



PUBLIC BANK (HONG KONG) LIMITED
Annual Report 2007



大眾銀行(香港) 實踐服務多元化

專業按揭 專業存款 私人貸款 中小企業貸款

我們的專業團隊助您達成目標

大眾銀行(香港)推廣優惠

- 特低儲蓄利率 - 活期
- 專業理財團隊 - 為您提供多項服務
- 私人貸款靈活彈性 - 盡享理財自由
- 高息活期/零存整付 - 隨時支取
- 中小企業貸款專項 - 助您發展

大眾銀行(香港) 專業熱誠 8107 0818



大眾銀行(香港)
08更多分行 服務更進一步

新界屯門分行 1-2樓全新大眾銀行大樓
電話：2445 1398 傳真：2445 1398

屯門新分行

大眾銀行(香港) 全力服務大眾



Corporate Information

Board of Directors

Tan Sri Dato' Sri Dr. Teh Hong Piow (Chairman)
Tan Sri Dato' Thong Yaw Hong (Co-Chairman)
Tan Yoke Kong
Chong Yam Kiang
Dato' Sri Tay Ah Lek
Dato' Chang Kat Kiam
Dato' Yeoh Chin Kee
Lee Chin Guan

Company Secretary

Chan Sau Kuen

Registered Office and Head Office

Public Bank Centre
120 Des Voeux Road Central
Hong Kong
Telephone : (852) 2541 9222
Facsimile : (852) 2541 0009
Website : www.publicbank.com.hk

Auditors

Ernst & Young
Certified Public Accountants

Legal Advisers

Gallant Y.T. Ho & Co.
Philip K H Wong, Kennedy Y H Wong & Co.
Siao, Wen and Leung

Principal Bankers

Bank of China
China Construction Bank
China Merchants Bank Co Limited
China Minsheng Banking Corp. Limited
CIMB Bank Berhad
Standard Chartered Bank (Hong Kong) Limited
The Bank of Tokyo Mitsubishi UFJ Limited
The Hongkong and Shanghai Banking Corporation Limited

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Branch Network

(As at 14 March 2008)

Hong Kong Island

Head Office and Branches

Head Office

Public Bank Centre, 120 Des Voeux Road Central
 Tel : 2541 9222 Telex : 73085 CBHK HKHH
 Post Box : G.P.O. Box 824 Fax : 2541 0009
 Website : www.publicbank.com.hk

- | | |
|--|---|
| <p>1 Main Branch G/F, Public Bank Centre 120 Des Voeux Road Central Tel: 25419222 Fax: 25452866 Manager: So Tak Fai, Peter</p> <p>2 Western Branch Shop 2-3, G/F, Kam Kwan Building 163-173 Des Voeux Road West Tel: 28582220 Fax: 28582638 Manager: Lau Yiu Fai, Lawrence</p> <p>3 Wanchai Commercial Centre Unit A, 9/F, China Overseas Building 139 Hennessy Road, Wanchai Tel: 28914171 Fax: 28341012 Manager: Chan Kong Hoi, Roy</p> <p>4 North Point Branch Shop A, G/F, Yue Yick Building 363-365 King's Road, North Point Tel: 25685141 Fax: 25670655 Manager: Yam Oi Yin, Pauline</p> | <p>5 Shek Tong Tsui Branch Shop B1, G/F, Hong Kong Plaza 369-375 Des Voeux Road West Tel: 25462055 Fax: 25597962 Manager: Chui King Yan, Connie</p> <p>6 Causeway Bay Branch G/F and M/F, 447 Hennessy Road Causeway Bay Tel: 25722363 Fax: 25723033 Manager: So Wai Ming, Aubrey</p> <p>7 Central Branch Unit A, G/F, Wing On House 71 Des Voeux Road Central Tel: 21472140 Fax: 21472244 Manager: Wong Kai Ip, Jimmy</p> <p>8 Aberdeen Branch Shop C, G/F, Kong Kai Building 184 Aberdeen Main Road, Aberdeen Tel: 28710928 Fax: 28710383 Manager: Lo Kai Huen, Richard</p> |
|--|---|

Kowloon

- | | |
|---|---|
| <p>9 Yaumatei Branch Shop No. 1, G/F, Ginza Square 565-567 Nathan Road, Yaumatei Tel: 23811678 Fax: 23956398 Manager: Siu Kit Ching, Christina</p> <p>10 Kowloon City Branch G/F, 15 Nga Tsin Wai Road, Kowloon City Tel: 23820147 Fax: 27184281 Manager: Cheung Wing Kwong</p> <p>11 Hung Hom Branch G/F, Hunghom Commercial Centre 37 Ma Tau Wai Road, Hung Hom Tel: 23639213 Fax: 23633195 Manager: Lee Wai Kwan, Luceta</p> <p>12 Kwun Tong Branch Unit 2310, Tower 1, Millennium City 1 388 Kwun Tong Road, Kwun Tong Tel: 23899119 Fax: 23899969 Manager: Kwok Ka Leung, Joe</p> <p>13 Mongkok Branch G/F, JCG Building, 16 Mongkok Road Mongkok Tel: 23918393 Fax: 23916909 Manager: Ngai Mo Ngan, Andy</p> | <p>14 San Po Kong Branch G/F, 92 Shung Ling Street, San Po Kong Tel: 23268318 Fax: 23269180 Manager: Kwong Hon Wun, Peter</p> <p>15 Cheung Sha Wan Branch Unit C2, G/F, 746 Cheung Sha Wan Road Cheung Sha Wan Tel: 27869858 Fax: 27869506 Manager: Chan Yu Chun, Desmond</p> <p>16 Prince Edward Branch G/F, 751 Nathan Road, Prince Edward Tel: 23973830 Fax: 23971006 Manager: Leung Yuen Fan, Maggie</p> <p>17 Wong Tai Sin Branch G/F, 89 Fung Tak Road, Wong Tai Sin Tel: 23287332 Fax: 23287991 Manager: Lau Keung Fai, David</p> |
|---|---|

New Territories

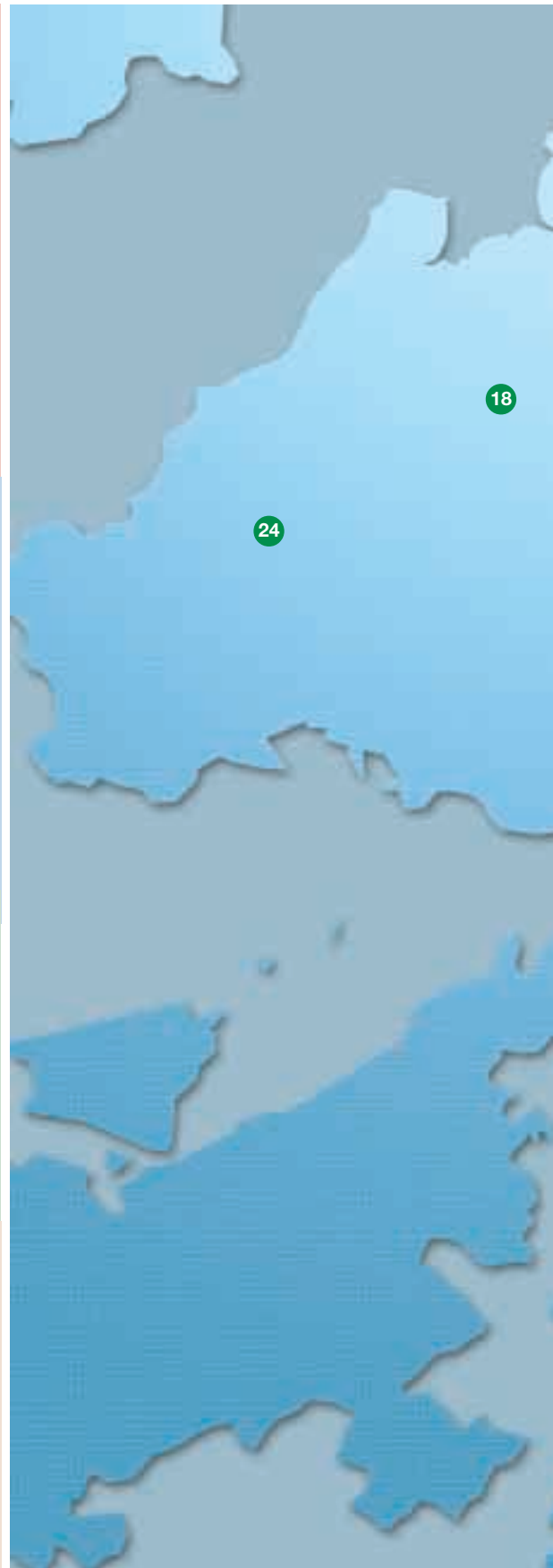
- | | |
|---|--|
| <p>18 Yuen Long Branch Shop No. 5, Fu Ho Building 3-7 Kau Yuk Road, Yuen Long Tel: 24794265 Fax: 24733934 Manager: Lam Wong Kan, Kent</p> <p>19 Tsuen Wan Branch G/F, Victory Court, 185-187 Castle Peak Road Tsuen Wan Tel: 24904191 Fax: 24904811 Manager: Choi Kam Yee, Catalina</p> <p>20 Kwai Chung Branch Shop 88B, Trendy Place, Kwai Chung Plaza 7-11 Kwai Foc Road, Kwai Chung Tel: 24800002 Fax: 24012367 Manager: Law Chan Shang, Peter</p> <p>21 Tai Po Branch Shop B, G/F, 18-24 Kwong Fuk Road, Tai Po Tel: 26572861 Fax: 26577389 Manager: Tsang Wai Chor</p> | <p>22 Fanling Branch Shop 1, G/F, Wo Fung Court 8 Wo Fung Street, Luen Wo Market, Fanling Tel: 26691559 Fax: 26698780 Manager: Kee Ka Wai</p> <p>23 Sheung Shui Branch G/F, 73 San Fung Avenue, Sheung Shui Tel: 26390307 Fax: 31240091 Manager: Yan Yi Kam, Patrick</p> <p>24 Tuen Mun Branch Shop E, G/F, Kam Lai Building Nos. 1-7 Kai Man Path, Tuen Mun Tel: 24401298 Fax: 24401398 Manager: Fong Fung Mei, Marisa</p> |
|---|--|

China

- | | |
|--|--|
| <p>25 Shenzhen Branch Shop No.1, G/F, Carrianna Friendship Square Renminnan Road, Shenzhen People's Republic of China Tel : (86-755) 2518 2822 Fax : (86-755) 2518 2327 Manager : Cheung Po Tung, David</p> <p>26 Futian Sub-branch 1-3 Jinrun Mansion, No. 6019 Shennan Road Futian District, Shenzhen People's Republic of China Tel : (86-755) 8280 0026 Fax : (86-755) 8280 0016 Manager: Cheung Ding Keung, Sammy</p> | <p>Shenyang Representative Office Unit A, 18/F, Sunwah Hi-tech Building No. 262 Shifu Road, Shenhe District, Shenyang Liaoning Province, People's Republic of China Tel : (86-24) 2279 1368 Fax : (86-24) 2279 1369 Representative: Li Yu Jie</p> <p>Shanghai Representative Office Room G, 8/F Majesty Building 138 Pu Dong Avenue, Shanghai People's Republic of China Tel : (86-21) 5887 8851 Fax : (86-21) 5887 9951 Representative: Chen Li Hang, Leo</p> |
|--|--|

Taiwan

Taipei Representative Office
 Room 905, No. 18 Chan-An E. Road Section 1, Taipei, Taiwan
 Tel : (88-62) 2563 8789
 Fax : (88-62) 2564 2047
Representative: Lu Chia Nan, Deanna







Chairman's Statement



Tan Sri Dato' Sri Dr. Teh Hong Piow
Chairman

“I am pleased to present a review of the performance of Public Bank (Hong Kong) Limited (the “Bank”) and its subsidiaries (the “Group”) for the financial year ended 31 December 2007.”

GROUP FINANCIAL PERFORMANCE

For the year ended 31 December 2007, the Group recorded a profit after tax of HK\$121.4 million (2006: HK\$145.5 million). The opening of new branches for the Bank in the year coupled with the increase in advertising and promotional activities in building the “PB Brand” had caused a significant increase in the operating expenses and the decrease in the earnings of the Group for the year under review.

During the year under review, the Bank registered a growth in loans and advances (including trade bills) of 51.7% or HK\$5.26 billion to HK\$15.42 billion as at 31 December 2007 from HK\$10.16 billion as at 31 December 2006. Customer deposits (excluding intra-group's deposits) also registered a growth of 36.9% or HK\$4.96 billion to HK\$18.39 billion as at 31 December 2007 from HK\$13.43 billion as at 31 December 2006. The significant growth rates in loans and customer deposits were attributed to the Bank's aggressive marketing and competitive pricing strategies in line with the building of the Public Bank Group's “PB Brand” in Hong Kong.

For the year under review, the Group's interest income increased by 24.3% or HK\$200.5 million to HK\$1,026.8 million from HK\$826.3 million for 2006, whilst interest expense increased by 34.2% or HK\$194.1 million to HK\$761.0 million from HK\$566.9 million for 2006. As a result, the Group's net interest income for 2007 increased by 2.5% or HK\$6.5 million to HK\$265.8 million when compared to the previous year.

Non-interest income of the Group increased by 10.5% or HK\$8.7 million to HK\$91.4 million for 2007, whilst operating expenses of the Group increased by 33.1% or HK\$55.1 million to HK\$221.5 million for 2007. The significant increase in the operating expenses is mainly attributed to the opening of new branches for the Bank and the increase in advertising and promotional activities in building the “PB Brand” and in developing the loans and deposits businesses.

BUSINESS DEVELOPMENT OF THE BANK

During the year under review, the Bank continued to expand its network of branches with the opening of 8 new branches in Hong Kong and a new sub-branch in Shenzhen in the People's Republic of China ("PRC"), bringing the Bank's branch network to 23 branches in Hong Kong and 2 branches in the PRC. The Bank will continue with the branch expansion programme in 2008 and aim to open a further 10 to 12 new branches in Hong Kong and another new sub-branch in Shenzhen in the PRC.

The Bank will continue to expand the network of branches in Hong Kong and in Shenzhen in the PRC, as well as relocate the branches to better locations of high visibility and easy access by customers. The Bank will continue to focus on growing retail and commercial banking businesses through the expanded branch network, innovative product development and aggressive marketing and advertising campaigns. The Group will continue to target selected market segments of the Bank to grow the retail and commercial banking businesses.

The Bank will also continue to seek further synergies to develop business as well as lower the operating costs through further integration of the operations of the Bank and its fellow subsidiary, Public Finance Limited, where applicable, and cross-selling to the enlarged customer base of the Group.

ACKNOWLEDGEMENT

On behalf of the Board of Directors, I wish to take this opportunity to express our appreciation to the management and staff of the Group for their commitment, dedication and perseverance, and sincere gratitude to our customers for their invaluable patronage, and to the shareholders for their continued confidence in and support of the Group, and to the Hong Kong Monetary Authority, Securities and Futures Commission and other relevant authorities for their invaluable advice, guidance and support.

Tan Sri Dato' Sri Dr. Teh Hong Piow

Chairman

8 January 2008



Report of the Directors

The directors present their report and the audited financial statements of the Bank and its subsidiaries (the "Group") for the year ended 31 December 2007.

PRINCIPAL ACTIVITIES

The principal activities of the Group have not changed during the year and consisted of the provision of a comprehensive range of commercial and retail banking, financial and related services.

RESULTS AND DIVIDENDS

The Group's profit for the year ended 31 December 2007 and the state of affairs of the Bank and of the Group at that date are set out in the financial statements on pages 11 to 90.

The directors do not recommend the payment of any dividend in respect of the year.

PROPERTY AND EQUIPMENT AND INVESTMENT PROPERTIES

Details of movements in the property and equipment and investment properties of the Bank and of the Group during the year are set out in notes 21 and 22 to the financial statements, respectively.

SHARE CAPITAL

There were no movements in either the Bank's authorised or issued share capital during the year.

RESERVES

Details of movements in the reserves of the Bank and of the Group during the year are set out in note 27 to the financial statements.

DIRECTORS

The directors of the Bank during the year and up to the date of this report were as follows:

Tan Sri Dato' Sri Dr. Teh Hong Piow, *Chairman*

Tan Sri Dato' Thong Yaw Hong, *Co-Chairman*

Tan Yoke Kong

Chong Yam Kiang

Dato' Sri Tay Ah Lek

Dato' Chang Kat Kiam

Dato' Yeoh Chin Kee

Lee Chin Guan

In accordance with Article 105 of the New Articles of Association of the Bank, Mr. Chong Yam Kiang, Dato' Sri Tay Ah Lek and Dato' Chang Kat Kiam shall retire by rotation and, being eligible, will offer themselves for re-election at the forthcoming annual general meeting.

DIRECTORS' RIGHTS TO ACQUIRE SHARES

Pursuant to the employees' share option schemes of Public Financial Holdings Limited ("PFHL"), the Bank's immediate holding company, and Public Bank Berhad ("PBB"), the Bank's ultimate holding company, certain directors of the Bank have been granted options to subscribe for ordinary shares of PFHL and PBB.

At the balance sheet date, the interests of the directors in any rights to subscribe for ordinary shares in PFHL and PBB were as follows:

| Interests in | Name of director | Number of ordinary shares attached to the share options | | | Exercise price | Exercise period |
|--------------|---------------------------------|--|-------------------------------|---------------------------------|----------------|--------------------------------------|
| | | At the beginning of the year | Granted during the year | Exercised during the year | | |
| 1. PFHL | Dato' Sri Tay Ah Lek | 1,680,000 | - | - | 1,680,000 | HK\$6.35 10.6.2005 to 9.6.2015 |
| | Dato' Yeoh Chin Kee | 700,000 | - | - | 700,000 | HK\$6.35 10.6.2005 to 9.6.2015 |
| | Lee Chin Guan | 350,000 | - | - | 350,000 | HK\$6.35 10.6.2005 to 9.6.2015 |
| | Dato' Chang Kat Kiam | 1,680,000 | - | - | 1,680,000 | HK\$6.35 10.6.2005 to 9.6.2015 |
| | Tan Yoke Kong | 1,928,000 | - | - | 1,928,000 | HK\$6.35 10.6.2005 to 9.6.2015 |
| 2. PBB | Tan Sri Dato' Thong Yaw Hong | 2,000,000 | - | 2,000,000 | - | RM6.37 24.2.2005 to 24.2.2008 |
| | Dato' Sri Tay Ah Lek | 4,500,000 | - | 4,500,000 | - | RM6.37 24.2.2005 to 24.2.2008 |

Report of the Directors

DIRECTORS' RIGHTS TO ACQUIRE SHARES (Continued)

| Interests in | Name of director | Number of ordinary shares attached to the share options | | | | Exercise price | Exercise period |
|-----------------------|----------------------|--|-------------------------------|---------------------------------|------------------------------|-------------------|---------------------------|
| | | At the beginning of the year | Granted during the year | Exercised during the year | At the end of the year | | |
| 2. PBB (Continued) | Dato' Yeoh Chin Kee | 2,025,000 | - | 2,025,000 | - | RM6.37 | 24.2.2005 to 24.2.2008 |
| | | 2,000,000 | - | 2,000,000 | - | RM5.67 | 5.12.2005 to 24.2.2008 |
| | | 4,025,000 | - | 4,025,000 | - | | |
| | Lee Chin Guan | 1,125,000 | - | 1,125,000 | - | RM6.37 | 24.2.2005 to 24.2.2008 |
| | | 650,000 | - | 650,000 | - | RM5.67 | 5.12.2005 to 24.2.2008 |
| | | 1,775,000 | - | 1,775,000 | - | | |
| | Dato' Chang Kat Kiam | 123,000 | - | 123,000 | - | RM6.37 | 24.2.2005 to 24.2.2008 |
| | | 130,000 | - | 130,000 | - | RM5.67 | 5.12.2005 to 24.2.2008 |
| | | 253,000 | - | 253,000 | - | | |
| | Tan Yoke Kong | 30,000 | - | 30,000 | - | RM6.37 | 15.2.2005 to 24.2.2008 |
| | | 40,000 | - | 40,000 | - | RM5.67 | 5.12.2005 to 24.2.2008 |
| | | 70,000 | - | 70,000 | - | | |
| | Chong Yam Kiang | 35,000 | - | 35,000 | - | RM6.37 | 15.2.2005 to 24.2.2008 |
| | | 35,000 | - | 35,000 | - | RM5.67 | 5.12.2005 to 24.2.2008 |
| | | 70,000 | - | 70,000 | - | | |

DIRECTORS' RIGHTS TO ACQUIRE SHARES (Continued)

Notes:

1. The options to subscribe for ordinary shares of HK\$0.10 each in PFHL under the Employees' Share Option Scheme of PFHL are only exercisable during certain periods as notified by the board or the Share Option Committee of PFHL to each grantee which it may in its absolute discretion determine from time to time before the expiry of the share options on 9 June 2015.
2. The options to subscribe for ordinary shares of RM1.00 each in Public Bank were first granted on 10 April 1998 under the Public Bank Berhad Employees' Share Option Scheme (the "PBB ESOS"). Following approvals from the relevant authorities and the shareholders of Public Bank, the PBB ESOS has been extended for a total of five years to 25 February 2008.

