | 43,712 |
| America | 21,364 | 5,195 | 614,492 | 547,523 | 160,106 |
| Total | <u>917,550</u> | <u>429,255</u> | <u>41,361,231</u> | <u>35,801,580</u> | <u>8,531,840</u> |

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

for the year ended 31 December 2005

4. ADVANCES TO CUSTOMERS - BY INDUSTRY SECTORS

The Group's gross advances to customers (including advances booked in overseas branches and subsidiaries) are analysed and reported by industry sectors according to the usage of the loans and/or the business activities of the borrowers as follows:

| | 2005 HK\$'000 | 2004 HK\$'000 |
|---|-------------------|-------------------|
| Loans for use in Hong Kong | | |
| Industrial, commercial and financial | | |
| - Property development | 1,609,344 | 1,908,862 |
| - Property investment | 5,853,131 | 4,535,567 |
| - Financial concerns | 1,229,845 | 1,710,024 |
| - Stockbrokers | 321,693 | 332,380 |
| - Wholesale and retail trade | 569,231 | 703,129 |
| - Manufacturing | 839,950 | 1,028,883 |
| - Transport and transport equipment | 210,865 | 188,054 |
| - Others | 4,461,475 | 2,901,625 |
| Individuals | | |
| - Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme | 790,925 | 902,046 |
| - Loans for the purchase of other residential properties | 3,403,990 | 2,547,051 |
| - Credit card advances | 125,134 | 75,928 |
| - Others | 1,222,148 | 1,039,947 |
| | <u>20,637,731</u> | <u>17,873,496</u> |
| Trade finance | 653,624 | 521,789 |
| Loans for use outside Hong Kong | 3,005,289 | 1,894,934 |
| | <u>24,296,644</u> | <u>20,290,219</u> |

5. ADVANCES TO CUSTOMERS - BY GEOGRAPHICAL AREAS

The Group's gross advances to customers by countries or geographical areas after taking into account any risk transfers are as follows:

| | Total advances | | Advances overdue for over three months | |
|-------------------------------|-------------------|-------------------|--|------------------|
| | 2005 HK\$'000 | 2004 HK\$'000 | 2005 HK\$'000 | 2004 HK\$'000 |
| Hong Kong | 21,712,908 | 18,770,951 | 510,679 | 795,319 |
| People's Republic of China | 346,814 | 299,049 | 165,146 | 17,299 |
| Macau | 1,131,352 | 256,263 | - | - |
| America | 554,673 | 469,864 | - | - |
| Others | 550,897 | 494,092 | - | - |
| Total | <u>24,296,644</u> | <u>20,290,219</u> | <u>675,825</u> | <u>812,618</u> |

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

for the year ended 31 December 2005

6. CROSS-BORDER CLAIMS

The Group's cross-border claims by countries or geographical areas which constitutes 10% or more of the relevant disclosure item after taking into account any risk transfers are as follows:

| | 2005 | | | |
|----------------------------------|---|--|--------------------|-------------------|
| | Banks and other financial institutions HK\$'000 | Public sector entities HK\$'000 | Others HK\$'000 | Total HK\$'000 |
| Asia Pacific excluding Hong Kong | 6,544,341 | 63,428 | 1,188,122 | 7,795,891 |
| - of which - Australia | 3,053,656 | 1,077 | 102,101 | 3,156,834 |
| North and South America | 1,490,869 | 16,235 | 991,315 | 2,498,419 |
| Europe | 11,244,111 | 2,259 | 383,957 | 11,630,327 |
| - of which - United Kingdom | 2,696,447 | 1,099 | 356,529 | 3,054,075 |
| - of which - Germany | <u>3,666,446</u> | <u>999</u> | <u>8,603</u> | <u>3,676,048</u> |
| | 2004 | | | |
| | Banks and other financial institutions HK\$'000 | Public sector entities HK\$'000 | Others HK\$'000 | Total HK\$'000 |
| Asia Pacific excluding Hong Kong | 6,337,848 | 93,933 | 627,242 | 7,059,023 |
| North and South America | 1,193,244 | 35,455 | 834,073 | 2,062,772 |
| Europe | 8,847,098 | 3,989 | 200,370 | 9,051,457 |
| - of which - United Kingdom | <u>2,107,986</u> | <u>1,585</u> | <u>184,909</u> | <u>2,294,480</u> |