Save as disclosed above, at no time during the year was the Bank, its immediate holding company and ultimate holding company or any of its subsidiaries and fellow subsidiaries a party to any arrangement to enable the Bank's directors, their respective spouse or minor children to acquire benefits by means of the acquisition of shares in, or debentures of, the Bank or in any other body corporate.

DIRECTORS' INTERESTS IN CONTRACTS

Save as disclosed in note 31 to the financial statements, no director had a material interest, whether direct or indirect, in any contract of significance to the business of the Bank to which the Bank or any of its immediate holding company and ultimate holding company, subsidiaries and fellow subsidiaries was a party at the balance sheet date or at any time during the year.

COMPLIANCE WITH SUPERVISORY POLICY MANUALS

The Group has complied with the disclosure requirements of the "Banking (Disclosure) Rules" and "Corporate Governance of Locally Incorporated Authorised Institutions" under the Supervisory Policy Manuals issued by the Hong Kong Monetary Authority ("HKMA"). The Bank has complied with capital requirements related to capital base and capital adequacy ratio stipulated by the HKMA.

DONATIONS

During the year, the Group made charitable donations totalling HK\$11,000 (2006: HK\$72,100).

AUDITORS

Ernst & Young retire and a resolution for their reappointment as auditors of the Bank will be proposed at the forthcoming annual general meeting.

ON BEHALF OF THE BOARD

Tan Sri Dato' Sri Dr. Teh Hong Piow

Director

Tan Sri Dato' Thong Yaw Hong

Director

Hong Kong

8 January 2008



Independent Auditors' Report



To the shareholders of Public Bank (Hong Kong) Limited
(Incorporated in Hong Kong with limited liability)

We have audited the financial statements of Public Bank (Hong Kong) Limited set out on pages 11 to 90, which comprise the consolidated and the Bank's balance sheets as at 31 December 2007, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

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

AUDITORS' RESPONSIBILITY

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

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

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

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

OPINION

In our opinion, the financial statements give a true and fair view of the state of affairs of the Bank and of the Group as at 31 December 2007 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

Ernst & Young

Certified Public Accountants
18th Floor, Two International Finance Centre
8 Finance Street
Hong Kong
8 January 2008



Consolidated Income Statement

For the year ended 31 December 2007

| | Notes | 2007 HK\$'000 | 2006 HK\$'000 |
|--|-------|------------------|------------------|
| Interest income | 4 | 1,026,832 | 826,252 |
| Interest expense | 4 | (761,015) | (566,914) |
| NET INTEREST INCOME | | 265,817 | 259,338 |
| Other operating income | 5 | 91,350 | 82,646 |
| OPERATING INCOME | | 357,167 | 341,984 |
| Operating expenses | 6 | (221,459) | (166,368) |
| Impairment allowances for loans and advances and receivables and held-to-maturity investments | 7 | 6,749 | (3,328) |
| Write-back of impairment allowance against a loan to a jointly-controlled entity | | – | 1,000 |
| Loss on disposal of a subsidiary | | – | (3) |
| Gain on disposal of a jointly-controlled entity | | – | 41 |
| Share of profits and losses of a jointly-controlled entity | 18 | (163) | 176 |
| PROFIT BEFORE TAX | | 142,294 | 173,502 |
| Tax | 9 | (20,861) | (28,002) |
| PROFIT FOR THE YEAR | | 121,433 | 145,500 |
| Attributable to: Equity holders of the Bank | 10 | 121,433 | 145,500 |

Consolidated Balance Sheet

31 December 2007

| | Notes | 2007 HK\$'000 | 2006 HK\$'000 |
|---|-------|-------------------|-------------------|
| ASSETS | | | |
| Cash and short term placements | 11 | 5,792,899 | 2,007,460 |
| Placements with banks and financial institutions | 12 | 441,539 | 566,773 |
| Financial assets designated at fair value through profit or loss | 13 | 12,262 | 10,213 |
| Derivative financial instruments | 29 | 2,644 | 12,780 |
| Loans and advances and receivables | 14 | 15,419,881 | 10,160,296 |
| Available-for-sale financial assets | 15 | 6,804 | 6,804 |
| Held-to-maturity investments | 16 | 2,864,390 | 3,749,502 |
| Interests in a jointly-controlled entity | 18 | 1,513 | 1,676 |
| Other assets | 19 | 192,324 | 176,592 |
| Intangible assets | 20 | 232 | 599 |
| Property and equipment | 21 | 642,062 | 516,859 |
| Investment properties | 22 | 17,900 | 23,366 |
| Total assets | | 25,394,450 | 17,232,920 |
| LIABILITIES | | | |
| Deposits and balances of banks and other financial institutions at amortised cost | | 2,263,902 | 516,097 |
| Derivative financial instruments | 29 | 2,381 | 9,735 |
| Customer deposits at amortised cost | 23 | 18,388,413 | 13,431,513 |
| Certificates of deposit issued at amortised cost | | 2,049,227 | 769,674 |
| Other liabilities | 24 | 275,018 | 331,072 |
| Current tax payable | | 1,014 | 9,597 |
| Deferred tax liabilities | 25 | 88,715 | 67,435 |
| Total liabilities | | 23,068,670 | 15,135,123 |
| EQUITY | | | |
| Issued capital | 26 | 810,000 | 810,000 |
| Reserves | 27 | 1,515,780 | 1,287,797 |
| Total equity | | 2,325,780 | 2,097,797 |
| Total equity and liabilities | | 25,394,450 | 17,232,920 |

Tan Sri Dato' Sri Dr. Teh Hong Piow
Director

Tan Sri Dato' Thong Yaw Hong
Director

Tan Yoke Kong
Director



Consolidated Summary Statement of Changes in Equity

For the year ended 31 December 2007

| | Notes | 2007 HK\$'000 | 2006 HK\$'000 |
|---|--------|------------------|------------------|
| TOTAL EQUITY | | | |
| Balance at beginning of year | | 2,097,797 | 1,872,687 |
| Surplus on revaluation of buildings | 21, 27 | 103,080 | 135,279 |
| Deferred tax debited to equity | 25, 27 | (17,930) | (23,674) |
| Total income and expense for the year recognised directly in equity | | 85,150 | 111,605 |
| Profit for the year | | 121,433 | 145,500 |
| Exchange difference | | 21,400 | – |
| Dividends: | | | |
| 2005 final dividend | | – | (31,995) |
| Balance at end of year | | 2,325,780 | 2,097,797 |

Consolidated Cash Flow Statement

For the year ended 31 December 2007

| | Notes | 2007 HK\$'000 | 2006 HK\$'000 |
|---|-------|--------------------|------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Profit before tax | | 142,294 | 173,502 |
| Adjustments for: | | | |
| Dividend income from listed investments | 5 | – | (125) |
| Dividend income from unlisted investments | 5 | (980) | (780) |
| Depreciation charges | 6 | 19,400 | 14,686 |
| Increase in fair value of buildings | 6 | (3,079) | (8,455) |
| Increase in fair value of investment properties | 6 | (4,700) | (5,406) |
| (Decrease)/increase in impairment allowances on loans and advances and receivables | 7 | (16,549) | 3,328 |
| Increase in impairment allowances for held-to-maturity investments | 7 | 9,800 | – |
| Net gain on disposal of property and equipment | | (627) | (184) |
| Loss on disposal of a subsidiary | | – | 3 |
| Write-back of impairment allowance against a loan to a jointly-controlled entity | | – | (1,000) |
| Gain on disposal of a jointly-controlled entity | | – | (41) |
| Increase in impairment for intangible assets | 20 | 367 | – |
| Share of profits and losses of a jointly-controlled entity | 18 | 163 | (176) |
| Exchange difference | | 21,407 | – |
| | | 167,496 | 175,352 |
| Increase in operating assets: | | | |
| (Increase)/decrease in cash and short term placements | | (114,905) | 41,067 |
| Decrease/(increase) in placements with banks and financial institutions | | 62,848 | (20,097) |
| (Increase)/decrease in financial assets designated at fair value through profit or loss | | (2,049) | 55,807 |
| Decrease in derivative financial instruments | | 10,136 | 35,075 |
| Increase in loans and advances and receivables | | (5,243,036) | (1,087,287) |
| Decrease in held-to-maturity investments | | 1,550,101 | 115,347 |
| (Increase)/decrease in other assets | | (15,732) | 6,147 |
| | | (3,752,637) | (853,941) |
| Increase in operating liabilities: | | | |
| Increase/(decrease) in deposits and balances of banks and other financial institutions at amortised cost | | 1,747,805 | (450,282) |
| Increase in customer deposits at amortised cost | | 4,956,900 | 1,906,604 |
| Increase/(decrease) in certificates of deposit issued at amortised cost | | 1,279,553 | (653,777) |
| Decrease in derivative financial instruments | | (7,354) | (44,789) |
| (Decrease)/increase in other liabilities | | (56,054) | 60,177 |
| | | 7,920,850 | 817,933 |
| Net cash generated from operating activities before tax | | 4,335,709 | 139,344 |
| Hong Kong profits tax paid | | (23,209) | (17,446) |
| Overseas tax (paid)/refunded | | (2,886) | 1,700 |
| Net cash inflow from operating activities | | 4,309,614 | 123,598 |



| | Notes | 2007 HK\$'000 | 2006 HK\$'000 |
|---|-------|------------------|------------------|
| NET CASH INFLOW FROM OPERATING ACTIVITIES | | 4,309,614 | 123,598 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Proceeds from disposal of a subsidiary | | - | 8,498 |
| Proceeds from disposal of investment properties | 22 | - | 3,700 |
| Purchases of property and equipment | 21 | (28,607) | (1,890) |
| Proceeds from disposal of a jointly-controlled entity | | - | 19,641 |
| Proceeds from disposal of a loan to a jointly controlled entity | | - | 31,000 |
| Proceeds from disposal of property and equipment | | 950 | 731 |
| Dividends from unlisted investments | | 980 | 905 |
| Net cash (outflow)/inflow from investing activities | | (26,677) | 62,585 |
| CASH FLOWS FROM FINANCING ACTIVITY | | | |
| Dividends paid | | - | (31,995) |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | | 4,282,937 | 154,188 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | | 2,697,917 | 2,543,729 |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | | 6,980,854 | 2,697,917 |
| ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS | | | |
| Cash and short term placements repayable on demand | | 390,241 | 240,584 |
| Money at call and short notice with original maturity within three months | | 5,207,633 | 1,686,756 |
| Placements with banks and financial institutions with original maturity within three months | | 269,135 | 331,521 |
| Held-to-maturity investments with original maturity within three months | | 1,113,845 | 439,056 |
| | | 6,980,854 | 2,697,917 |

Balance Sheet

31 December 2007

| | Notes | 2007 HK\$'000 | 2006 HK\$'000 |
|---|-------|-------------------|------------------|
| ASSETS | | | |
| Cash and short term placements | 11 | 5,791,877 | 2,006,446 |
| Placements with banks and financial institutions | 12 | 441,539 | 566,773 |
| Financial assets designated at fair value through profit or loss | 13 | 12,262 | 10,213 |
| Derivative financial instruments | 29 | 2,644 | 12,780 |
| Loans and advances and receivables | 14 | 15,419,881 | 10,160,296 |
| Available-for-sale financial assets | 15 | 6,804 | 6,804 |
| Held-to-maturity investments | 16 | 2,864,390 | 3,749,502 |
| Interests in subsidiaries | 17 | 56,952 | 56,952 |
| Interest in a jointly-controlled entity | 18 | 1,500 | 1,500 |
| Other assets | 19 | 191,513 | 203,336 |
| Property and equipment | 21 | 641,969 | 457,786 |
| Investment properties | 22 | 17,900 | 23,366 |
| Total assets | | 25,449,231 | 17,255,754 |
| LIABILITIES | | | |
| Deposits and balances of banks and other financial institutions at amortised cost | | 2,263,902 | 516,097 |
| Derivative financial instruments | 29 | 2,381 | 9,735 |
| Customer deposits at amortised cost | 23 | 18,421,936 | 13,485,273 |
| Certificates of deposit issued at amortised cost | | 2,049,227 | 769,674 |
| Other liabilities | 24 | 319,411 | 411,414 |
| Current tax payable | | 9 | 9,080 |
| Deferred tax liabilities | 25 | 79,510 | 58,303 |
| Total liabilities | | 23,136,376 | 15,259,576 |
| EQUITY | | | |
| Issued capital | 26 | 810,000 | 810,000 |
| Reserves | 27 | 1,502,855 | 1,186,178 |
| Total equity | | 2,312,855 | 1,996,178 |
| Total equity and liabilities | | 25,449,231 | 17,255,754 |

Tan Sri Dato' Sri Dr. Teh Hong Piow
Director

Tan Sri Dato' Thong Yaw Hong
Director

Tan Yoke Kong
Director

Notes to Financial Statements

1. CORPORATE INFORMATION

The Bank is a limited liability company and its registered office is located at Public Bank Centre, 120 Des Voeux Road Central, Hong Kong. During the year, the Group's principal activities were the provision of a comprehensive range of commercial and retail banking, financial and related services.

Details of the principal activities of the Bank's subsidiaries are set out in note 17 to the financial statements.

The Bank is a wholly-owned subsidiary of PFHL. In the opinion of the directors, the ultimate holding company of the Bank is PBB, which is incorporated in Malaysia.

2.1 BASIS OF PREPARATION

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") (which also include Hong Kong Accounting Standards ("HKASs") and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA"), accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. Preparation of financial statements have also made reference to applicable Supervisory Policy Manual and the Banking (Disclosure) Rules issued by the HKMA.

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of properties and investment properties, available-for-sale financial assets, financial assets and financial liabilities (including derivative financial instruments) at fair value through profit or loss.

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiaries as at and for the year ended 31 December each year. The financial statements of the subsidiaries and a jointly-controlled entity are prepared for the same reporting year as the Group, using consistent accounting policies.

All intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions are eliminated in full.

Subsidiaries are fully consolidated from the date on which control is transferred to the Bank. Control is achieved where the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the date of acquisition or up to the date of disposal, as appropriate.

The subsidiaries consolidated for accounting purpose and which are members of the consolidated Group are as follows:

- Public Bank (Nominees) Limited, PB Finance Limited, Public Investments Limited, Public Realty Limited, Public Credit Limited, Public Futures Limited, Public Pacific Securities Limited and Public Financial Securities Limited.



Notes to Financial Statements

2.1 BASIS OF PREPARATION (Continued)

Basis of capital disclosures

The Group has complied with capital requirements during the annual reporting period related to capital base and capital adequacy ratio as stipulated by the HKMA, and also complied with the Banking (Disclosure) Rules issued by the HKMA.

Should the Group have not complied with externally imposed capital requirements of the HKMA, capital management plans should be submitted to the HKMA for restoration of capital to the minimum required level as soon as possible.

The computation of the capital adequacy ratio of the Group is based on the risk weighted exposures to the capital base of the Bank on solo basis for regulatory purpose.

There are no major restrictions or impediments on the transfer of capital or funds among the members of the institution's consolidation group except that Public Financial Securities Limited's liquidity, capital and other performance indicators should satisfy the minimum requirements of Financial Resources Rules issued by Securities and Futures Commission.

2.2 IMPACT OF NEW AND REVISED HKFRSs AND HKASs

The HKICPA has issued a number of new and revised HKFRSs, and HKASs and Interpretations ("Int"), which are generally effective for accounting periods beginning on or after 1 January 2007. The Group has adopted the following HKFRSs and HKASs issued up to 31 December 2007 which are pertinent to its operations and relevant to these financial statements.

- HKAS 1 Amendment Capital Disclosures
- HKFRS 7 Financial Instruments: Disclosures
- HK(IFRIC) – Int 8 Scope of HKFRS 2
- HK(IFRIC) – Int 9 Reassessment of Embedded Derivatives
- HK(IFRIC) – Int 10 Interim Financial Reporting and Impairment

The HKAS 1 Amendment will affect the disclosures of qualitative information about the Group's objective, policies and processes for managing capital; quantitative data about what the Group regards as capital; compliance with any capital requirements and the consequences of any non-compliance.

The HKFRS 7 requires disclosures that enable users of the financial statements to evaluate the significance of the Group's financial instruments and the nature and extent of risks arising from those financial instruments and also incorporates major disclosure requirements of HKAS 32.

The HK(IFRIC) – Int 8 addresses the application of HKFRS 2 to particular transactions in which the entity cannot identify specifically some or all of the goods or services received.

The HK(IFRIC) – Int 9 addresses the application of HKAS 39 that an entity shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract, and prohibits subsequent reassessment throughout the life of the contract except for exceptional circumstances.

2.2 IMPACT OF NEW AND REVISED HKFRSs AND HKASs (Continued)

The HK(IFRIC) – Int 10 addresses the interaction between the requirements of HKAS 34 and the recognition of impairment losses on goodwill in HKAS 36 and certain financial assets in HKAS 39 and that an entity shall not reverse an impairment loss recognised in a previous interim period in respect of goodwill and investment in either an equity instrument or a financial asset carried at cost.

There was no material impact on the basis of preparation of the consolidated balance sheet and income statement arising from the above-mentioned accounting standards except for information related to disclosure requirements of HKAS 1 Amendment and HKFRS 7 which had been disclosed in financial statements.

2.3 IMPACT OF ISSUED BUT NOT YET EFFECTIVE HKFRSs AND HKASs

The Group has not applied the following new and revised HKFRSs and HKASs, which have been issued but are not yet effective, in these financial statements:

- HKFRS 8 Operating Segments
- HKAS 23 (Revised) Borrowing Costs (Revised)
- HK(IFRIC) – Int 11 HKFRS 2 Group and Treasury Share Transactions
- HK(IFRIC) – Int 12 Service Concession Arrangements
- HK(IFRIC) – Int 13 Customer Loyalty Programmes
- HK(IFRIC) – Int 14 HKAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

HKFRS 8 (effective for accounting period beginning on or after 1 January 2009) supersedes HKAS 14 Segment Reporting. Under HKAS 14, segments were identified and reported on the basis of a risk and return analysis, and items were reported on the basis of the accounting policies used for external reporting. Under HKFRS 8, segments are components of an entity regularly reviewed by an entity's chief operating decision-maker or an authorised qualified staff of the entity. Items are reported based on internal reporting.

HKAS 23 (Revised) shall be applied for annual periods beginning on or after 1 January 2009.

HK(IFRIC) – Int 11 and HK(IFRIC) – Int 12 shall be applied for annual periods beginning on or after 1 March 2007 and 1 January 2008 respectively.

HK(IFRIC) – Int 13 shall be applied for annual periods beginning on or after 1 July 2008.

HK(IFRIC) – Int 14 shall be applied for annual periods beginning on or after 1 January 2008.

The Group is in the process of making an assessment of the impact of these new revised HKFRSs and HKASs upon initial application and expects that the adoption of the above pronouncements will not have significant impact on the Group's results of operations and financial position as at the date of the financial statements.



Notes to Financial Statements

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below.

(1) Foreign currency translation

The consolidated financial statements are presented in Hong Kong dollars, which is the Group's functional and presentational currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

(i) Transactions and balances

Transactions in foreign currencies are initially recorded in the functional currency rate of exchange ruling at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to "Other operating income" or "Other operating expenses" in the income statement with the exception of differences on foreign currency borrowings that provide an effective hedge against a net investment in a foreign entity which is taken directly to equity until the disposal of the net investment, at which time they are recognised in the income statement. Tax charges and credits attributable to exchange differences on those borrowings are also recorded in equity.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operations and translated at closing rate.

(ii) Group companies

As at the reporting date, the assets and liabilities of subsidiaries and overseas branches are translated into the Group's presentational currency at the rate of exchange ruling at the balance sheet date, and their income statements are translated at the weighted average exchange rates for the year. Exchange differences arising on translation are taken directly to a separate component of equity. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the income statement as part of gain or loss on disposal.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(2) Financial instruments – initial recognition and subsequent measurement

(i) Date of recognition

Purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the marketplace are recognised on the trade date, i.e. the date that the Group commits to purchase or sell the asset. Derivatives are recognised on trade date basis.

(ii) Initial recognition of financial instruments

The classification of financial instruments at initial recognition depends on the purpose for which the financial instruments were acquired and their characteristics. All financial instruments are measured initially at their fair value plus, in the case of financial assets and financial liabilities not at fair value through profit or loss, any directly attributable incremental costs of acquisition or issue.

(iii) Derivative financial instruments

Derivatives include interest rate swaps and futures, cross currency swaps, forward foreign exchange contracts and options on interest rates, foreign currencies and equities. Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of derivatives held for trading are included in “Net trading income”.

Derivatives embedded in other financial instruments, such as the conversion option in an acquired convertible bond, are treated as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contract, and the host contract is not itself held for trading or designated at fair value through profit or loss. The embedded derivatives separated from the host contract are carried at fair value in the trading portfolio with changes in fair value recognised in the income statement.

(iv) Financial assets designated at fair value through profit or loss

Financial assets classified in this category are designated by management on initial recognition when the following criteria are met:

- the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis; or
- the assets and liabilities are part of a group of financial assets, financial liabilities or both of which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- the financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recorded.



Notes to Financial Statements

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(2) Financial instruments – initial recognition and subsequent measurement (Continued)

(iv) Financial assets designated at fair value through profit or loss (Continued)

Financial assets and financial liabilities at fair value through profit or loss are recorded in the balance sheet at fair value. Changes in fair value are recorded in “Net gain or loss on financial assets designated at fair value through profit or loss”. Interest earned or incurred is accrued in interest income or expense, respectively, according to the terms of the contract, while dividend income is recorded in “Other operating income” when the right to the payment has been established.

(v) Held-to-maturity investments

Held-to-maturity investments at amortised cost are those which carry fixed or determinable payments and have fixed maturities and which the Group has the intention and ability to hold to maturity. After initial measurement, held-to-maturity investments are subsequently measured at amortised cost using the effective interest rate method, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortisation is included in “Interest income” in the income statement. The losses arising from impairment of such investments are recognised in the income statement as “Impairment allowances for loans and advances and receivables and held-to-maturity investments”.

(vi) Cash and short term placements, placements with banks and financial institutions, and loans and advances and receivables

Cash and short term placements, placements with banks and financial institutions, and loans and advances and receivables are categorised as loans and advances. They are carried at amortised cost and are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market. They are not entered into with the intention of immediate or short term resale. After initial measurement, amounts due from banks and loans and advances are subsequently measured at amortised cost using the effective interest rate method, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the effective interest rate. The amortisation is included in “Interest income” in the income statement. The losses arising from impairment are recognised in the income statement in “Impairment allowances”.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(2) Financial instruments – initial recognition and subsequent measurement (Continued)

(vii) Available-for-sale financial assets

Available-for-sale financial assets are those which are designated as such or do not qualify to be classified as designated at fair value through profit or loss, held-to-maturity investments or loans and advances. They include equity instruments, investments in mutual funds and money market and other debt instruments.

After initial measurement, available-for-sale financial assets are subsequently measured at fair value. Unrealised gains and losses are recognised directly in equity in the “Available-for-sale financial assets revaluation reserve”.

When the security is disposed of, the cumulative gain or loss previously recognised in equity is recognised in the income statement in “Other operating income” or “Operating expenses”. Where the Group holds more than one investment in the same security, they are deemed to be disposed of on a first-in-first-out basis. Interest earned whilst holding available-for-sale financial assets is reported as interest income using the effective interest rate. Dividends earned whilst holding available-for-sale financial assets are recognised in the income statement as “Other operating income” when the right of the payment has been established. The losses arising from impairment of such investments are recognised in the income statement in “Impairment allowances” and removed from the available-for-sale financial assets revaluation reserve.

(viii) Certificates of deposit

Issued financial instruments or their components, which are not designated at fair value through profit or loss, are classified as liabilities under “Certificates of deposit issued at amortised cost” where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number or own equity shares. The components of compound financial instruments, that contain both liability and equity elements, are accounted for separately, with the equity component being assigned the residual amount after deducting from the instrument as a whole the amount separately determined as the fair value of the liability component on the date of issue.

After initial measurement, debt issued and other borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the effective interest rate.



Notes to Financial Statements

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(3) Derecognition of financial assets and financial liabilities

(i) Financial assets

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired; or
- the Group has transferred its rights to receive cash flows from the asset or had assumed an obligation to pay the received cash flows in full without material delay to a third party under a “pass-through” arrangement; and
- either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Group had transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group’s continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Group’s continuing involvement is the amount of the transferred asset that the Group may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Group’s continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

(ii) Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in income statement.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(4) Determination of fair value

The fair value for financial instruments traded in active markets at the balance sheet date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist, option pricing models and other relevant valuation models.

(5) Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred “loss event”) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that a borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with default.

(i) Placements with banks and financial institutions, and loans and advances and receivables

For amounts due from banks and loans and advances to customers carried at amortised cost, the Group first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.



Notes to Financial Statements

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(5) Impairment of financial assets (Continued)

(i) Placements with banks and financial institutions, and loans and advances and receivables (Continued)

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). 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. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral had been realised or had been transferred to the Group. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. Any subsequent reversal of an impairment is recognised in the income statement, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date. If a future write-off is later recovered, the recovery is credited to the "Impairment allowances".

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Group's internal credit risk-based system that considers credit risk characteristics such as asset type, industry, collateral type, economic factors and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(5) Impairment of financial assets (Continued)

(ii) Held-to-maturity investments

For held-to-maturity investments, the Group assesses individually whether there is objective evidence of impairment. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced and the amount of the loss is recognised in the income statement.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognised, any amounts formerly charged are credited to the "Impairment allowances", to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

(iii) Available-for-sale financial assets

For available-for-sale financial assets, the Group assesses at each balance sheet date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss, measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the income statement, is removed from equity and recognised in the income statement. Impairment losses on equity investments are not reversed through the income statement; increases in their fair value after impairment are recognised directly in equity.

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. Interest continues to be accrued at the original effective interest rate on the reduced carrying amount of the asset and is recorded as part of "Interest income". If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement.



Notes to Financial Statements

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(6) Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

(i) Group as a lessee

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments and included in "Property and equipment" with the corresponding liability to the lessor included in "Other liabilities". Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income in "Interest expense".

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term, if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term.

Operating lease payments are not recognised in the balance sheet. Any rentals payable are accounted for on a straight-line basis over the lease term and included in "Operating expenses".

(ii) Group as a lessor

Leases where the Group does not transfer substantially all the risk and benefits of ownership of the asset are classified as operating leases. The Group leases out all of its investment properties as operating leases, thus generating rental income. Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the period in which they are earned.

The amounts due from the lessees under finance leases are recorded in the balance sheet as loans and advances to customers. The amount comprises the gross investment in the finance leases less gross earnings allocated to future accounting periods. The total gross earnings under finance leases are allocated to the accounting periods over the duration of the underlying agreements so as to produce an approximately constant periodic rate of return on the net cash investment for each accounting period.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(7) Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

(i) Interest income and expense

For all financial instruments measured at amortised cost and interest bearing financial instruments classified as available-for-sale financial assets, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Once the recorded value of a financial asset or a group of similar financial assets had been reduced due to an impairment loss, interest income continues to be recognised using the original effective interest rate applied to the new carrying amount.

(ii) Fee and commission income

The Group earns fee and commission income from a diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

(a) *Fee income earned from services that are provided over a certain period of time*

Fees earned from the provision of services over a period of time are accrued over that period. These fees include commission income and asset management, custody and other management and advisory fees. Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.

(b) *Fee income from providing transaction services*

Fees arising from negotiating or participating in the negotiation of a transaction for a third party, such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses, are recognised on completion of the underlying transaction.

(iii) Dividend income

Revenue is recognised when the Group's right to receive the payment is established.



Notes to Financial Statements

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(7) Recognition of income and expenses (Continued)

(iv) Net trading income

Results arising from trading activities include all gains and losses from changes in fair value for financial assets and financial liabilities held for trading. This includes any ineffectiveness recorded in hedging transactions.

(v) Rental income

Rental income arising on investment properties is accounted for on a straight-line basis over the lease terms on ongoing leases and is recorded in the income statement in "Other operating income".

(8) Cash and cash equivalents

Cash and cash equivalents as referred to in the cash flow statement comprises cash on hand, and amounts due from banks on demand or with an original maturity period of three months or less.

(9) Subsidiaries

A subsidiary is an entity in which the Bank, directly or indirectly, controls more than half of its voting power or issued share capital or controls the composition of its board of directors; or over which the Bank has a contractual right to exercise a dominant influence with respect to that entity's financial and operating policies.

The results of subsidiaries are included in the Bank's income statement to the extent of dividends received and receivable. The Bank's investments in subsidiaries are stated at cost less any impairment losses.

(10) Joint venture companies and jointly-controlled entity

A joint venture is an entity set up by contractual arrangement, whereby the Group and other parties undertake an economic activity. The joint venture operates as a separate entity in which the Group and the other parties have an interest.

The joint venture agreement between the venturers stipulates the capital contributions of the joint venture parties, the duration of the joint venture entity and the basis on which the assets are to be realised upon its dissolution. The profits and losses from the joint venture's operations and any distributions of surplus assets are shared by the ventures, either in proportion to their respective capital contributions, or in accordance with the terms of the joint venture agreement.

A joint venture is treated as:

- (a) a subsidiary, if the Group, directly or indirectly, controls more than half of its voting power or issued share capital or controls the composition of its board of directors; or over which the Group has a contractual right to exercise a dominant influence with respect to the joint venture's financial and operating policies;
- (b) a jointly-controlled entity, if the Group does not have unilateral control, but has joint control, directly or indirectly, over the joint venture;

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(10) Joint venture companies and jointly-controlled entity (Continued)

- (c) an associate, if the Group does not have unilateral or joint control, but holds, directly or indirectly, generally not less than 20% of the joint venture's registered capital and is in a position to exercise significant influence over the joint venture; or
- (d) an equity investment accounted for in accordance with HKAS 39, if the Bank holds, directly or indirectly, less than 20% of the joint venture's registered capital and has neither joint control of, nor is in a position to exercise significant influence over, the joint venture.

A jointly-controlled entity is a joint venture that is subject to joint control, resulting in none of the participating parties having unilateral control over the economic activity of the jointly-controlled entity.

The Group's share of the post-acquisition results and reserves of a jointly-controlled entity is included in the consolidated income statement and consolidated reserves, respectively. The Group's interests in a jointly-controlled entity is stated in the consolidated balance sheet at the Group's share of net assets under the equity method of accounting, less any impairment losses. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

The results of a jointly-controlled entity are included in the Group's income statement to the extent of dividends received and receivable. The Group's interests in a jointly-controlled entity are treated as non-current assets and are stated at cost less any impairment losses.

(11) Related parties

A party is considered to be related to the Group if:

- (a) the party, directly or indirectly through one or more intermediaries, (i) controls, is controlled by, or is under common control with, the Group; (ii) has an interest in the Group that gives it significant influence over the Group; or (iii) has joint control over the Group;
- (b) the party is an associate;
- (c) the party is a jointly-controlled entity;
- (d) the party is a member of the key management personnel of the Group or its holding companies;
- (e) the party is a close member of the family of any individual referred to in (a) or (d);
- (f) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or
- (g) the party is a post-employment benefit plan for the benefit of the employees of the Group, or of any entity that is a related party of the Group.



Notes to Financial Statements

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(12) Property and equipment, and depreciation

Property and equipment are stated at cost or valuation less accumulated depreciation and any impairment losses. The cost of an item of property and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after items of property and equipment have been put into operation, such as repairs and maintenance, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property and equipment, and where the cost of the item can be measured reliably, the expenditure is capitalised as an additional cost of that asset or as a replacement.

Valuations are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount. Changes in the values of property and equipment are dealt with as movements in the asset revaluation reserve. If the total of this reserve is insufficient to cover a deficit, on an individual asset basis, the excess of the deficit is charged to the income statement. Any subsequent revaluation surplus is credited to the income statement to the extent of the deficit previously charged. On disposal of a revalued asset, the relevant portion of the asset revaluation reserve realised in respect of previous valuations is transferred to retained profits as a movement in reserves.

Depreciation is calculated using the straight-line method to write down the cost of each item of property and equipment to its residual value over its estimated useful life, as follows:

- Buildings Remaining lease period
- Furniture, fixtures, equipment and motor vehicles 3 – 10 years

Where parts of an item of property and equipment have different useful lives, the cost or valuation of that item is allocated on a reasonable basis among the parts and each part is depreciated separately.

Residual values, useful lives and the depreciation method are reviewed, and adjusted if appropriate, at each balance sheet date.

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss on disposal or retirement recognised in the income statement in the year the asset is derecognised is the difference between the net sale proceeds and the carrying amount of the relevant asset.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(13) Investment properties

Investment properties are interests in land and buildings held to earn rental income and/or for capital appreciation, rather than for use in the production or supply of goods or services or for administrative purposes; or for sale in the ordinary course of business. Such properties are measured initially at cost, including transaction costs. Subsequent to initial recognition, investment properties are stated at fair value, which reflects market conditions at the balance sheet date. Gains or losses arising from changes in the fair values of investment properties are included in the income statement in the year in which they arise.

Any gains or losses on the retirement or disposal of an investment property are recognised in the income statement in the year of retirement or disposal.

For a transfer from investment properties to owner-occupied properties, the deemed cost of property for subsequent accounting is its fair value at the date of change in use. If the property occupied by the Group as an owner-occupied property becomes an investment property, the Group accounts for such property in accordance with the policy stated under "Property and equipment and depreciation" up to the date of change in use, and any difference at that date between the carrying amount and the fair value of the property is accounted for.

(14) Intangible assets

Intangible assets, representing eligibility rights to trade on or through Hong Kong Exchanges and Clearing Limited, are stated at cost less impairment as at 1 January 2007. The carrying amount of intangible assets is subject to an annual impairment test, and impairment, if any, is charged to the income statement.

(15) Impairment of non-financial assets

The Group assesses at each reporting date or more frequently if events or changes in circumstances indicate that the carrying value may be impaired, whether there is an indication that a non-financial asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. Where the carrying amount of an asset (or cash-generating unit) exceeds its recoverable amount, the asset (or cash-generating unit) it considered impaired is written down to its recoverable amount.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. Impairment losses relating to goodwill cannot be reversed for subsequent increases in its recoverable amount in future periods.



Notes to Financial Statements

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(16) Financial guarantees

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognised in the financial statements at fair value, in "Other liabilities", being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the income statement in "Impairment allowances". The premium received is recognised in the income statement in "Net fees and commission income" on a straight line basis over the life of the guarantee.

(17) Repossessed assets and valuation of collateral

Collateral assets for loans and advances and receivables are repossessed by the Group when the borrowers are unable to service their repayments, and would be realised in satisfaction of outstanding debts. Advances with repossessed collateral assets will continue to be accounted for as customer advances, except for those where the Group has taken the legal title with control of the repossessed collateral assets, in which cases, the repossessed assets are shown under other accounts at the predetermined value with a corresponding reduction in the related advances. Individual impairment allowance is made on the shortfall between the expected net realisable value of repossessed assets and the outstanding advances.

Collateral assets (including repossessed assets and assets not yet repossessed) are recognised at the lower of their carrying amount of the related loans and advances and receivables and fair value less costs to sell.

(18) Provisions

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

When the effect of discounting is material, the amount recognised for a provision is the present value at the balance sheet date of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in operating expenses in the income statement.

(19) Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the income statement, or in equity if it relates to items that are recognised in the same or a different period directly in equity.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(19) Income tax (Continued)

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- where the deferred tax liability arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries and interests in joint venture, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carry forward of unused tax credit and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credit and unused tax losses can be utilised except:

- where the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries and interests in joint venture, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

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 profit will be available to allow all or part of the deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it is probable that sufficient taxable profit will be available to allow or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the balance sheet date.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.



Notes to Financial Statements

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(20) Employee benefits

(a) Retirement benefit schemes

The Group operates two defined contribution retirement benefit schemes for those employees who are eligible to participate. The assets of the schemes are held separately from those of the Group in independently administered funds.

Contributions are made based on a percentage of the participating employees' relevant monthly income from the Group, and are charged to the income statement as they become payable in accordance with the rules of the respective schemes. When an employee leaves the Occupational Retirement Scheme Ordinance Scheme prior to his/her interest in the Group's employer non-mandatory contributions vesting with the employee, the ongoing contributions payable by the Group may be reduced by the relevant amount of forfeited contributions. When an employee leaves the Mandatory Provident Fund, the Group's mandatory contributions vest fully with the employee.

(b) Employee leave entitlements

The cost of accumulating compensated absences is recognised as an expense and measured based on the additional amount that the Group expects to pay as a result of the unused entitlement that has accumulated as at the balance sheet date.

(21) Dividends

Final dividends proposed by the directors are classified as a separate allocation of retained profits within the equity section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

Interim dividends are simultaneously proposed and declared, because the Bank's New Articles of Association grant the directors the authority to declare interim dividends. Consequently, interim dividends are recognised immediately as a liability when they are proposed and declared.

3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

Judgements

In the process of applying the Group's accounting policies, management has made the following judgements, apart from those involving estimations, which have the most significant effect on the amounts recognised in the financial statements:

Held-to-maturity investments

The Group follows the guidance of HKAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. This classification requires significant 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, it is required to reclassify the entire class of held-to-maturity investments to other appropriate classes of financial assets. The investments would then be measured at fair value and not at amortised cost.

3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES (Continued)

Estimation uncertainty

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 discussed below.

Impairment allowances on loans and advances and receivables, and held-to-maturity investments

The Group reviews its portfolios of loans and advances and receivables and held-to-maturity investments to assess impairment on a regular basis. In determining whether an impairment loss should be recorded in the income statement, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans and held-to-maturity investments before the decrease can be identified with an individual loan or held-to-maturity investment in those portfolios. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the Group.

For loans and advances and receivables for which no individual impairment is observed, management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the loan portfolio when scheduling its future cash flows. 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.

4. INTEREST INCOME AND EXPENSE

The interest income for the year ended 31 December 2007 amounted to HK\$1,026,832,000 (2006: HK\$826,252,000) and interest expense for the year ended 31 December 2007 amounted to HK\$761,015,000 (2006 : HK\$566,914,000) pursuant to the adoption of effective interest method for financial assets and financial liabilities which are not designated at fair value through profit or loss. The interest income of the impaired loans and advances for the year ended 31 December 2007 amounted to HK\$4,587,000 (2006: HK\$6,489,000).

Notes to Financial Statements

5. OTHER OPERATING INCOME

| | Group | |
|--|----------------|----------|
| | 2007 | 2006 |
| | HK\$'000 | HK\$'000 |
| Fees and commission income: | | |
| Retail and commercial banking | 39,254 | 33,486 |
| Securities | 34,004 | 21,596 |
| | 73,258 | 55,082 |
| Less: Fees and commission expenses | (1,249) | (168) |
| Net fees and commission income | 72,009 | 54,914 |
| Gross rental income | 3,647 | 3,807 |
| Less: Direct operating expenses | - | (9) |
| Net rental income | 3,647 | 3,798 |
| Gain less losses arising from dealing in foreign currencies | 11,960 | 4,948 |
| Net (loss)/gain on derivative financial instruments | (2,782) | 9,714 |
| Gain on disposal of financial assets designated at fair value through profit or loss | - | 3,477 |
| Net gain on financial assets designated at fair value through profit or loss | 2,023 | 1,931 |
| Dividend income from listed investments | - | 125 |
| Dividend income from unlisted investments | 980 | 780 |
| Others | 3,513 | 2,959 |
| | 91,350 | 82,646 |

There were no net gain or losses arising from held-to-maturity investments, loans and advances and receivables, financial liabilities at amortised cost and financial liabilities designated at fair value through profit or loss for years 2007 and 2006. There were also no net gain or losses on sale of available-for-sale financial assets transferred from equity and recognised in profit or loss for the years 2007 and 2006.