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

for the year ended 31 December 2005

7. CURRENCY RISK

The Group's foreign currency exposures arising from non-trading and structural position which constitute 10% or more of the total net position in all foreign currencies are as follows:

| | 2005 | | | Total |
|---------------------------------|---------------|---------------|--------------|---------------|
| | US\$ | MOP | RMB | |
| Equivalent in thousands of HK\$ | | | | |
| Spot assets | 10,218,181 | 84,168 | 302,187 | 10,604,536 |
| Spot liabilities | (10,120,222) | (74,005) | (294,232) | (10,488,459) |
| Forward purchases | 72,533 | – | – | 72,533 |
| Forward sales | (156,901) | (4,004) | – | (160,905) |
| Net long position | <u>13,591</u> | <u>6,159</u> | <u>7,955</u> | <u>27,705</u> |
| | | | | MOP |
| Net structural position | | | | <u>48,545</u> |
| | | | | |
| | 2004 | | | Total |
| | US\$ | MOP | RMB | |
| Equivalent in thousands of HK\$ | | | | |
| Spot assets | 8,052,649 | 65,664 | 218,096 | 8,336,409 |
| Spot liabilities | (8,064,146) | (46,720) | (212,232) | (8,323,098) |
| Forward purchases | 112,120 | – | 566 | 112,686 |
| Forward sales | (89,653) | – | – | (89,653) |
| Net long position | <u>10,970</u> | <u>18,944</u> | <u>6,430</u> | <u>36,344</u> |
| | | | | MOP |
| Net structural position | | | | <u>48,545</u> |

8. OVERDUE AND RESCHEDULED ASSETS

| | 2005 | |
|--------------------------------------|--|------------------------------------|
| | Gross amount of advances HK\$'000 | Percentage to total advances |
| Advances overdue for | | |
| - 6 months or less but over 3 months | 62,520 | 0.3 |
| - 1 year or less but over 6 months | 24,381 | 0.1 |
| - over 1 year | 588,924 | 2.4 |
| Total overdue advances | <u>675,825</u> | <u>2.8</u> |
| Rescheduled advances | <u>300,473</u> | <u>1.2</u> |
| | | |
| | 2004 | |
| | Gross amount of advances HK\$'000 | Percentage to total advances |
| Advances overdue for | | |
| - 6 months or less but over 3 months | 19,391 | 0.1 |
| - 1 year or less but over 6 months | 52,108 | 0.3 |
| - over 1 year | 741,119 | 3.6 |
| Total overdue advances | <u>812,618</u> | <u>4.0</u> |
| Rescheduled advances | <u>438,149</u> | <u>2.2</u> |

The value of the security of the above overdue advances is analysed as follows:

| | 2005 HK\$'000 | 2004 HK\$'000 |
|--------------------------|------------------|------------------|
| Total overdue advances | <u>675,825</u> | <u>812,618</u> |
| Secured amount | 655,448 | 727,534 |
| Unsecured amount | 20,377 | 85,084 |
| | <u>675,825</u> | <u>812,618</u> |
| Market value of security | <u>977,315</u> | <u>845,862</u> |

The loan borrowers are predominantly located in Hong Kong.

There were no advances to banks and other financial institutions or other assets which were overdue for over 3 months as at 31 December 2005 and 31 December 2004, nor were there any rescheduled advances to banks and other financial institutions.

Repossessed assets held by the Group as at 31 December 2005 amounted to HK\$146,822,000 (2004: HK\$141,850,000).

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

for the year ended 31 December 2005

9. CAPITAL ADEQUACY AND LIQUIDITY RATIO

| | 2005 % | 2004 % (Restated) |
|---------------------------------------|--------------|-------------------------|
| Capital adequacy ratio at 31 December | | |
| - Unadjusted | <u>15.20</u> | <u>18.84</u> |
| - Adjusted | <u>15.19</u> | <u>18.81</u> |
| Average liquidity ratio for the year | <u>49.13</u> | <u>52.34</u> |

The capital adequacy ratio is calculated as the ratio, expressed as a percentage, of the capital base to the risk assets, as specified in the Third Schedule of the Banking Ordinance, with reference to the financial information of the Bank, Liu Chong Hing Finance Limited, Liu Chong Hing Banking Corporation, Cayman, Right Way Investments Limited, and Gallbraith Limited.

The adjusted capital adequacy ratio which takes into account of market risks as at the balance sheet date is calculated on the same basis as the unadjusted capital adequacy ratio and in accordance with the Guideline "Maintenance of Adequate Capital Against Market Risks" issued by the Hong Kong Monetary Authority.

The average liquidity ratio is calculated as the ratio, expressed as a percentage, of the average of each calendar month's average ratio, as specified in the Fourth Schedule of the Banking Ordinance, with reference to the financial information of the Bank, Liu Chong Hing Finance Limited, Liu Chong Hing Banking Corporation, Cayman, Right Way Investments Limited, and Gallbraith Limited.