All fees and commission income and expense are related to financial assets or financial liabilities which are not designated at fair value through profit or loss. No fees and commission income and expense are related to trust and other fiduciary activities.



6. OPERATING EXPENSES

| | Notes | Group | |
|---|-------|------------------|------------------|
| | | 2007 HK\$'000 | 2006 HK\$'000 |
| Staff costs (including directors' remuneration, note 8): | | | |
| Salaries and other staff costs | | 112,453 | 97,684 |
| Pension contributions | | 4,756 | 4,075 |
| | | 117,209 | 101,759 |
| Premises and equipment expenses: | | | |
| Minimum lease payments under operating leases in respect of buildings | | 14,833 | 5,145 |
| Others | | 18,103 | 13,744 |
| | | 32,936 | 18,889 |
| Auditors' remuneration | | 1,638 | 1,291 |
| Depreciation charges | 21 | 19,400 | 14,686 |
| Net gain on disposal of property and equipment | | (627) | (184) |
| Others | | 58,682 | 43,788 |
| Operating expenses before changes in fair value of buildings and investment properties | | 229,238 | 180,229 |
| Changes in fair value of buildings | 21 | (3,079) | (8,455) |
| Changes in fair value of investment properties | 22 | (4,700) | (5,406) |
| | | (7,779) | (13,861) |
| | | 221,459 | 166,368 |

Notes to Financial Statements

7. IMPAIRMENT ALLOWANCES

| | Group | |
|---|------------------|------------------|
| | 2007 HK\$'000 | 2006 HK\$'000 |
| Charge for/(write-back of) impairment against: | | |
| – Loans and advances | 2,346 | 7,244 |
| – Held-to-maturity investments | 9,800 | – |
| – Trade bills, accrued interest and receivables | (18,895) | (3,916) |
| | (6,749) | 3,328 |
| Net charge for/(write-back of) impairment allowances: | | |
| – Individually assessed | (326) | 4,944 |
| – Collectively assessed | (6,423) | (1,616) |
| | (6,749) | 3,328 |
| Of which: | | |
| – new impairment allowances (including any amount directly written off during the year) | 32,817 | 12,044 |
| – releases and recoveries | (39,566) | (8,716) |
| Net (write-back)/charge to the consolidated income statement | (6,749) | 3,328 |

There were no impairment allowances for other financial assets (other than loans and advances and receivables, and held-to-maturity investments) for the years 2007 and 2006.

8. DIRECTORS' REMUNERATION

Directors' remuneration disclosed pursuant to Section 161 of the Companies Ordinance was as follows:

| | Group | |
|------------------|------------------|------------------|
| | 2007 HK\$'000 | 2006 HK\$'000 |
| Fees | 690 | 1,065 |
| Other emoluments | 1,348 | 7,129 |
| | 2,038 | 8,194 |

9. TAX

| | Group | |
|---|---------------|---------------|
| | 2007 | 2006 |
| | HK\$'000 | HK\$'000 |
| Current tax charge: | | |
| Hong Kong | 14,543 | 26,786 |
| Elsewhere | 5,568 | 3,086 |
| Over-provisions in prior years | (2,600) | (1,700) |
| Deferred tax charge/(credit), net (Note 25) | 3,350 | (170) |
| | 20,861 | 28,002 |

Hong Kong profits tax has been provided at the rate of 17.5% (2006: 17.5%) on the estimated assessable profits arising in Hong Kong during the year. Taxes on profits assessable elsewhere have been calculated at the rates of tax prevailing in the countries in which the Group operates, based on existing legislation, interpretations and practices in respect thereof.

A reconciliation of the tax expense applicable to profit before tax using the statutory rates for the locations in which the Bank and its subsidiaries and a jointly-controlled entity are domiciled to the tax expense at the effective tax rates, and a reconciliation of the applicable rates to the effective tax rates, are as follows:

| | Group | | | | | |
|---|----------------|-------------|----------------|-------------|----------------|-------------|
| | 2007 | | | | | |
| | Hong Kong | | Mainland China | | Total | |
| | HK\$'000 | % | HK\$'000 | % | HK\$'000 | % |
| Profit before tax | 109,577 | | 32,717 | | 142,294 | |
| Tax at the applicable tax rate | 19,176 | 17.5 | 5,568 | 17.0 | 24,744 | 17.4 |
| Estimated tax effect of net income that is not taxable | (1,171) | (1.0) | - | - | (1,171) | (0.8) |
| Estimated tax losses from previous periods utilised | (194) | (0.2) | - | - | (194) | (0.2) |
| Estimated tax losses not recognised | 82 | 0.1 | - | - | 82 | 0.1 |
| Adjustments in respect of current tax of previous periods | (2,600) | (2.4) | - | - | (2,600) | (1.8) |
| Tax charge at the Group's effective rate | 15,293 | 14.0 | 5,568 | 17.0 | 20,861 | 14.7 |



Notes to Financial Statements

9. TAX (Continued)

Group

| | Hong Kong | | 2006 Mainland China | | Total | |
|---|----------------|-------------|------------------------|------------|----------------|-------------|
| | HK\$'000 | % | HK\$'000 | % | HK\$'000 | % |
| Profit before tax | <u>152,927</u> | | <u>20,575</u> | | <u>173,502</u> | |
| Tax at the applicable tax rate | 26,762 | 17.5 | 3,086 | 15.0 | 29,848 | 17.2 |
| Share of profits and losses of a jointly-controlled entity | (37) | – | – | – | (37) | – |
| Estimated tax effect of net income not subject to tax | (135) | (0.1) | – | – | (135) | (0.1) |
| Estimated tax losses not recognised | 26 | – | – | – | 26 | – |
| Adjustments in respect of current tax of previous periods | – | – | (1,700) | (8.3) | (1,700) | (1.0) |
| Tax charge at the Group's effective rate | <u>26,616</u> | <u>17.4</u> | <u>1,386</u> | <u>6.7</u> | <u>28,002</u> | <u>16.1</u> |

10. PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK

The consolidated profit attributable to equity holders of the Bank for the year ended 31 December 2007 includes a profit of HK\$210,476,000 (2006: HK\$188,709,000) which has been dealt with in the financial statements of the Bank (Note 27).

11. CASH AND SHORT TERM PLACEMENTS

| | Group | | Bank | |
|--|------------------|------------------|------------------|------------------|
| | 2007 HK\$'000 | 2006 HK\$'000 | 2007 HK\$'000 | 2006 HK\$'000 |
| Cash in hand | 97,450 | 65,793 | 97,450 | 65,793 |
| Placement with banks and financial institutions | 292,791 | 174,791 | 291,769 | 173,777 |
| Money at call and short notice | 5,402,658 | 1,766,876 | 5,402,658 | 1,766,876 |
| | 5,792,899 | 2,007,460 | 5,791,877 | 2,006,446 |

The carrying amounts of the short term placements approximate their fair values, and over 90% of the placements are rated with grading of Baa2 or above based on the rating of an external credit agency, Moody's.



12. PLACEMENTS WITH BANKS AND FINANCIAL INSTITUTIONS

| | Group and Bank | |
|--|----------------|----------|
| | 2007 | 2006 |
| | HK\$'000 | HK\$'000 |
| Placements with banks and financial institutions | 441,539 | 566,773 |

The carrying amounts of the placements with banks and financial institutions approximate their fair value, and over 90% of the placements were rated with grading of Baa2 or above based on the rating of an external credit agency, Moody's.

13. FINANCIAL ASSETS DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS

| | Group and Bank | |
|--|----------------|----------|
| | 2007 | 2006 |
| | HK\$'000 | HK\$'000 |
| Unlisted equity investment funds, at quoted market price | 12,262 | 10,213 |

They were designated as fair value through profit or loss upon initial recognition.

14. LOANS AND ADVANCES AND RECEIVABLES

| | Group and Bank | |
|--|-------------------|------------|
| | 2007 | 2006 |
| | HK\$'000 | HK\$'000 |
| Loans and advances to customers | 15,252,073 | 10,066,010 |
| Trade bills | 166,087 | 98,381 |
| | 15,418,160 | 10,164,391 |
| Accrued interest | 46,334 | 61,338 |
| Gross loans and advances and receivables | 15,464,494 | 10,225,729 |
| Less: Impairment allowances for loans and advances and receivables | | |
| – Individually assessed | (27,554) | (42,075) |
| – Collectively assessed | (17,059) | (23,358) |
| | (44,613) | (65,433) |
| Loans and advances and receivables | 15,419,881 | 10,160,296 |

There were neither loans and advances to banks nor other accounts other than trade bills and accrued interest.

Over 90% of the loans and advances and receivables are unrated exposures. The carrying amounts of loans and advances and other receivables, net of impairment allowances, approximate their fair values.

Notes to Financial Statements

14. LOANS AND ADVANCES AND RECEIVABLES (Continued)

The Group's and the Bank's loans and advances and receivables are collateralised by properties, cash, securities and taxi licences. Over 75% of collateral were properties and taxi licenses.

(a) Overdue and impaired loans and advances and receivables

| | Group and Bank | | | |
|---|-----------------------------|---|-----------------------------|---|
| | 2007 | | 2006 | |
| | Gross amount HK\$'000 | Percentage of total loans and advances | Gross amount HK\$'000 | Percentage of total loans and advances |
| Loans and advances to customers overdue for: | | | | |
| Six months or less but over three months | 47,029 | 0.31 | 2,595 | 0.03 |
| One year or less but over six months | 3,964 | 0.03 | 10,499 | 0.10 |
| Over one year | 7,362 | 0.05 | 51,890 | 0.51 |
| Loans and advances to customers overdue for more than three months | 58,355 | 0.39 | 64,984 | 0.64 |
| Rescheduled loans and advances and loss accounts overdue for three months or less | 17,460 | 0.10 | 13,369 | 0.13 |
| Total overdue and impaired loans and advances to customers | 75,815 | 0.49 | 78,353 | 0.77 |

| | Group and Bank | |
|--|----------------|----------|
| | 2007 | 2006 |
| | HK\$'000 | HK\$'000 |
| Trade bills and accrued interest overdue for: | | |
| Six months or less but over three months | 1,006 | 9 |
| One year or less but over six months | 468 | 890 |
| Over one year | 1,210 | 21,253 |
| Total overdue and impaired accrued interest | 2,684 | 22,152 |

Impaired loans and advances and receivables are individually determined to be impaired taking into account overdue aging analysis and other qualitative factors such as bankruptcy proceedings and individual voluntary arrangements.

14. LOANS AND ADVANCES AND RECEIVABLES (Continued)

(b) Geographical analysis of overdue and impaired loans and advances, and individual and collective impairment allowances

| | Group and Bank | | | | | |
|---|----------------|-------------------|---------------|-----------|-------------------|----------------|
| | 2007 | | | 2006 | | |
| | Hong Kong | Mainland China | Total | Hong Kong | Mainland China | Total |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| (i) Analysis of overdue loans and advances to customers | | | | | | |
| Loans and advances overdue more than three months | 58,355 | - | 58,355 | 49,304 | 18,348 | 67,652 |
| Individual impairment allowances | 19,255 | - | 19,255 | 17,029 | - | 17,029 |
| Collective impairment allowances | - | - | - | - | 6 | 6 |
| Current market value and fair value of collateral | | | 40,897 | | | 107,876 |
| (ii) Analysis of impaired loans and advances to customers | | | | | | |
| Impaired loans and advances | 75,815 | - | 75,815 | 54,291 | 24,062 | 78,353 |
| Individual impairment allowances | 24,265 | - | 24,265 | 19,764 | - | 19,764 |
| Collective impairment allowances | - | - | - | - | - | - |
| Current market value and fair value of collateral | | | 48,878 | | | 145,372 |

Over 90% of the Group's gross loans and advances and receivables and their related impairment allowances are derived from operations carried out in Hong Kong. Accordingly, no geographical segment information is presented herein.



Notes to Financial Statements

14. LOANS AND ADVANCES AND RECEIVABLES (Continued)

- (c) The value of collateral held in respect of its overdue loans and advances to customers and the split between the portion of the overdue loans and advances covered by credit protection (covered portion) and the remaining portion (uncovered portion) are as follows:

| | Group and Bank | |
|---|-----------------------|----------|
| | 2007 | 2006 |
| | HK\$'000 | HK\$'000 |
| Current market value and fair value of collateral held against the covered portion of overdue loans and advances to customers | 40,897 | 107,876 |
| Covered portion of overdue loans and advances to customers | 36,644 | 53,917 |
| Uncovered portion of overdue loans and advances to customers | 21,711 | 11,067 |

The eligibility of assets taken as collateral should satisfy following criteria:

- The market value of the asset is readily determinable or can be reasonably established and verified.
- The asset is marketable and there exists a readily available secondary market for disposal of the asset.
- The Group's right to repossess the asset is legally enforceable without impediment.
- The Group is able to secure control over the asset if necessary.

The main types of guarantors for credit risk mitigation are as follows:

- Central government with grading of Aa3 or above
- Unrated public sector enterprises
- Banks with grading of Baa2 or above
- Unrated corporations
- Individual shareholders and directors of corporate customers

(d) Repossessed assets

As at 31 December 2007, there were no repossessed assets of the Group (2006: HK\$20,415,000).

14. LOANS AND ADVANCES AND RECEIVABLES (Continued)

(e) Past due but not impaired loans and advances and receivables

| | 2007 | | 2006 | |
|---|--------------------------|---|-----------------------------|---|
| | Gross amount HK\$'000 | Percentage of total loans and advances | Gross amount HK\$'000 | Percentage of total loans and advances |
| Loans overdue less than three months | 412,888 | 2.70 | 246,175 | 2.42 |
| Rescheduled but not impaired loans and advances | 710 | – | 2,719 | 0.03 |
| | 413,598 | 2.70 | 248,894 | 2.45 |
| Trade bills and accrued interest overdue less than three months | 6,055 | | 4,917 | |

(f) Movements in impairment allowances on loans and advances and receivables

| | 2007 | | Total HK\$'000 |
|--|---|---|-------------------|
| | Individual impairment allowance HK\$'000 | Collective impairment allowance HK\$'000 | |
| At 1 January 2007 | 42,075 | 23,358 | 65,433 |
| Amounts written off | (6,251) | – | (6,251) |
| Impairment allowances charged to the income statement | 23,017 | – | 23,017 |
| Impairment allowances released to the income statement | (33,143) | (6,423) | (39,566) |
| Net release of impairment allowances | (10,126) | (6,423) | (16,549) |
| Loans and advances and receivables recovered | 1,856 | – | 1,856 |
| Exchange difference | – | 124 | 124 |
| At 31 December 2007 | 27,554 | 17,059 | 44,613 |
| Deducted from: | | | |
| Loans and advances | 24,265 | 16,146 | 40,411 |
| Trade bills and accrued interest | 3,289 | 913 | 4,202 |
| | 27,554 | 17,059 | 44,613 |

Notes to Financial Statements

14. LOANS AND ADVANCES AND RECEIVABLES (Continued)

(f) Movements in impairment allowances on loans and advances and receivables (Continued)

Group and Bank

| | 2006 | | Total HK\$'000 |
|---|---|---|-------------------|
| | Individual impairment allowance HK\$'000 | Collective impairment allowance HK\$'000 | |
| | At 1 January 2006 | 68,379 | |
| Amounts written off | (33,197) | – | (33,197) |
| Impairment allowances charged to the income statement | 12,044 | – | 12,044 |
| Impairment allowances released to the income statement | (7,100) | (1,616) | (8,716) |
| Net charge/(release) of impairment allowances | 4,944 | (1,616) | 3,328 |
| Loans and advances and receivables recovered | 1,949 | – | 1,949 |
| At 31 December 2006 | 42,075 | 23,358 | 65,433 |
| Deducted from: | | | |
| Loans and advances | 19,764 | 22,571 | 42,335 |
| Trade bills and accrued interest | 22,311 | 787 | 23,098 |
| | 42,075 | 23,358 | 65,433 |

There were no other overdue or rescheduled advances to banks and other financial institutions or other assets (other than loans and advances and receivables and held-to-maturity investments) as at 31 December 2007 and 2006.

There were no impairment allowances for other assets (other than loans and advances and receivables, held-to-maturity investments and intangible assets) as at 31 December 2007 and 2006, and no impairment allowances and losses were charged to the income statement for such other assets in the financial years ended 2007 and 2006.

14. LOANS AND ADVANCES AND RECEIVABLES (Continued)

(g) Finance lease receivables

Included in loans and advances and receivables were receivables in respect of assets leased under finance leases as set out below:

Group and Bank

| | Minimum lease payments | | Present value of minimum lease payments | |
|--|------------------------|------------------|---|------------------|
| | 2007 HK\$'000 | 2006 HK\$'000 | 2007 HK\$'000 | 2006 HK\$'000 |
| Amounts receivable under finance leases: | | | | |
| Within one year | 432,247 | 346,816 | 328,631 | 258,432 |
| In the second to fifth years, inclusive | 769,793 | 607,193 | 488,626 | 342,146 |
| Over five years | 2,122,594 | 2,098,568 | 1,484,347 | 1,201,171 |
| | 3,324,634 | 3,052,577 | 2,301,604 | 1,801,749 |
| Less: Unearned finance income | (1,023,030) | (1,250,828) | | |
| Present value of minimum lease payments receivable | 2,301,604 | 1,801,749 | | |

The Group and the Bank has entered into finance lease arrangements with customers in respect of motor vehicles and equipment. The terms of the finance leases entered into range from 1 to 25 years.

15. AVAILABLE-FOR-SALE FINANCIAL ASSETS

| | Group and Bank | |
|-------------------------------------|------------------|------------------|
| | 2007 HK\$'000 | 2006 HK\$'000 |
| Unlisted equity investment, at cost | 6,804 | 6,804 |

Unlisted equity investment is stated at cost as the investment does not have a quoted market price in an active market and its fair value cannot be reliably measured.



Notes to Financial Statements

16. HELD-TO-MATURITY INVESTMENTS

| | Group and Bank | |
|---|------------------|-----------|
| | 2007 | 2006 |
| | HK\$'000 | HK\$'000 |
| Certificates of deposit held | 175,696 | 564,186 |
| Treasury bills (including Exchange Fund Bills) | 297,478 | 99,224 |
| Other debt securities | 2,401,016 | 3,086,092 |
| | 2,874,190 | 3,749,502 |
| Less : Individual impairment allowance | (9,800) | – |
| | 2,864,390 | 3,749,502 |
| Listed or unlisted: | | |
| – listed in Hong Kong | 19,986 | 19,980 |
| – listed outside Hong Kong | – | 46,661 |
| – unlisted | 2,844,404 | 3,682,861 |
| | 2,864,390 | 3,749,502 |
| Analysed by issuers: | | |
| – Central government | 297,478 | 99,224 |
| – Public sector entities | – | 23,329 |
| – Banks and other financial institutions | 2,418,655 | 3,284,098 |
| – Corporate entities | 148,257 | 342,851 |
| | 2,864,390 | 3,749,502 |
| Market value of listed held-to-maturity investments | | |
| – Hong Kong | 19,810 | 19,540 |
| – outside Hong Kong | – | 46,618 |
| | 19,810 | 66,158 |

Over 90% of exposures attributed to the held-to-maturity investments are rated with grading of Baa2 or above based on credit rating of an external credit agency, Moody's.

16. HELD-TO-MATURITY INVESTMENTS (Continued)

Overdue analysis of impaired held-to-maturity investments

| | Group and Bank | | | |
|---|-----------------------------|---|-----------------------------|---|
| | 2007 | | 2006 | |
| | Gross amount HK\$'000 | Percentage of total held-to-maturity investments | Gross amount HK\$'000 | Percentage of total held-to-maturity investments |
| A corporate entity: | | | | |
| Securitisation exposures overdue less than three months but impaired | 77,907 | 2.71 | – | – |
| Less: Individual impairment allowance | (9,800) | | – | |
| | 68,107 | | – | |

The Bank acted as an investing institution to invest in subordinated capital notes issued by the entity. The exposures (net of individual impairment allowance) have been deducted in amount of HK\$68,107,000 from the Group and the Bank's core capital and supplementary capital in "Capital Disclosures" of Supplementary Information.

There were no other held-to-maturity investments overdue more than three months and no other securitisation exposures.

Notes to Financial Statements

17. INTERESTS IN SUBSIDIARIES

| | Bank | |
|--------------------------|-----------------|----------|
| | 2007 | 2006 |
| | HK\$'000 | HK\$'000 |
| Unlisted shares, at cost | 56,952 | 56,952 |

The amounts due from and to subsidiaries are unsecured, interest-free and have no fixed terms of repayment.

The carrying amounts of the amounts due from and to subsidiaries approximate to their fair values.

Particulars of the Bank's subsidiaries, which are all incorporated and operate in Hong Kong, were as follows:

| Name | Nominal value of issued ordinary share capital HK\$'000 | Percentage of equity directly attributable to the Bank | Principal activities |
|-------------------------------------|--|---|-------------------------------|
| Public Bank (Nominees) Limited | 100 | 100 | Provision of nominee services |
| PB Finance Limited | 25,000 | 100 | Dormant |
| Public Investments Limited | 5,000 | 100 | Dormant |
| Public Realty Limited | 100 | 100 | Dormant |
| Public Credit Limited | 5,000 | 100 | Dormant |
| Public Futures Limited | 20,000 | 100 | Dormant |
| Public Pacific Securities Limited | 12,000 | 100 | Dormant |
| Public Financial Securities Limited | 15,000 | 100 | Securities brokerage |

18. INTEREST IN A JOINTLY-CONTROLLED ENTITY

| | Group | | Bank | |
|---|------------------|------------------|------------------|------------------|
| | 2007 HK\$'000 | 2006 HK\$'000 | 2007 HK\$'000 | 2006 HK\$'000 |
| Unlisted shares, at cost | – | – | 1,500 | 1,500 |
| Share of net assets other than goodwill | 1,513 | 1,676 | – | – |
| | 1,513 | 1,676 | 1,500 | 1,500 |

Particulars of the Group's jointly-controlled entity are as follows:

| Name | Business structure | Place of incorporation and operations | Percentage of interest and profit sharing | Voting power | Principal activity |
|--------------------------|--------------------|---------------------------------------|---|--------------|--|
| Net Alliance Co. Limited | Corporate | Hong Kong | 17.6 | 2 out of 8* | Provision of electronic banking support services |

* Representing the number of votes on the board of directors attributable to the Group.

The following table illustrates the summarised financial information of the Group's interest in a jointly-controlled entity:

| | 2007 HK\$'000 | 2006 HK\$'000 |
|--|------------------|------------------|
| Share of the jointly-controlled entity assets and liabilities: | | |
| Assets | 2,321 | 1,970 |
| Liabilities | (808) | (294) |
| Net assets | 1,513 | 1,676 |
| Share of the jointly-controlled entity profits and losses: | | |
| Total income | 1,291 | 1,803 |
| Total expenses | (1,454) | (1,627) |
| (Loss)/profit after tax | (163) | 176 |

The financial statements of Net Alliance Co. Limited are coterminous with those of the Group. The most recent management financial statements of Net Alliance Co. Limited are used by the Group in applying the equity method.



Notes to Financial Statements

19. OTHER ASSETS

| | Group | | Bank | |
|---|----------------|----------|----------------|----------|
| | 2007 | 2006 | 2007 | 2006 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Interest receivable on bank placements and held-to-maturity investments | 35,744 | 51,125 | 35,744 | 51,125 |
| Other debtors, deposits and prepayments | 156,580 | 125,467 | 155,769 | 152,211 |
| | 192,324 | 176,592 | 191,513 | 203,336 |

The Group's and the Bank's interest receivable from authorised institutions were current in nature while the Group's and the Bank's other debtors, deposits and prepayments were non-current in nature as at 31 December 2007 and 2006.

The carrying amounts of the other debtors, deposits and prepayments approximate their fair values.

20. INTANGIBLE ASSETS

| | Group | |
|---|----------|----------|
| | 2007 | 2006 |
| | HK\$'000 | HK\$'000 |
| Cost: | | |
| At beginning of year | 1,437 | 1,437 |
| Accumulated impairment: | | |
| At beginning of year | 838 | 838 |
| Impairment recognised in the income statement during the year | 367 | – |
| At end of year | 1,205 | 838 |
| Net carrying amount: | | |
| At end of year | 232 | 599 |

The trading rights are retained for stock trading and stockbroking activities, and are of indefinite useful lives. They represent three units of Stock Exchange Trading Right and one unit of Futures Exchange Trading Right in Hong Kong Exchanges and Clearing Limited.

No intangible assets were held by the Bank as at 31 December 2007 and 2006.

Notes to Financial Statements

21. PROPERTY AND EQUIPMENT

| | Group | | | Bank | | |
|-------------------------------------|--|----------------------|-------------------|--|----------------------|-------------------|
| | Furniture, fixtures, equipment and motor | | | Furniture, fixtures, equipment and motor | | |
| | Buildings HK\$'000 | vehicles HK\$'000 | Total HK\$'000 | Buildings HK\$'000 | vehicles HK\$'000 | Total HK\$'000 |
| Cost or valuation: | | | | | | |
| At 1 January 2007 | | | | | | |
| – cost | – | 176,581 | 176,581 | – | 167,674 | 167,674 |
| – valuation | 508,634 | – | 508,634 | 449,704 | – | 449,704 |
| Transfer from investment properties | 10,166 | – | 10,166 | 10,166 | – | 10,166 |
| Additions | – | 28,607 | 28,607 | – | 28,608 | 28,608 |
| Disposals/write-off | – | (38,027) | (38,027) | – | (37,243) | (37,243) |
| Surplus on revaluation | 95,050 | – | 95,050 | 95,050 | – | 95,050 |
| Transfer from group company | – | – | – | 58,930 | – | 58,930 |
| At 31 December 2007 | 613,850 | 167,161 | 781,011 | 613,850 | 159,039 | 772,889 |
| Accumulated depreciation: | | | | | | |
| At 1 January 2007 | – | 168,356 | 168,356 | – | 159,592 | 159,592 |
| Provided during the year | 11,103 | 8,297 | 19,400 | 10,680 | 8,248 | 18,928 |
| Disposals/write-off | – | (37,704) | (37,704) | – | (36,920) | (36,920) |
| Write-back on revaluation | (11,110) | – | (11,110) | (10,687) | – | (10,687) |
| Exchange difference | 7 | – | 7 | 7 | – | 7 |
| At 31 December 2007 | – | 138,949 | 138,949 | – | 130,920 | 130,920 |
| Net carrying amount: | | | | | | |
| Analysis of cost or valuation | | | | | | |
| At 31 December 2007 | | | | | | |
| – cost | – | 28,212 | 28,212 | – | 28,119 | 28,119 |
| – valuation | 613,850 | – | 613,850 | 613,850 | – | 613,850 |
| | 613,850 | 28,212 | 642,062 | 613,850 | 28,119 | 641,969 |
| At 31 December 2006 | | | | | | |
| – cost | – | 8,225 | 8,225 | – | 8,082 | 8,082 |
| – valuation | 508,634 | – | 508,634 | 449,704 | – | 449,704 |
| | 508,634 | 8,225 | 516,859 | 449,704 | 8,082 | 457,786 |

Notes to Financial Statements

21. PROPERTY AND EQUIPMENT (Continued)

| | Group | | | Bank | | |
|-------------------------------|-----------------------|---|-------------------|-----------------------|---|-------------------|
| | Buildings HK\$'000 | Furniture, fixtures, equipment and motor vehicles HK\$'000 | Total HK\$'000 | Buildings HK\$'000 | Furniture, fixtures, equipment and motor vehicles HK\$'000 | Total HK\$'000 |
| Cost or valuation: | | | | | | |
| At 1 January 2006 | | | | | | |
| – cost | – | 175,431 | 175,431 | – | 166,671 | 166,671 |
| – valuation | 372,870 | – | 372,870 | 326,899 | – | 326,899 |
| Additions | – | 1,890 | 1,890 | – | 1,743 | 1,743 |
| Disposals/write-off | – | (740) | (740) | – | (740) | (740) |
| Surplus on revaluation | 135,764 | – | 135,764 | 122,805 | – | 122,805 |
| At 31 December 2006 | 508,634 | 176,581 | 685,215 | 449,704 | 167,674 | 617,378 |
| Accumulated depreciation: | | | | | | |
| At 1 January 2006 | – | 161,833 | 161,833 | – | 153,083 | 153,083 |
| Provided during the year | 7,970 | 6,716 | 14,686 | 6,985 | 6,702 | 13,687 |
| Disposals/write-off | – | (193) | (193) | – | (193) | (193) |
| Write-back on revaluation | (7,970) | – | (7,970) | (6,985) | – | (6,985) |
| At 31 December 2006 | – | 168,356 | 168,356 | – | 159,592 | 159,592 |
| Net carrying amount: | | | | | | |
| Analysis of cost or valuation | | | | | | |
| At 31 December 2006 | | | | | | |
| – cost | – | 8,225 | 8,225 | – | 8,082 | 8,082 |
| – valuation | 508,634 | – | 508,634 | 449,704 | – | 449,704 |
| | 508,634 | 8,225 | 516,859 | 449,704 | 8,082 | 457,786 |
| At 31 December 2005 | | | | | | |
| – cost | – | 13,598 | 13,598 | – | 13,588 | 13,588 |
| – valuation | 372,870 | – | 372,870 | 326,899 | – | 326,899 |
| | 372,870 | 13,598 | 386,468 | 326,899 | 13,588 | 340,487 |

21. PROPERTY AND EQUIPMENT (Continued)

All of the Group's and the Bank's properties were revalued as at 31 December 2007 by C S Surveyors Limited, a firm of independent professionally qualified valuers, on an open market value, based on their existing use. The revaluation surpluses of HK\$103,080,000 (2006: HK\$135,279,000) and HK\$102,658,000 (2006: HK\$121,332,000) of the Group and the Bank respectively, have been credited to the asset revaluation reserve (Note 27), while a surplus of HK\$3,079,000 (2006: HK\$8,455,000) has been credited to the respective income statement (Note 6). The net carrying amount of the buildings comprises:

| | Group | | Bank | |
|---|------------------|------------------|------------------|------------------|
| | 2007 HK\$'000 | 2006 HK\$'000 | 2007 HK\$'000 | 2006 HK\$'000 |
| Long term leases in Hong Kong | 458,350 | 372,584 | 458,350 | 332,654 |
| Medium term leases in Hong Kong | 123,000 | 107,050 | 123,000 | 88,050 |
| Medium term leases outside Hong Kong | 32,500 | 29,000 | 32,500 | 29,000 |
| | 613,850 | 508,634 | 613,850 | 449,704 |

Had the Group's and the Bank's revalued buildings been carried at cost less accumulated depreciation, they would have been included in the financial statements at approximately HK\$151,024,000 (2006: HK\$144,363,000) and HK\$151,024,000 (2006: HK\$129,981,000), respectively.

22. INVESTMENT PROPERTIES

| | Group and Bank | |
|---|------------------|------------------|
| | 2007 HK\$'000 | 2006 HK\$'000 |
| Carrying amount at 1 January | 23,366 | 21,660 |
| Disposal | – | (3,700) |
| Transfer to owner-occupied property | (10,166) | – |
| Carrying amount before change in fair value | 13,200 | 17,960 |
| Change in fair value (Note 6) | 4,700 | 5,406 |
| Carrying amount at 31 December | 17,900 | 23,366 |

Investment properties with a carrying amount of HK\$13,200,000 were revalued at HK\$17,900,000 based on the revaluation report issued by C S Surveyors Limited, a firm of independent professionally qualified valuers, on an open market value, based on their existing use. The investment properties are leased to third parties under operating lease, further details of which are included in note 30(a) to the financial statements.

The Group's and the Bank's investment properties are situated in Hong Kong and are held under medium term leases in Hong Kong.



Notes to Financial Statements

23. CUSTOMER DEPOSITS AT AMORTISED COST

| | Group | | Bank | |
|--------------------------------------|-------------------|------------|-------------------|------------|
| | 2007 | 2006 | 2007 | 2006 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Demand deposits and current accounts | 774,497 | 655,436 | 807,802 | 707,689 |
| Savings deposits | 2,363,790 | 2,016,059 | 2,364,008 | 2,017,566 |
| Time, call and notice deposits | 15,250,126 | 10,760,018 | 15,250,126 | 10,760,018 |
| | 18,388,413 | 13,431,513 | 18,421,936 | 13,485,273 |

24. OTHER LIABILITIES

| | Group | | Bank | |
|--|----------------|----------|----------------|----------|
| | 2007 | 2006 | 2007 | 2006 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Interest payable | 46,334 | 57,923 | 46,334 | 57,923 |
| Bills payable | – | 37,513 | – | 37,513 |
| Creditors, accruals and other payables | 228,684 | 235,636 | 227,770 | 260,671 |
| Due to subsidiaries | – | – | 45,307 | 55,307 |
| | 275,018 | 331,072 | 319,411 | 411,414 |

Other liabilities were current in nature and the carrying amounts approximate their fair values.

The amounts due to subsidiaries included in the Bank's other liabilities were unsecured, interest-free and have no fixed terms of repayment.

25. DEFERRED TAX

The movements in deferred tax assets and liabilities during the year were as follows:

Group – 2007

Deferred tax assets

| | Collective impairment allowance HK\$'000 |
|--|---|
| At 1 January 2007 | 3,700 |
| Deferred tax charged to the income statement during the year | (750) |
| Gross deferred tax assets at 31 December 2007 | <u>2,950</u> |

Deferred tax liabilities

| | Depreciation allowance in excess of related depreciation HK\$'000 | Revaluation of buildings HK\$'000 | Revaluation of investment properties HK\$'000 | Total HK\$'000 |
|---|--|---|--|-------------------|
| At 1 January 2007 | 943 | 68,192 | 2,000 | 71,135 |
| Deferred tax debited to equity during the year (Note 27) | – | 17,930 | – | 17,930 |
| Deferred tax charged to the income statement during the year (Note 9) | 1,777 | – | 823 | 2,600 |
| Gross deferred tax liabilities at 31 December 2007 | <u>2,720</u> | <u>86,122</u> | <u>2,823</u> | <u>91,665</u> |
| Net deferred tax liabilities at 31 December 2007 | | | | <u>88,715</u> |



Notes to Financial Statements

25. DEFERRED TAX (Continued)

Bank – 2007

Deferred tax assets

| | Collective impairment allowance HK\$'000 |
|--|---|
| At 1 January 2007 | 3,700 |
| Deferred tax charged to the income statement during the year | (750) |
| Gross deferred tax assets at 31 December 2007 | 2,950 |

Deferred tax liabilities

| | Depreciation allowance in excess of related depreciation HK\$'000 | Revaluation of buildings HK\$'000 | Revaluation of investment properties HK\$'000 | Total HK\$'000 |
|--|--|--|--|---------------------------|
| At 1 January 2007 | 1,043 | 58,960 | 2,000 | 62,003 |
| Deferred tax debited to equity during the year (Note 27) | – | 17,857 | – | 17,857 |
| Deferred tax charged to the income statement during the year | 1,777 | – | 823 | 2,600 |
| Gross deferred tax liabilities at 31 December 2007 | 2,820 | 76,817 | 2,823 | 82,460 |
| Net deferred tax liabilities at 31 December 2007 | | | | 79,510 |

25. DEFERRED TAX (Continued)

Group – 2006

Deferred tax assets

| | Collective impairment allowance HK\$'000 |
|---|---|
| At 1 January 2006 | 3,512 |
| Deferred tax credited to the income statement during the year | 188 |
| Gross deferred tax assets at 31 December 2006 | <u>3,700</u> |

Deferred tax liabilities

| | Depreciation allowance in excess of related depreciation HK\$'000 | Revaluation of buildings HK\$'000 | Revaluation of investment properties HK\$'000 | Total HK\$'000 |
|--|--|---|--|-------------------|
| At 1 January 2006 | 1,871 | 44,518 | 1,054 | 47,443 |
| Deferred tax debited to equity during the year (Note 27) | – | 23,674 | – | 23,674 |
| Deferred tax (credited)/charged to the income statement during the year (Note 9) | (928) | – | 946 | 18 |
| Gross deferred tax liabilities at 31 December 2006 | <u>943</u> | <u>68,192</u> | <u>2,000</u> | <u>71,135</u> |
| Net deferred tax liabilities at 31 December 2006 | | | | <u>67,435</u> |

Notes to Financial Statements

25. DEFERRED TAX (Continued)

Bank – 2006

Deferred tax assets

| | Collective impairment allowance HK\$'000 |
|---|---|
| At 1 January 2006 | 3,512 |
| Deferred tax credited to the income statement during the year | 188 |
| Gross deferred tax assets at 31 December 2006 | <u>3,700</u> |

Deferred tax liabilities

| | Depreciation allowance in excess of related depreciation HK\$'000 | Revaluation of buildings HK\$'000 | Revaluation of investment properties HK\$'000 | Total HK\$'000 |
|---|--|---|--|-------------------|
| At 1 January 2006 | 1,799 | 37,727 | 1,054 | 40,580 |
| Deferred tax debited to equity during the year (Note 27) | – | 21,233 | – | 21,233 |
| Deferred tax (credited)/charged to the income statement during the year | (756) | – | 946 | 190 |
| Gross deferred tax liabilities at 31 December 2006 | <u>1,043</u> | <u>58,960</u> | <u>2,000</u> | <u>62,003</u> |
| Net deferred tax liabilities at 31 December 2006 | | | | <u>58,303</u> |

The Group has tax losses arising in Hong Kong of HK\$35,895,000 (2006: HK\$36,536,000) that are available indefinitely for offsetting against future taxable profits of the companies in which the losses arose. Deferred tax assets have not been recognised in respect of these losses as they have arisen in subsidiaries that have incurred losses for some time.

There are no significant income tax consequences attaching to the payment of dividends by the Bank to its shareholders.



26. SHARE CAPITAL

| | 2007 HK\$'000 | 2006 HK\$'000 |
|--|------------------|------------------|
| Authorised: | | |
| 10,000,000 ordinary shares of HK\$100 each | 1,000,000 | 1,000,000 |
| Issued and fully paid: | | |
| 8,100,000 ordinary shares of HK\$100 each | 810,000 | 810,000 |

27. RESERVES

| | Notes | Group | | Bank | |
|--|-------|------------------|------------------|------------------|------------------|
| | | 2007 HK\$'000 | 2006 HK\$'000 | 2007 HK\$'000 | 2006 HK\$'000 |
| Share premium: | | | | | |
| At beginning of year and balance sheet date | | 43,935 | 43,935 | 43,935 | 43,935 |
| Group reconstruction reserve: | | | | | |
| At beginning of year and balance sheet date | | 3,065 | 3,065 | – | – |
| Translation reserve: | | | | | |
| At beginning of year | | – | – | – | – |
| Exchange difference | | 21,400 | – | 21,400 | – |
| At balance sheet date | | 21,400 | – | 21,400 | – |
| General reserve: | | | | | |
| At beginning of year and balance sheet date | | 232,640 | 232,640 | 230,640 | 230,640 |
| Capital reserve: | | | | | |
| At beginning of year and balance sheet date | | 17,660 | 17,660 | 3,660 | 3,660 |
| Regulatory reserve (Note): | | | | | |
| At beginning of year | | 78,286 | 66,136 | 78,286 | 66,136 |
| Transfer from retained profits | | 58,837 | 12,150 | 58,837 | 12,150 |
| At balance sheet date | | 137,123 | 78,286 | 137,123 | 78,286 |

Notes to Financial Statements

27. RESERVES (Continued)

| | Notes | Group | | Bank | |
|--------------------------------|-------|------------------|------------------|------------------|------------------|
| | | 2007 HK\$'000 | 2006 HK\$'000 | 2007 HK\$'000 | 2006 HK\$'000 |
| Asset revaluation reserve: | | | | | |
| At beginning of year | | 323,342 | 211,737 | 279,819 | 179,720 |
| Surplus on revaluation | 21 | 103,080 | 135,279 | 102,658 | 121,332 |
| Deferred tax charge | 25 | (17,930) | (23,674) | (17,857) | (21,233) |
| At balance sheet date | | 408,492 | 323,342 | 364,620 | 279,819 |
| Retained profits: | | | | | |
| At beginning of year | | 588,869 | 455,519 | 549,838 | 373,279 |
| Net profit for the year | | 121,433 | 145,500 | 210,476 | 188,709 |
| Transfer to regulatory reserve | | (58,837) | (12,150) | (58,837) | (12,150) |
| At balance sheet date | | 651,465 | 588,869 | 701,477 | 549,838 |
| Total at beginning of year | | 1,287,797 | 1,030,692 | 1,186,178 | 897,370 |
| Total at balance sheet date | | 1,515,780 | 1,287,797 | 1,502,855 | 1,186,178 |

Note: In accordance with the HKMA's guideline "Impact of the New Hong Kong Accounting Standards on Authorised Institutions' Capital Base and Regulatory Reserve" (the "Guideline"), the regulatory reserve, together with the Bank's collective impairment allowance were included as supplementary capital in the Group's capital base at 31 December 2007 as defined in the Guideline.