10. OTHER FINANCIAL INFORMATION

The components of the total capital base after deductions as reported under Part I of the Capital Adequacy Return are as follows:

| | 2005 HK\$'000 | 2004 HK\$'000 (Restated) |
|--|------------------|--------------------------------|
| Core capital | | |
| Paid up ordinary share capital | 217,500 | 217,500 |
| Share premium account | 1,542,817 | 1,542,817 |
| Reserves (eligible for inclusion in core capital) | <u>3,266,501</u> | <u>3,214,131</u> |
| | 5,026,818 | 4,974,448 |
| Eligible supplemental capital | | |
| Reserves on revaluation of land and interests in land | 24,722 | 19,263 |
| Reserves on revaluation of holding of securities not held for trading purposes | 40,646 | 27,771 |
| General provision for doubtful debts | – | 201,873 |
| Impairment allowance under collective assessment and regulatory reserve | <u>254,770</u> | – |
| Total capital base before deductions | 5,346,956 | 5,223,355 |
| Deductions from total capital base | <u>(493,223)</u> | <u>(281,833)</u> |
| Total capital base after deductions | <u>4,853,733</u> | <u>4,941,522</u> |

HEAD OFFICE, BRANCHES, SUBSIDIARIES AND AFFILIATES

as at 10 March 2006

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|----------------------------------|--|------------------|
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| Causeway Bay | 488 Jaffe Road | 2893 6225 |
| Centre Street | 234 Des Voeux Road West | 2548 3954 |
| Happy Valley | 1-9 Yuk Sau Street | 2575 3201 |
| North Point | 376 King's Road | 2570 0585 |
| Sai Ying Pun | 81-85 Des Voeux Road West | 2547 6513 |
| Shau Kei Wan | 203-205 Shau Kei Wan Road | 2560 6277 |
| Sheung Wan | 163 Wing Lok Street | 2543 0653 |
| Wan Chai | 265-267 Hennessy Road | 2511 3931 |
| Western | 347-349 Des Voeux Road West | 2547 3809 |
| KOWLOON BRANCHES | | |
| Castle Peak Road | 285-287 Castle Peak Road | 2387 2421 |
| Cho Yiu Chuen | G/F, Block C, King Cho Road | 2742 2211 |
| How Ming Street | 114 How Ming Street | 2342 6386 |
| Kowloon City | 31-33 Nga Tsin Wai Road | 2382 7392 |
| Kwong Tin Estate | No. 205, Shopping Centre, Kwong Tin Estate | 2717 2414 |
| Kwun Tong | 31-33 Mut Wah Street | 2342 7328 |
| Lai Chi Kok Road | 139 Lai Chi Kok Road | 2391 1573 |
| Lei Yue Mun | LG1, Lower Ground Floor, Lei Yue Mun Plaza Yau Tong | 2772 6320 |
| Mongkok | 591 Nathan Road | 3191 0001 |
| San Po Kong | 55-57 Yin Hing Street | 2325 5303 |
| Sham Shui Po | 144-148 Tai Po Road | 2777 4441 |
| Shun Lee Estate | Lee Yat House, Shun Lee Estate | 2342 7141 |
| Tak Tin Estate | No. 207, Shopping Centre, Tak Tin Estate | 2775 1175 |
| To Kwa Wan | 34-34A Tam Kung Road | 2711 4404 |
| Tsim Sha Tsui | 16 Granville Road | 2369 4091 |
| Tsz Wan Shan | 60-64 Sheung Fung Street | 2327 0913 |
| NEW TERRITORIES BRANCHES | | |
| Fanling | 2 Wo Lung Street, Luen Wo Market, Fanling | 2675 6203 |
| Heng On Estate | Level 3, Commercial Centre, Heng On Estate Ma On Shan, Sha Tin | 2641 1911 |
| Sheung Shui | 71 San Fung Avenue, Sheung Shui | 2670 6295 |
| Sheung Tak Estate | Shop No. 237, Sheung Tak Shopping Centre Sheung Tak Estate, Tseung Kwan O | 2178 1203 |
| Tin Tsz Estate | Shop No. 110, 1/F, Tin Tsz Shopping Centre Tin Tsz Estate, Tin Shui Wai | 2616 4618 |
| Tsuen Wan | Jade Plaza, 298 Sha Tsui Road, Tsuen Wan | 2408 7481 |
| Tuen Mun Glorious Garden | Shop No. 82, Glorious Garden 45 Lung Mun Road, Tuen Mun | 2453 0181 |
| Wan Tau Tong Estate | Shop Nos. 11-12A, Wan Loi House Wan Tau Tong Estate, Tai Po | 2656 4313 |
| Yuen Long | 99-109 Castle Peak Road, Yuen Long | 2475 5307 |

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| Liu Chong Hing Banking Corporation, Cayman | |
| Liu Chong Hing Data Processing Limited | |
| Liu Chong Hing (Management) Limited | |
| Liu Chong Hing (Nominees) Limited | |
| Card Alliance Company Limited | |
| Chong Hing Commodities and Futures Limited | |
| Chong Hing Finance Limited (formerly known as "Liu Chong Hing Finance Limited") | |
| Chong Hing Insurance Company Limited (formerly known as "Liu Chong Hing Insurance Company Limited") | |
| Chong Hing Securities Limited | |
| Gallbraith Limited | |
| Right Way Investments Limited | |
| AFFILIATES | |
| Liu Chong Hing Investment Limited | |
| COSCO Pacific Limited | |
| The Bank of Tokyo-Mitsubishi UFJ, Ltd (formerly known as "The Bank of Tokyo-Mitsubishi, Ltd") | |