28. LOANS TO DIRECTORS AND OFFICERS

Loans granted by the Bank to directors and officers disclosed pursuant to Section 161B (9) of the Hong Kong Companies Ordinance were as follows:

| | Group and Bank | |
|--|------------------|------------------|
| | 2007 HK\$'000 | 2006 HK\$'000 |
| Aggregate amount of principal and interest outstanding at end of year | 266 | 301 |
| Maximum aggregate amount of principal and interest outstanding during the year | 557 | 8,104 |

The loans to directors and officers are granted on essentially the same terms with those granted to other customers, and/or at prevailing market rates and have no fixed terms of repayment, apart from a loan to an officer, which is repayable on 25 December 2015 and is secured by a property at a fair value of HK\$380,000 as at 31 December 2007.

29. OFF-BALANCE SHEET EXPOSURE

(a) Contingent liabilities and commitments

The following is a summary of the contractual amount of each significant class of contingent liabilities and commitments of the Group and of the Bank outstanding at the balance sheet date:

Group and Bank – 2007

| | Contractual amount HK\$'000 | Credit equivalent amount HK\$'000 | Credit risk weighted amount HK\$'000 | Positive fair value – assets HK\$'000 | Negative fair value – liabilities HK\$'000 |
|--|-----------------------------------|--|---|---|--|
| Direct credit substitutes | 287,899 | - | 81,595 | - | - |
| Transaction-related contingencies | 3,844 | - | 958 | - | - |
| Trade related contingencies | 197,345 | - | 37,208 | - | - |
| Forward asset purchases | 85,898 | - | 17,180 | - | - |
| | 574,986 | - | 136,941 | - | - |
| Derivatives held for trading (Note b): | | | | | |
| Foreign exchange rate contracts | 2,021,126 | 2,121 | 866 | 2,591 | 2,342 |
| Interest rate swaps | 400,000 | - | - | 53 | 39 |
| | 2,421,126 | 2,121 | 866 | 2,644 | 2,381 |
| Other commitments with an original maturity of: | | | | | |
| Not more than one year | - | - | - | - | - |
| More than one year | 508,023 | - | 254,011 | - | - |
| Other commitments which are unconditionally cancellable or which provide for automatic cancellation due to deterioration of creditworthiness of the counterparties | 3,777,456 | - | - | - | - |
| | 7,281,591 | 2,121 | 391,818 | 2,644 | 2,381 |
| Capital commitment: | | | | | |
| Contracted, but not provided for | 9,210 | - | 9,210 | - | - |
| Authorised, but not contracted for | 11,179 | - | 11,179 | - | - |
| | 20,389 | - | 20,389 | - | - |

Notes to Financial Statements

29. OFF-BALANCE SHEET EXPOSURE (Continued)

(a) Contingent liabilities and commitments (Continued)

Group and Bank – 2006

| | Contractual amount HK\$'000 | Credit equivalent amount HK\$'000 | Credit risk weighted amount HK\$'000 | Positive fair value – assets HK\$'000 | Negative fair value – liabilities HK\$'000 |
|--|-----------------------------------|--|---|---|--|
| Direct credit substitutes | 90,111 | – | 66,060 | – | – |
| Transaction-related contingencies | 6,842 | – | 2,955 | – | – |
| Trade related contingencies | 169,626 | – | 28,499 | – | – |
| Forward forward deposits placed | 3,988 | – | 798 | – | – |
| Forward asset purchases | 19,504 | – | 3,901 | – | – |
| | 290,071 | – | 102,213 | – | – |
| Derivatives held for trading: | | | | | |
| Foreign exchange rate contracts | 5,286,409 | 10,987 | 10,575 | 11,434 | 8,129 |
| Interest rate swaps and future contracts | 227,780 | – | – | 1,346 | 1,606 |
| | 5,514,189 | 10,987 | 10,575 | 12,780 | 9,735 |
| Other commitments with an original maturity of : | | | | | |
| Not more than one year | – | – | – | – | – |
| More than one year | 279,594 | – | 139,797 | – | – |
| Other commitments which are unconditionally cancellable or which provide for automatic cancellation due to deterioration of creditworthiness of the counterparties | 3,297,413 | – | – | – | – |
| | 9,381,267 | 10,987 | 252,585 | 12,780 | 9,735 |
| Capital commitments: | | | | | |
| Contracted, but not provided for | 4,707 | – | 4,707 | – | – |
| Authorised, but not contracted for | 6,897 | – | 6,897 | – | – |
| | 11,604 | – | 11,604 | – | – |

29. OFF-BALANCE SHEET EXPOSURE (Continued)

(a) Contingent liabilities and commitments (Continued)

The Group and the Bank had not entered into any bilateral netting arrangements and accordingly the above amounts are shown on a gross basis. The credit risk weighted amounts are calculated in accordance with the Third Schedule of the Banking Ordinance and guidelines issued by the HKMA. The amounts calculated are dependent upon the status of the counterparty and the maturity characteristics. The risk weights used range from 0% to 100% for contingent liabilities and commitments and from 0% to 50% for exchange rate contracts.

As at 31 December 2007 and 2006, the Group and the Bank had no other material outstanding contingent liabilities and commitments save as disclosed above.

(b) Derivative financial instruments

The Group and the Bank use the following derivative financial instruments:

Currency forwards represent commitments to purchase foreign and domestic currencies, including undelivered spot transactions. Foreign currency and interest rate futures are contractual obligations to receive or pay a net amount based on changes in currency rates or interest rates or to buy or sell foreign currency or a financial instrument on a future date at a specified price, established in an organised financial market. The credit risk is negligible, as changes in the futures contract value are settled daily with the exchange. Forward rate agreements are individually negotiated interest rate futures that call for a cash settlement at a future date for the difference between a contracted rate of interest and the current market rate, based on a notional principal amount.

Interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an exchange of interest rates (for example, fixed rate or floating rate). No exchange of principal takes place. The Group's and the Bank's credit risk represents the potential cost to replace the swap contracts if counterparties fail to perform their obligations. This risk is monitored on an ongoing basis with reference to the current fair value, a proportion of the notional amount of the contracts and the liquidity of the market. To control the level of credit risk taken, the Group and the Bank assess counterparties using the same techniques as for its lending activities.

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Group's and the Bank's exposure to credit or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates or foreign exchange rates relative to their terms. The aggregate contractual or notional amount of derivative financial instruments on hand, the extent to which instruments are favourable or unfavourable, and thus the aggregate fair values of derivative financial assets and liabilities, can fluctuate significantly from time to time.

Notes to Financial Statements

30. OPERATING LEASE ARRANGEMENTS

(a) As lessor

The Group and the Bank lease their investment properties (Note 22) under operating lease arrangements, and the terms of the leases range from one to five years. The terms of the leases generally require the tenants to pay security deposits.

At 31 December 2007, the Group and the Bank had total future minimum lease rental receivables under non-cancellable operating leases falling due as follows:

| | Group and Bank | |
|---|-----------------------|----------|
| | 2007 | 2006 |
| | HK\$'000 | HK\$'000 |
| Within one year | 1,211 | 533 |
| In the second to fifth years, inclusive | 331 | 222 |
| | 1,542 | 755 |

(b) As lessee

The Group and the Bank entered into non-cancellable operating lease arrangements with landlords, and the terms of the lease range from one to five years. The terms of the leases generally require the Group and the Bank to pay security deposits.

At 31 December 2007, the Group and the Bank had total future minimum lease rental payables under non-cancellable operating leases falling due as follows:

| | Group and Bank | |
|---|-----------------------|----------|
| | 2007 | 2006 |
| | HK\$'000 | HK\$'000 |
| Within one year | 19,157 | 9,661 |
| In the second to fifth years, inclusive | 17,728 | 13,927 |
| | 36,885 | 23,588 |

31. RELATED PARTY TRANSACTIONS

The Bank has entered into a number of banking transactions with related parties in the normal course of business. In addition to those disclosed elsewhere in the financial statements, the details of related party transactions, related expenses and income for the year and outstanding balances as at year end were as follows:

| | Notes | Bank | |
|--|-------|------------------|------------------|
| | | 2007 HK\$'000 | 2006 HK\$'000 |
| Related party transactions included in the income statement: | | | |
| Management fees to the immediate holding company | (a) | 1,920 | 480 |
| Rental income from the ultimate holding company | (b) | – | 103 |
| Rent paid to the ultimate holding company | (c) | 140 | – |
| Rent paid to the immediate holding company | (c) | 2,250 | – |
| Rent paid to fellow subsidiaries | (c) | 3,809 | 70 |
| Interest paid to the ultimate holding company | (d) | 26,036 | – |
| Interest paid to the immediate holding company | (d) | 3,741 | 9,162 |
| Interest paid to fellow subsidiaries | (d) | 6,392 | 4,641 |
| Interest paid to key management personnel | (d) | 663 | 123 |
| Commission paid to a fellow subsidiary | (e) | 803 | 243 |

Details of compensation for key management personnel, which are the directors of the Bank are included in note 8 to the financial statements.

| | Notes | Bank | |
|--|-------|------------------|------------------|
| | | 2007 HK\$'000 | 2006 HK\$'000 |
| Related party transactions included in the assets and liabilities: | | | |
| Deposit from the ultimate holding company | (d) | 1,654,659 | – |
| Deposits from the immediate holding company | (d) | 32,026 | 682,284 |
| Deposits from fellow subsidiaries and an affiliated company | (d) | 396,165 | 179,214 |
| Customer deposits from key management personnel | (d) | 19,497 | 10,254 |
| Interest payable to the immediate holding company | (d) | 10 | 736 |
| Interest payable to fellow subsidiaries | (d) | 108 | 116 |
| Loans to key management personnel | (f) | 28 | 34 |
| Rental deposits to the immediate holding company | (c) | 500 | – |
| Rental deposits to fellow subsidiaries | (c) | 786 | 461 |



Notes to Financial Statements

31. RELATED PARTY TRANSACTIONS (Continued)

Notes:

- (a) The management fees arose from administrative services provided by the immediate holding company to the Bank in 2007. They were charged based on cost incurred by the immediate holding company during the year.
- (b) The rental income was derived from properties rented to Asia Financial Holdings Limited as its office last year.
- (c) The rent paid and rental deposits were derived from properties rented from the ultimate holding company, immediate holding company and fellow subsidiaries as our offices or branches during the year.
- (d) The ultimate holding company, immediate holding company, fellow subsidiaries, an affiliated company and key management personnel placed deposits with the Bank at the prevailing market rates. Interest expense/payables were paid by the Bank for the year in respect of the placements. The balances were included in customer deposits in the balance sheet.
- (e) The commission expenses represented commission paid for the referrals of taxi financing loans from a fellow subsidiary during the year.
- (f) The balances represented credit card outstanding granted to directors of the Bank and included in loans and advances and receivables in the balance sheet.

32. FAIR VALUE OF FINANCIAL INSTRUMENTS

Set out below is a comparison by class of the carrying amounts and fair values of the Group's and the Bank's financial instruments that are carried in the financial statements. The table does not include the fair values of non-financial assets and non-financial liabilities.

Group

| | 2007 | | | 2006 | | |
|---|-------------------------------|------------------------|----------------------------------|-------------------------------|------------------------|----------------------------------|
| | Carrying value HK\$'000 | Fair value HK\$'000 | Unrecognised loss HK\$'000 | Carrying value HK\$'000 | Fair value HK\$'000 | Unrecognised loss HK\$'000 |
| Financial assets | | | | | | |
| Cash and short term placements | 5,792,899 | 5,792,899 | - | 2,007,460 | 2,007,460 | - |
| Placements with banks and financial institutions | 441,539 | 441,539 | - | 566,773 | 566,773 | - |
| Financial assets designated at fair value through profit or loss | 12,262 | 12,262 | - | 10,213 | 10,213 | - |
| Derivative financial instruments | 2,644 | 2,644 | - | 12,780 | 12,780 | - |
| Loans and advances and receivables | 15,419,881 | 15,419,881 | - | 10,160,296 | 10,160,296 | - |
| Held-to-maturity investments | 2,864,390 | 2,860,158 | (4,232) | 3,749,502 | 3,716,216 | (33,286) |
| Other assets | 192,324 | 192,324 | - | 176,592 | 176,592 | - |
| Financial liabilities | | | | | | |
| Deposits and balances of banks and other financial institutions at amortised cost | 2,263,902 | 2,263,902 | - | 516,097 | 516,097 | - |
| Derivative financial instruments | 2,381 | 2,381 | - | 9,735 | 9,735 | - |
| Customer deposits at amortised cost | 18,388,413 | 18,388,413 | - | 13,431,513 | 13,431,513 | - |
| Certificates of deposit issued at amortised cost | 2,049,227 | 2,049,227 | - | 769,674 | 769,674 | - |
| Other liabilities | 275,018 | 275,018 | - | 331,072 | 331,072 | - |
| Total unrecognised change in unrealised fair value | | | (4,232) | | | (33,286) |

Notes to Financial Statements

32. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Bank

| | 2007 | | | 2006 | | |
|---|----------------|------------|-------------------|----------------|------------|-------------------|
| | Carrying value | Fair value | Unrecognised loss | Carrying value | Fair value | Unrecognised loss |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Financial assets | | | | | | |
| Cash and short term placements | 5,791,877 | 5,791,877 | - | 2,006,446 | 2,006,446 | - |
| Placements with banks and financial institutions | 441,539 | 441,539 | - | 566,773 | 566,773 | - |
| Financial assets designated at fair value through profit or loss | 12,262 | 12,262 | - | 10,213 | 10,213 | - |
| Derivative financial instruments | 2,644 | 2,644 | - | 12,780 | 12,780 | - |
| Loans and advances and receivables | 15,419,881 | 15,419,881 | - | 10,160,296 | 10,160,296 | - |
| Held-to-maturity investments | 2,864,390 | 2,860,158 | (4,232) | 3,749,502 | 3,716,216 | (33,286) |
| Other assets | 191,513 | 191,513 | - | 203,336 | 203,336 | - |
| Financial liabilities | | | | | | |
| Deposits and balances of banks and other financial institutions at amortised cost | 2,263,902 | 2,263,902 | - | 516,097 | 516,097 | - |
| Derivative financial instruments | 2,381 | 2,381 | - | 9,735 | 9,735 | - |
| Customer deposits at amortised cost | 18,421,936 | 18,421,936 | - | 13,485,273 | 13,485,273 | - |
| Certificates of deposit issued at amortised cost | 2,049,227 | 2,049,227 | - | 769,674 | 769,674 | - |
| Other liabilities | 319,411 | 319,411 | - | 411,414 | 411,414 | - |
| Total unrecognised change in unrealised fair value | | | (4,232) | | | (33,286) |

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the financial statements.

Assets and liabilities for which fair value approximates carrying value – Liquid or/and very short-term

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate their fair value. This assumption is also applied to demand deposits, savings accounts without a specific maturity and variable rate financial instruments.

32. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Fixed rate financial instruments

The fair value of fixed rate financial assets and financial liabilities carried at amortised cost are based on current interest rates offered for similar financial instruments appropriate for remaining term to maturity. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates. For those certificates of deposits issued and customer deposits where quoted market prices are not available, a discounted cash flow model is used based on a current interest rate yield curve appropriate for the remaining term to maturity.

Financial instruments recorded at fair value

The following table shows an analysis of financial instruments recorded at fair value, between those whose fair values are based on quoted market prices and those involving valuation techniques where all the model inputs are observable in the market.

Group and Bank – 2007

| | Quoted market price HK\$'000 | Valuation techniques – market observable inputs HK\$'000 | Total HK\$'000 |
|---|---------------------------------------|---|-------------------|
| Financial assets: | | | |
| Financial assets designated at fair value through profit or loss | 12,262 | – | 12,262 |
| Derivative financial instruments | – | 2,644 | 2,644 |
| | 12,262 | 2,644 | 14,906 |
| Financial liabilities: | | | |
| Derivative financial instruments | – | 2,381 | 2,381 |



Notes to Financial Statements

32. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Financial instruments recorded at fair value (Continued)

Group and Bank – 2006

| | Quoted market price HK\$'000 | Valuation techniques – market observable inputs HK\$'000 | Total HK\$'000 |
|---|---------------------------------------|---|-------------------|
| Financial assets: | | | |
| Financial assets designated at fair value | | | |
| through profit or loss | 10,213 | – | 10,213 |
| Derivative financial instruments | – | 12,780 | 12,780 |
| | 10,213 | 12,780 | 22,993 |
| Financial liabilities: | | | |
| Derivative financial instruments | – | 9,735 | 9,735 |

Derivative financial instruments are recorded at fair value based on prices of similar market transactions.

Unlisted equity investments stated at cost amounted to HK\$6,804,000 (2006: HK\$6,804,000) was excluded from the fair value of financial instruments disclosure.

There were no financial assets and financial liabilities that offset against each other at the end of the years 2007 and 2006.

33. MATURITY ANALYSIS OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The table below shows an analysis of financial assets and financial liabilities analysed by principal amount according to when they are expected to be recovered or settled. The Group's and the Bank's contractual undiscounted repayment obligations are shown in section "Liquidity Risk Management" of note 34 to the financial statements.

Group – 2007

| | Repayable on demand HK\$'000 | Up to 1 month HK\$'000 | Over 1 month but not more than 3 months HK\$'000 | Over 3 months but not more than 12 months HK\$'000 | Over 1 year but not more than 5 years HK\$'000 | Over 5 years HK\$'000 | Repayable within an indefinite period HK\$'000 | Total HK\$'000 |
|---|------------------------------------|------------------------------|---|---|---|-----------------------------|--|-------------------|
| Financial assets: | | | | | | | | |
| Cash and short term placements | 390,241 | 5,402,658 | - | - | - | - | - | 5,792,899 |
| Placements with banks and financial institutions | - | - | 301,175 | 140,364 | - | - | - | 441,539 |
| Financial assets designated at fair value through profit or loss | - | - | - | - | - | - | 12,262 | 12,262 |
| Derivative financial instruments | - | 475 | 1,580 | 589 | - | - | - | 2,644 |
| Loans and advances and receivables | 567,414 | 1,222,931 | 1,083,126 | 823,360 | 4,965,344 | 6,708,204 | 94,115 | 15,464,494 |
| Available-for-sale financial assets | - | - | - | - | - | - | 6,804 | 6,804 |
| Held-to-maturity investments | - | 1,293,378 | 580,093 | 781,432 | 219,287 | - | - | 2,874,190 |
| Other assets | - | 53,295 | - | 139,029 | - | - | - | 192,324 |
| Total financial assets | 957,655 | 7,972,737 | 1,965,974 | 1,884,774 | 5,184,631 | 6,708,204 | 113,181 | 24,787,156 |
| Financial liabilities: | | | | | | | | |
| Deposits and balances of banks and other financial institutions at amortised cost | 36,074 | 2,130,542 | 35,244 | 62,042 | - | - | - | 2,263,902 |
| Customer deposits at amortised cost | 3,138,288 | 11,952,573 | 2,501,911 | 773,340 | 22,301 | - | - | 18,388,413 |
| Certificates of deposit issued at amortised cost | - | - | 99,995 | 1,149,723 | 799,509 | - | - | 2,049,227 |
| Derivative financial instruments | - | 1,560 | 285 | 536 | - | - | - | 2,381 |
| Other liabilities | - | 72,243 | - | 202,775 | - | - | - | 275,018 |
| Total financial liabilities | 3,174,362 | 14,156,918 | 2,637,435 | 2,188,416 | 821,810 | - | - | 22,978,941 |



Notes to Financial Statements

33. MATURITY ANALYSIS OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (Continued)**Bank – 2007**

| | Repayable on demand HK\$'000 | Up to 1 month HK\$'000 | Over 1 month but not more than 3 months HK\$'000 | Over 3 months but not more than 12 months HK\$'000 | Over 1 year but not more than 5 years HK\$'000 | Over 5 years HK\$'000 | Repayable within an indefinite period HK\$'000 | Total HK\$'000 |
|---|------------------------------------|------------------------------|---|---|---|-----------------------------|--|-------------------|
| Financial assets: | | | | | | | | |
| Cash and short term placements | 389,219 | 5,402,658 | - | - | - | - | - | 5,791,877 |
| Placements with banks and financial institutions | - | - | 301,175 | 140,364 | - | - | - | 441,539 |
| Financial assets designated at fair value through profit or loss | - | - | - | - | - | - | 12,262 | 12,262 |
| Derivative financial instruments | - | 475 | 1,580 | 589 | - | - | - | 2,644 |
| Loans and advances and receivables | 567,414 | 1,222,931 | 1,083,126 | 823,360 | 4,965,344 | 6,708,204 | 94,115 | 15,464,494 |
| Available-for-sale financial assets | - | - | - | - | - | - | 6,804 | 6,804 |
| Held-to-maturity investments | - | 1,293,378 | 580,093 | 781,432 | 219,287 | - | - | 2,874,190 |
| Other assets | - | 53,295 | - | 138,218 | - | - | - | 191,513 |
| Total financial assets | 956,633 | 7,972,737 | 1,965,974 | 1,883,963 | 5,184,631 | 6,708,204 | 113,181 | 24,785,323 |
| Financial liabilities: | | | | | | | | |
| Deposits and balances of banks and other financial institutions at amortised cost | 36,074 | 2,130,542 | 35,244 | 62,042 | - | - | - | 2,263,902 |
| Customer deposits at amortised cost | 3,171,811 | 11,952,573 | 2,501,911 | 773,340 | 22,301 | - | - | 18,421,936 |
| Certificates of deposit issued at amortised cost | - | - | 99,995 | 1,149,723 | 799,509 | - | - | 2,049,227 |
| Derivative financial instruments | - | 1,560 | 285 | 536 | - | - | - | 2,381 |
| Other liabilities | - | 72,243 | - | 247,168 | - | - | - | 319,411 |
| Total financial liabilities | 3,207,885 | 14,156,918 | 2,637,435 | 2,232,809 | 821,810 | - | - | 23,056,857 |

33. MATURITY ANALYSIS OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (Continued)

Group – 2006

| | Repayable on demand HK\$'000 | Up to 1 month HK\$'000 | Over 1 month but not more than 3 months HK\$'000 | Over 3 months but not more than 12 months HK\$'000 | Over 1 year but not more than 5 years HK\$'000 | Over 5 years HK\$'000 | Repayable within an indefinite period HK\$'000 | Total HK\$'000 |
|---|------------------------------------|------------------------------|---|---|---|-----------------------------|--|-------------------|
| Financial assets: | | | | | | | | |
| Cash and short term placements | 240,584 | 1,766,876 | - | - | - | - | - | 2,007,460 |
| Placements with banks and financial institutions | - | - | 481,966 | 84,807 | - | - | - | 566,773 |
| Financial assets designated at fair value through profit or loss | - | - | - | - | - | - | 10,213 | 10,213 |
| Derivative financial instruments | - | 804 | 4,770 | 5,586 | 1,620 | - | - | 12,780 |
| Loans and advances and receivables | 445,821 | 685,640 | 917,697 | 843,248 | 2,860,602 | 4,374,622 | 98,099 | 10,225,729 |
| Available-for-sale financial assets | - | - | - | - | - | - | 6,804 | 6,804 |
| Held-to-maturity investments | - | 573,435 | 559,644 | 506,222 | 1,967,321 | 142,880 | - | 3,749,502 |
| Other assets | - | 85,500 | - | 91,092 | - | - | - | 176,592 |
| Total financial assets | 686,405 | 3,112,255 | 1,964,077 | 1,530,955 | 4,829,543 | 4,517,502 | 115,116 | 16,755,853 |
| Financial liabilities: | | | | | | | | |
| Deposits and balances of | | | | | | | | |
| banks and other financial | | | | | | | | |
| institutions at amortised cost | 12,811 | 470,411 | 22,913 | 9,962 | - | - | - | 516,097 |
| Customer deposits at amortised cost | 2,671,495 | 8,512,210 | 1,530,254 | 685,465 | 32,089 | - | - | 13,431,513 |
| Certificates of deposit issued at amortised cost | - | - | 249,979 | 419,751 | 99,944 | - | - | 769,674 |
| Derivative financial instruments | - | 664 | 2,303 | 5,408 | 1,360 | - | - | 9,735 |
| Other liabilities | - | 58,142 | - | 272,930 | - | - | - | 331,072 |
| Total financial liabilities | 2,684,306 | 9,041,427 | 1,805,449 | 1,393,516 | 133,393 | - | - | 15,058,091 |

Notes to Financial Statements

33. MATURITY ANALYSIS OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (Continued)

Bank – 2006

| | Repayable on demand HK\$'000 | Up to 1 month HK\$'000 | Over 1 month but not more than 3 months HK\$'000 | Over 3 months but not more than 12 months HK\$'000 | Over 1 year but not more than 5 years HK\$'000 | Over 5 years HK\$'000 | Repayable within an indefinite period HK\$'000 | Total HK\$'000 |
|---|------------------------------------|------------------------------|---|---|---|-----------------------------|--|-------------------|
| Financial assets | | | | | | | | |
| Cash and short term placements | 239,570 | 1,766,876 | - | - | - | - | - | 2,006,446 |
| Placements with banks and financial institutions | - | - | 481,966 | 84,807 | - | - | - | 566,773 |
| Financial assets designated at fair value through profit or loss | - | - | - | - | - | - | 10,213 | 10,213 |
| Derivative financial instruments | - | 804 | 4,770 | 5,586 | 1,620 | - | - | 12,780 |
| Loans and advances and receivables | 445,821 | 685,640 | 917,697 | 843,248 | 2,860,602 | 4,374,622 | 98,099 | 10,225,729 |
| Available-for-sale financial assets | - | - | - | - | - | - | 6,804 | 6,804 |
| Held-to-maturity investments | - | 573,435 | 559,644 | 506,222 | 1,967,321 | 142,880 | - | 3,749,502 |
| Other assets | - | 85,500 | - | 117,836 | - | - | - | 203,336 |
| Total financial assets | 685,391 | 3,112,255 | 1,964,077 | 1,557,699 | 4,829,543 | 4,517,502 | 115,116 | 16,781,583 |
| Financial liabilities: | | | | | | | | |
| Deposits and balances of | | | | | | | | |
| banks and other financial | | | | | | | | |
| institutions at amortised cost | 12,811 | 470,411 | 22,913 | 9,962 | - | - | - | 516,097 |
| Customer deposits at amortised cost | 2,725,255 | 8,512,210 | 1,530,254 | 685,465 | 32,089 | - | - | 13,485,273 |
| Certificates of deposit issued | | | | | | | | |
| at amortised cost | - | - | 249,979 | 419,751 | 99,944 | - | - | 769,674 |
| Derivative financial instruments | - | 664 | 2,303 | 5,408 | 1,360 | - | - | 9,735 |
| Other liabilities | - | 58,142 | - | 353,272 | - | - | - | 411,414 |
| Total financial liabilities | 2,738,066 | 9,041,427 | 1,805,449 | 1,473,858 | 133,393 | - | - | 15,192,193 |

34. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial instruments, other than derivatives, comprise certificates of deposit issued and cash and short term deposits. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group has various other financial assets such as trade bills, held-to-maturity investments, loans and advances and receivables, available-for-sale financial assets and financial assets designated at fair value through profit or loss, which arise directly from its operations.

The Group also enters into derivative transactions, including principally interest rate swaps and forward currency contracts held for trading. The purpose is to manage or mitigate interest rate risk and currency risk arising from the Group's operation.

The main risks arising from the Group's financial instruments are interest rate risk, credit risk, liquidity risk, foreign currency risk and market risk. The board reviews and agrees policies for managing each of these risks and they are summarised below. The Group's accounting policies in relation to derivatives are set out in note 2.4 to the financial statements.

Risk Management

The Group has established systems, policies and procedures for the control and monitoring of interest rate, credit, liquidity, capital, foreign currency, market and operational risks, which are approved and endorsed by the board of directors and reviewed regularly by the Group's management, Credit Risk Management Committee, Asset and Liability Management Committee, Operational Risk Management Committee and other designated committees or working groups. Material risks are identified and measured by designated committees and/or working groups before the launch of new products or services or business activities, and monitored, documented and controlled against applicable risk limits after the implementation of new products or services or business activities. The internal auditors of the Bank also perform regular audits to ensure compliance with the policies and procedures.



Notes to Financial Statements

34. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Market Risk Management

(a) Interest Rate Risk

Interest rate risk is the risk that the Group's position may be adversely affected by a change of market interest rates. The Group's interest rate risk arises primarily from the timing difference in the maturity and the repricing of the Group's interest bearing assets, liabilities and off-balance sheet commitments. The primary objective of interest rate risk management is to limit the potential adverse effects of interest rate movements in net interest income by closely monitoring the net repricing gap of the Group's assets and liabilities. The interest rate risk is managed by the Group's Treasury Department and monitored and measured monthly by the Asset and Liability Management Committee against limits approved by the board of directors.

Interest rate risk exposure in banking book:

The relevant principal interest rate risk arise from repricing risk and basis risk.

Repricing risk is one of sources of interest rate risks which arises from timing differences in interest rate changes and cash flows that occur in the repricing and maturity of fixed and floating rate assets, liabilities and off-balance sheet financial instruments. Should the interest rate increase by 200 basis point and the positive net interest gap of HK\$1,812 million up to twelve months, profit and loss would increase by HK\$31 million for the next twelve months after the reporting date.

Based on the positive net interest gap of HK\$2,128 million up to five years, economic value would increase by positive HK\$18 million.

Basis risk is one of sources of interest rate risks which arises from imperfect correlation between changes in the interest rates earned and paid on different financial instruments with similar repricing characteristics. The Group adopts the following scenarios for sensitivity analysis: (i) Interest rate on managed-rate assets would decrease by 200 basis point whilst interest rate on other interest-bearing assets and interest-bearing liabilities would be kept unchanged. Based on the scenario assumption, profit and loss would decrease by HK\$199 million for the next twelve months; (ii) Interest rate on fixed-rate liabilities and floating-rate liabilities would increase by 200 basis points whilst interest rate on interest-bearing assets would be kept unchanged except for variable rate assets. Based on the scenario assumption, profit and loss would decrease by HK\$320 million for the next twelve months.



34. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Market Risk Management (Continued)

(a) Interest Rate Risk (Continued)

The carrying amounts of financial instruments exposed to interest rate risk based on maturity or repricing as at 31 December 2007 and 2006 are detailed as follows:

2007

| | One year or less HK\$'000 | Over 1 year but not more than 2 years HK\$'000 | Over 2 years but not more than 3 years HK\$'000 | Over 3 years but not more than 4 years HK\$'000 | Over 4 years but not more than 5 years HK\$'000 | Over 5 years HK\$'000 | Non- interest bearing HK\$'000 | Total HK\$'000 |
|---|---------------------------------|---|--|--|--|-----------------------------|---|-------------------|
| Assets: | | | | | | | | |
| Fixed rate financial assets | | | | | | | | |
| Cash and short term placements | 5,352,658 | - | - | - | - | - | 390,241 | 5,742,899 |
| Placements with banks and financial institutions | 292,538 | - | - | - | - | - | - | 292,538 |
| Loans and advances and receivables | 597,600 | 157,198 | 91,674 | 43,967 | 25,970 | - | - | 916,409 |
| Derivative financial instruments | - | - | - | - | - | - | 2,644 | 2,644 |
| Financial assets designated at fair value through profit or loss | - | - | - | - | - | - | 12,262 | 12,262 |
| Available-for-sale financial assets | - | - | - | - | - | - | 6,804 | 6,804 |
| Held-to-maturity investments | 2,292,535 | 19,985 | - | - | - | - | - | 2,312,520 |
| Other assets | 400,000 | - | - | - | - | - | - | 400,000 |
| | 8,935,331 | 177,183 | 91,674 | 43,967 | 25,970 | - | 411,951 | 9,686,076 |
| Floating rate financial assets | | | | | | | | |
| Cash and short term placements | 50,000 | - | - | - | - | - | - | 50,000 |
| Placements with banks and financial institutions | 149,001 | - | - | - | - | - | - | 149,001 |
| Loans and advances and receivables | 14,548,085 | - | - | - | - | - | - | 14,548,085 |
| Held-to-maturity investments | 561,670 | - | - | - | - | - | - | 561,670 |
| | 15,308,756 | - | - | - | - | - | - | 15,308,756 |
| Less: | | | | | | | | |
| Liabilities: | | | | | | | | |
| Fixed rate financial liabilities | | | | | | | | |
| Deposits and balances of banks and other financial institutions at amortised cost | 2,227,839 | - | - | - | - | - | 36,063 | 2,263,902 |
| Customer deposits at amortised cost | 15,008,775 | 21,714 | 586 | - | - | - | - | 15,031,075 |
| Derivative financial instruments | - | - | - | - | - | - | 2,381 | 2,381 |
| | 17,236,614 | 21,714 | 586 | - | - | - | 38,444 | 17,297,358 |
| Floating rate financial liabilities | | | | | | | | |
| Customer deposits at amortised cost | 2,746,611 | - | - | - | - | - | 610,727 | 3,357,338 |
| Certificates of deposit issued at amortised cost | 2,049,227 | - | - | - | - | - | - | 2,049,227 |
| Other liabilities | 400,000 | - | - | - | - | - | - | 400,000 |
| | 5,195,838 | - | - | - | - | - | 610,727 | 5,806,565 |
| Total interest sensitivity gap | 1,811,635 | 155,469 | 91,088 | 43,967 | 25,970 | - | (237,220) | 1,890,909 |

Notes to Financial Statements

34. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Market Risk Management (Continued)

(a) Interest Rate Risk (Continued)

2006

| | One year or less HK\$'000 | Over 1 year but not more than 2 years HK\$'000 | Over 2 years but not more than 3 years HK\$'000 | Over 3 years but not more than 4 years HK\$'000 | Over 4 years but not more than 5 years HK\$'000 | Over 5 years HK\$'000 | Non- interest bearing HK\$'000 | Total HK\$'000 |
|---|---------------------------------|---|--|--|--|-----------------------------|---|-------------------|
| Assets: | | | | | | | | |
| Fixed rate financial assets | | | | | | | | |
| Cash and short term placements | 1,715,764 | - | - | - | - | - | 240,584 | 1,956,348 |
| Placements with banks and financial institutions | 452,080 | - | - | - | - | - | - | 452,080 |
| Loans and advances and receivables | 520,749 | 135,600 | 72,606 | 48,774 | - | - | - | 777,729 |
| Derivative financial instruments | - | - | - | - | - | - | 12,780 | 12,780 |
| Financial assets designated at fair value through profit or loss | - | - | - | - | - | - | 10,213 | 10,213 |
| Available-for-sale financial assets | - | - | - | - | - | - | 6,804 | 6,804 |
| Held-to-maturity investments | 1,928,844 | 140,024 | 166,652 | 97,181 | - | - | - | 2,332,701 |
| Other assets | 150,000 | - | - | - | - | - | - | 150,000 |
| | 4,767,437 | 275,624 | 239,258 | 145,955 | - | - | 270,381 | 5,698,655 |
| Floating rate financial assets | | | | | | | | |
| Cash and short term placements | 51,112 | - | - | - | - | - | - | 51,112 |
| Placements with banks and financial institutions | 114,693 | - | - | - | - | - | - | 114,693 |
| Loans and advances and receivables | 9,448,000 | - | - | - | - | - | - | 9,448,000 |
| Held-to-maturity investments | 1,416,801 | - | - | - | - | - | - | 1,416,801 |
| | 11,030,606 | - | - | - | - | - | - | 11,030,606 |
| Less: | | | | | | | | |
| Liabilities: | | | | | | | | |
| Fixed rate financial liabilities | | | | | | | | |
| Deposits and balances of banks and other financial institutions at amortised cost | 503,286 | - | - | - | - | - | 12,811 | 516,097 |
| Customer deposits at amortised cost | 10,554,484 | 31,475 | 614 | - | - | - | - | 10,586,573 |
| Derivative financial instruments | - | - | - | - | - | - | 9,735 | 9,735 |
| | 11,057,770 | 31,475 | 614 | - | - | - | 22,546 | 11,112,405 |
| Floating rate financial liabilities | | | | | | | | |
| Customer deposits at amortised cost | 2,232,459 | - | - | - | - | - | 612,481 | 2,844,940 |
| Certificates of deposit issued at amortised cost | 769,674 | - | - | - | - | - | - | 769,674 |
| Other liabilities | 150,000 | - | - | - | - | - | - | 150,000 |
| | 3,152,133 | - | - | - | - | - | 612,481 | 3,764,614 |
| Total interest sensitivity gap | 1,588,140 | 244,149 | 238,644 | 145,955 | - | - | (364,646) | 1,852,242 |

34. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Market Risk Management (Continued)

(a) Interest Rate Risk (Continued)

The table below summaries the effective average interest rates at 31 December for monetary financial instruments:

| | 2007 Rate (%) | 2006 Rate (%) |
|---|--|---------------------|
| Assets | | |
| Placements with banks and financial institutions (including short term placements) | 5.44 | 5.00 |
| Loans and advances and receivables (including trade bills) | 5.43 | 5.81 |
| Held-to-maturity investments | 3.84 | 4.27 |
| Liabilities | | |
| Deposits and balances of banks and other financial institutions at amortised cost | 4.94 | 4.59 |
| Customer deposits at amortised cost | 4.00 | 4.09 |
| Certificates of deposit issued at amortised cost | 4.85 | 4.78 |

(b) Currency Risk

Currency risk is the risk that the holding of foreign currencies will affect the Bank's position as a result of a change in foreign currency exchange rates. The Group's foreign exchange risk positions arise from foreign exchange dealing, commercial banking operations and structural foreign currency exposures. All foreign exchange positions are managed by the Group's Treasury Department within limits approved by the board of directors. The Group's assets and liabilities are mainly denominated in Hong Kong dollars and United States dollars of which the exchange rates have remained relatively stable among each other for the years ended 31 December 2007 and 2006.

(c) Price Risk

Price risk is the risk to the Bank's earnings and capital due to changes in the prices of securities including commodities, debt securities and equities.

The Group monitors market risk principally by limits established for transactions and open positions. These limits are reviewed and approved by the board of directors and are monitored on a daily basis.

The Group does not actively trade in financial instruments and in the opinion of the board of directors, the price risk related to trading activities to which the Group is exposed is not material. Accordingly, no quantitative market risk disclosures for price risk have been prepared.



Notes to Financial Statements

34. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Credit Risk Management

Credit risk is the risk that a customer or counterparty in a transaction may default. It arises from the lending, trade finance, treasury and other activities undertaken by the Group.

The Group has a credit risk management process to measure, monitor and control credit risk. Its Credit Policy Manual defines the credit extension and measurement criteria, the credit review, approval and monitoring processes, and the loan classification and provisioning systems. It has a hierarchy of credit authority which approves credit in compliance with the Group's credit policy. Credit risk exposures are measured and monitored against credit limits and other control limits (such as connected exposures, large exposures and risk concentration limits set by the Credit Risk Management Committee and approved by the board of directors). Segregation of duties in key credit functions is in place to ensure separate credit control and monitoring. Management and recovery of problem credits is handled by an independent work-out team.

The Group manages its credit risk within a conservative framework. Its credit policy is regularly revised, taking into account factors such as prevailing business and economic conditions, regulatory requirements and its capital resources. Its policy on connected lending exposures defines and states connected parties, statutory and applicable connected lending limits, types of connected transactions, taking of collateral, capital adequacy treatment detailed procedures and controls for monitoring of connected lending exposures. In general, interest rates and other terms and conditions applying to connected lending should not be more favourable than loans granted to non-connected borrowers under similar circumstances. The terms and conditions should be determined on normal commercial terms at arm's length and in the ordinary course of business of the Group.

Credit and compliance audits are periodically conducted by the Internal Audit Department to evaluate the effectiveness of the credit review, approval and monitoring processes and to test the compliance of the established credit policies and procedures.

The Credit Committee of the Bank monitors the quality of financial assets which are neither past due nor impaired by financial performance indicators (such as loan-to-value ratio, debts servicing ratio, financial soundness of borrowers and personal guarantee) through meeting discussions, management information systems and reports. Those loan borrowers subject to legal proceedings, negative comments from other counterparties and rescheduled arrangements are put under watch lists or under "special mention" grade for management oversight.

The Credit Committee of the Bank monitors the quality of past due or impaired financial assets by internal grading of "substandard", "doubtful" and "loss" through the same meeting discussions and management information systems and reports. The impaired financial assets include those subject to personal bankruptcy petitions, corporate winding-up and rescheduled arrangements.

The Credit Risk Management Committee of the Bank is responsible for establishing the framework for identifying, measuring, monitoring and controlling credit risk of existing and new products, and approving credit risk management policies and credit risk tolerable limits as and when necessary.

34. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Credit Risk Management (Continued)

The Group mitigates credit risk by credit protection provided by guarantors and by loan collaterals such as cash, properties, taxi licenses and cabs and securities.

Maximum credit exposures without taking into account the fair value of collateral were as follows:

| | Group | | Bank | |
|---|-------------------|------------------|-------------------|------------------|
| | 2007 HK\$'000 | 2006 HK\$'000 | 2007 HK\$'000 | 2006 HK\$'000 |
| Loans and advances and other receivables | 15,464,494 | 10,225,729 | 15,464,494 | 10,225,729 |
| Loan commitments | 2,547,639 | 1,561,502 | 2,547,639 | 1,561,502 |
| Placements with banks and financial institutions | 441,539 | 566,773 | 441,539 | 566,773 |
| Short term placements (excluding cash in hand) | 5,695,449 | 1,941,667 | 5,694,427 | 1,940,653 |
| Held-to-maturity investments | 2,864,390 | 3,749,502 | 2,864,390 | 3,749,502 |
| Derivative financial instruments | 2,644 | 12,780 | 2,644 | 12,780 |
| Interest in a jointly-controlled entity | 1,513 | 1,676 | 1,500 | 1,500 |

Other quantitative data about credit risk exposure to loans and advances are disclosed in note 14 "Loans and advances and receivables" and the significant concentrations of credit risk attributed to loans and advances are detailed in "Advances to Customers by Industry Sectors" of Supplementary Information.

Liquidity Risk Management

Liquidity risk is the risk that the Group cannot meet its current obligation. To manage liquidity risk, the Group has established the liquidity management policy which is reviewed by management and approved by the directors. The Group measures the liquidity of the Group using the statutory liquidity ratio, loan-to-deposit ratio and maturity mismatch ratio and other relevant performance measures.

The Asset and Liability Management Committee of the Bank monitors the liquidity position as part of the ongoing assets and liabilities management, and set up trigger limits to monitor liquidity risk. It also closely monitors the liquidity of the subsidiaries on a periodic basis to ensure that the liquidity structure of the subsidiaries' assets, liabilities and commitments can meet the funding needs, and that internal liquidity trigger limits are complied with. Standby facilities are maintained to provide liquidity to meet unexpected and material cash outflows in the ordinary course of business.

Notes to Financial Statements

34. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Liquidity Risk Management (Continued)

Maturity analysis of financial liabilities, based on contractual undiscounted cash flow, were as follows:

Group – 2007

| | Repayable on demand HK\$'000 | Up to 1 month HK\$'000 | Over 1 month but not more than 3 months HK\$'000 | Over 3 months but not more than 12 months HK\$'000 | Over 1 year but not more than 5 years HK\$'000 | Over 5 years HK\$'000 | Repayable within an indefinite period HK\$'000 | Total HK\$'000 |
|--|------------------------------------|------------------------------|---|---|---|-----------------------------|--|-------------------|
| Forward assets purchase | - | 84,027 | 1,935 | - | - | - | - | 85,962 |
| Net amount of interest rate swaps | - | - | - | 40 | - | - | - | 40 |
| Net amount of foreign currency contracts | - | 1,560 | 285 | 496 | - | - | - | 2,341 |
| Gross loan commitments | 1,537,619 | 402,345 | 93,585 | 6,067 | 406,553 | 101,470 | - | 2,547,639 |
| Customer deposits at amortised cost | 3,142,947 | 12,003,217 | 2,531,806 | 800,483 | 24,501 | - | - | 18,502,954 |
| Deposits and balances of banks and other financial institutions at amortised cost | 36,074 | 2,136,868 | 36,230 | 63,590 | - | - | - | 2,272,762 |
| Certificates of deposit issued at amortised cost | - | - | 100,942 | 1,178,740 | 847,842 | - | - | 2,127,524 |
| Other liabilities | - | 72,243 | - | 202,775 | - | - | - | 275,018 |
| | 4,716,640 | 14,700,260 | 2,764,783 | 2,252,191 | 1,278,896 | 101,470 | - | 25,814,240 |

34. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Liquidity Risk Management (Continued)

Group – 2006

| | Repayable on demand HK\$'000 | Up to 1 month HK\$'000 | Over 1 month but not more than 3 months HK\$'000 | Over 3 months but not more than 12 months HK\$'000 | Over 1 year but not more than 5 years HK\$'000 | Over 5 years HK\$'000 | Repayable within an indefinite period HK\$'000 | Total HK\$'000 |
|--|------------------------------------|------------------------------|---|---|---|-----------------------------|--|-------------------|
| Forward assets purchase | - | 19,539 | - | - | - | - | - | 19,539 |
| Net amount of interest rate swaps and futures | - | - | - | 1,606 | - | - | - | 1,606 |
| Net amount of foreign currency contracts | - | 664 | 2,303 | 3,802 | 1,360 | - | - | 8,129 |
| Gross loan commitments | 1,124,440 | 127,307 | 29,557 | 25,983 | 178,402 | 75,813 | - | 1,561,502 |
| Customer deposits at amortised cost | 2,676,333 | 8,549,562 | 1,551,346 | 706,627 | 35,206 | - | - | 13,519,074 |
| Deposits and balances of banks and other financial institutions at amortised cost | 12,811 | 474,014 | 23,553 | 10,296 | - | - | - | 520,674 |
| Certificates of deposit issued at amortised cost | - | - | 252,558 | 433,910 | 105,230 | - | - | 791,698 |
| Other liabilities | - | 58,142 | - | 272,930 | - | - | - | 331,072 |
| | 3,813,584 | 9,229,228 | 1,859,317 | 1,455,154 | 320,198 | 75,813 | - | 16,753,294 |

Notes to Financial Statements

34. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Liquidity Risk Management (Continued)

Maturity analysis of financial liabilities, based on contractual undiscounted cash flow, were as follows:

Bank – 2007

| | Repayable on demand HK\$'000 | Up to 1 month HK\$'000 | Over 1 month but not more than 3 months HK\$'000 | Over 3 months but not more than 12 months HK\$'000 | Over 1 year but not more than 5 years HK\$'000 | Over 5 years HK\$'000 | Repayable within an indefinite period HK\$'000 | Total HK\$'000 |
|--|------------------------------------|------------------------------|---|---|---|-----------------------------|--|-------------------|
| Forward assets purchase | - | 84,027 | 1,935 | - | - | - | - | 85,962 |
| Net amount of interest rate swaps | - | - | - | 40 | - | - | - | 40 |
| Net amount of foreign currency contracts | - | 1,560 | 285 | 496 | - | - | - | 2,341 |
| Gross loan commitments | 1,537,619 | 402,345 | 93,585 | 6,067 | 406,553 | 101,470 | - | 2,547,639 |
| Customer deposits at amortised cost | 3,176,471 | 12,003,217 | 2,531,806 | 800,483 | 24,501 | - | - | 18,536,478 |
| Deposits and balances of banks and other financial institutions at amortised cost | 36,074 | 2,136,868 | 36,230 | 63,590 | - | - | - | 2,272,762 |
| Certificates of deposit issued at amortised cost | - | - | 100,942 | 1,178,740 | 847,842 | - | - | 2,127,524 |
| Other liabilities | - | 72,243 | - | 247,168 | - | - | - | 319,411 |
| | 4,750,164 | 14,700,260 | 2,764,783 | 2,296,584 | 1,278,896 | 101,470 | - | 25,892,157 |



34. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Liquidity Risk Management (Continued)

Bank – 2006

| | Repayable on demand HK\$'000 | Up to 1 month HK\$'000 | Over 1 month but not more than 3 months HK\$'000 | Over 3 months but not more than 12 months HK\$'000 | Over 1 year but not more than 5 years HK\$'000 | Over 5 years HK\$'000 | Repayable within an indefinite period HK\$'000 | Total HK\$'000 |
|--|------------------------------------|------------------------------|---|---|---|-----------------------------|--|-------------------|
| Forward assets purchase | - | 19,539 | - | - | - | - | - | 19,539 |
| Net amount for interest rate swaps and futures | - | - | - | 1,606 | - | - | - | 1,606 |
| Net amount for foreign currency contracts | - | 664 | 2,303 | 3,802 | 1,360 | - | - | 8,129 |
| Gross loan commitments | 1,124,440 | 127,307 | 29,557 | 25,983 | 178,402 | 75,813 | - | 1,561,502 |
| Customer deposits at amortised cost | 2,730,098 | 8,549,562 | 1,551,346 | 706,627 | 35,206 | - | - | 13,572,839 |
| Deposits and balances of banks and other financial institutions at amortised cost | 12,811 | 474,014 | 23,553 | 10,296 | - | - | - | 520,674 |
| Certificates of deposit issued at amortised cost | - | - | 252,558 | 433,910 | 105,230 | - | - | 791,698 |
| Other liabilities | - | 58,142 | - | 353,272 | - | - | - | 411,414 |
| | 3,867,349 | 9,229,228 | 1,859,317 | 1,535,496 | 320,198 | 75,813 | - | 16,887,401 |

Notes to Financial Statements

34. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Operational Risk Management

The operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

The Bank has operational risk management function in place to identify, measure, monitor and control operational risk. Its Operational Risk Management Policy Manual defines responsibilities of various committees, business units and supporting departments, highlights key operational risk cause factors and categories with loss event types to facilitate measurement and assessment of operational risks and potential impact. The operational risk exposures are monitored by appropriate key risk indicators for tracking and escalation to management for providing early warning signals of increased operational risk or a breakdown in operational risk management. Regular operational risk management reports are received and consolidated from various parties and reported to the Operational Risk Management Committee for monitoring and control of operational risk.

Capital Management

Capital of the Bank for regulatory and risk management purpose include share capital, share premium, reserves, profit and loss, regulatory reserve and sub-ordinated debts, if any. The Finance and Control Department is responsible for monitoring the amount of capital base and capital adequacy ratio against trigger limits and for risk exposures, ensuring compliance with relevant statutory limits taking into account business growth, dividend payout and other relevant factors.

The Bank's policy is to maintain a strong capital base to support the development of the Bank's businesses and to meet the statutory capital adequacy ratio and other regulatory capital requirements. Capital is allocated to the various business activities of the Bank depending on the risk taken by each business division and in accordance with the requirements of relevant regulatory bodies, taking into account current and future activities within a time frame of three years.

Capital adequacy and core capital ratios

| | Group and Bank | |
|------------------------|-----------------------|--------|
| | 2007 | 2006 |
| Capital adequacy ratio | 13.16% | 16.96% |
| Core capital ratio | 11.81% | 15.56% |

The details of capital disclosures are disclosed in the section "Capital Disclosures" of Supplementary Information.

35. COMPARATIVE AMOUNTS

Certain comparative figures have been reclassified to conform with the current year's presentation.

36. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 8 January 2008.

Supplementary Information (Unaudited)

The following information does not form part of the financial statements on which the audit opinion is issued.

SEGMENT INFORMATION

(a) By geographical area

The Group operates predominantly in Hong Kong. The geographical analysis is based on the location of the principal operations of the Bank, its subsidiaries and branches which are responsible for reporting the results or booking the assets.

For the years 2007 and 2006, over 90% of the Group's total operating income (net of interest expense), profit before tax, loans and advances to customers, impaired loans and advances, collective and individual impairment allowance for loans and advances, total assets, total liabilities, contingent liabilities and commitments were derived from the operations of the Group's banking business in Hong Kong.

In addition, over 90% of the Group's gross advance to customers, overdue and impaired loans and other types of credit exposures, including those arising from off-balance sheet transactions, in 2007 and 2006 were located in Hong Kong, after taking into account the transfer of risk in respect of such advances, where appropriate.

(b) By business segments

The Group has the following main business segments:

The retail and commercial banking and lending segment mainly comprises the provision of deposit account services, wealth management services, securities trading and stockbroking, the extension of mortgages and consumer lending, hire purchase and leasing, provision of services and financing activities for customers in trading, manufacturing and various business sectors, foreign exchange activities, centralised cash management for deposit taking and lending, interest rate risk management, management of investment in securities and the overall funding management of the Group.

Other business segment comprises and letting of investment properties.

The Group's business for securities trading and stockbroking was reclassified to "retail and commercial banking and lending" from "other business segments" in 2006 for conformity with presentation in 2007 as the management consider that securities trading and stockbroking are part of retail and commercial banking business activities. The Group's inter-segment transactions during the year were mainly related to letting of investment properties.

Supplementary Information (Unaudited)

SEGMENT INFORMATION (Continued)

(b) By business segments (Continued)

2007

| | Retail and commercial banking and lending HK\$'000 | Other businesses HK\$'000 | Total HK\$'000 |
|---|--|---------------------------------|-------------------|
| Segment revenue | | | |
| Net interest income | 265,817 | – | 265,817 |
| Other operating income: | | | |
| Fees and commission income | 72,009 | – | 72,009 |
| Others | 18,120 | 1,221 | 19,341 |
| | 355,946 | 1,221 | 357,167 |
| Profit before tax and unallocated item | 136,564 | 5,893 | 142,457 |
| Unallocated item: | | | |
| Share of profits and losses of a jointly-controlled entity | | | (163) |
| | | | 142,294 |
| Tax | | | (20,861) |
| Profit after tax | | | 121,433 |
| Assets | 25,376,525 | 17,925 | 25,394,450 |

SEGMENT INFORMATION (Continued)

(b) By business segments (Continued)

2006

| | Retail and commercial banking and lending HK\$'000 (Restated) | Other businesses HK\$'000 (Restated) | Total HK\$'000 |
|---|--|---|-------------------|
| Segment revenue | | | |
| Net interest income | 259,338 | – | 259,338 |
| Other operating income: | | | |
| Fees and commission income | 54,914 | – | 54,914 |
| Others | 26,424 | 1,308 | 27,732 |
| | <u>340,676</u> | <u>1,308</u> | <u>341,984</u> |
| Profit before tax and unallocated items | <u>165,623</u> | <u>6,665</u> | <u>172,288</u> |
| Unallocated items: | | | |
| Net gain on disposal of a subsidiary and a jointly-controlled entity | | | 38 |
| Write-back of impairment allowances against loans to a jointly-controlled entity | | | 1,000 |
| Share of profits and losses of a jointly-controlled entity | | | <u>176</u> |
| Profit before tax | | | 173,502 |
| Tax | | | <u>(28,002)</u> |
| Profit after tax | | | <u>145,500</u> |
| Assets | <u>17,209,529</u> | <u>23,391</u> | <u>17,232,920</u> |

Supplementary Information (Unaudited)

SEGMENT INFORMATION (Continued)

(c) Advances to customers by industry sectors

Gross and impaired loans and advances to customers, impairment allowances, impaired loans written off and collateral are analysed by industry sectors pursuant to HKMA's guidelines as follows:

| | 2007 | | | | | | | | |
|--|-----------------------------|--|--|-----------------------------------|--|------------|--|-----------------------------------|--|
| | Gross loans and advances | Collective impairment allowances | Individual impairment allowances | New impairment | | Collateral | Percentage of gross advances covered by collateral | Impaired loans and advances | Overdue more than three months loans and advances |
| | | | | charged to income statement | Amount of impaired loans and advances written off | | | | |
| HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Loans for use in Hong Kong | | | | | | | | | |
| Industrial, commercial and financial: | | | | | | | | | |
| Property development | 566,999 | 624 | - | - | - | 109,583 | 19.3 | - | - |
| Property investment | 3,689,103 | 4,057 | - | - | - | 2,525,675 | 68.5 | 11,991 | 11,990 |
| Financial concerns | 94,043 | 103 | - | - | - | 49,158 | 52.3 | - | - |
| Stockbrokers | 155,971 | 172 | - | - | - | - | - | - | - |
| Telecommunication | 52 | - | - | - | - | - | - | - | - |
| Wholesale and retail trade | 27,082 | 30 | 5,739 | 5,737 | - | 3,919 | 14.5 | 14,139 | 13,695 |
| Manufacturing | 626,603 | 688 | 6,499 | 5,278 | - | 89,119 | 14.2 | 14,674 | 7,622 |
| Transport and transport equipment | 2,197,836 | 2,418 | 2,451 | 1,535 | 558 | 1,735,123 | 79.0 | 2,628 | 692 |
| Others | 1,702,170 | 1,555 | 2,919 | 3,344 | 1,703 | 35,805 | 2.1 | 5,291 | 2,842 |
| Individuals: | | | | | | | | | |
| Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme | 238,921 | 263 | - | - | - | 238,921 | 100.0 | 887 | 887 |
| Loans for the purchase of other residential properties | 4,105,925 | 4,517 | 656 | 34 | - | 4,105,269 | 100.0 | 3,283 | 2,532 |
| Credit card advances | 17,301 | 19 | - | 306 | 308 | - | - | - | - |
| Others | 484,207 | 533 | 2,084 | 1,195 | 1,290 | 244,773 | 50.6 | 2,108 | 1,562 |
| Trade finance | 602,676 | - | 3,917 | 4,122 | 2,392 | 50,853 | 8.4 | 20,814 | 16,533 |
| Loans for use outside Hong Kong | 743,184 | 1,167 | - | - | - | 197,133 | 26.5 | - | - |
| Total loans excluding trade bills | 15,252,073 | 16,146 | 24,265 | 21,551 | 6,251 | 9,385,331 | 61.5 | 75,815 | 58,355 |



SEGMENT INFORMATION (Continued)

(c) Advances to customers by industry sectors (Continued)

| | 2006 | | | | | | | | |
|---|--------------------------------------|--|--|---|---|------------------------|--|---|--|
| | Gross loans and advances HK\$'000 | Collective impairment allowances HK\$'000 | Individual impairment allowances HK\$'000 | New impairment allowances charged to income statement HK\$'000 | Amount of impaired loans and advances written off HK\$'000 | Collateral HK\$'000 | Percentage of gross advances covered by collateral | Impaired loans and advances HK\$'000 | Overdue more than three months loans HK\$'000 |
| Loans for use in Hong Kong | | | | | | | | | |
| Industrial, commercial and financial: | | | | | | | | | |
| Property development | 291,630 | 671 | - | - | - | 130,727 | 44.8 | - | - |
| Property investment | 1,715,055 | 3,945 | 409 | 593 | 8,284 | 1,494,424 | 87.1 | 4,599 | 4,024 |
| Financial concerns | 74,066 | 170 | - | - | - | 21,048 | 28.4 | - | - |
| Stockbrokers | 66,018 | 152 | - | - | - | 1,241 | 1.9 | - | - |
| Telecommunication | 51,578 | 117 | - | - | - | - | - | - | - |
| Wholesale and retail trade | 16,355 | 38 | - | - | - | - | - | - | - |
| Manufacturing | 483,925 | 1,113 | 3,496 | 4,426 | 7,987 | 88,469 | 18.3 | 4,582 | 3,296 |
| Transport and transport equipment | 1,686,953 | 3,881 | 898 | 970 | 1,668 | 1,364,916 | 80.9 | 1,355 | 934 |
| Others | 1,190,590 | 2,739 | 2,825 | 1,067 | 2,362 | 88,110 | 7.4 | 4,234 | 4,234 |
| Individuals: | | | | | | | | | |
| Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme | | | | | | | | | |
| | 257,769 | 593 | - | 718 | 3,358 | 257,769 | 100.0 | 640 | 364 |
| Loans for the purchase of other residential properties | | | | | | | | | |
| | 2,660,370 | 6,119 | 456 | 648 | 948 | 2,512,672 | 94.5 | 3,205 | 2,532 |
| Credit card advances | 12,467 | 29 | - | 293 | 292 | - | - | - | 34 |
| Others | 229,648 | 528 | 1,587 | - | - | 219,541 | 95.6 | 2,960 | 1,767 |
| Trade finance | 727,657 | - | 10,093 | 2,913 | 2,535 | 5,029 | 0.7 | 32,716 | 32,120 |
| Loans for use outside Hong Kong | 601,929 | 2,476 | - | 28 | 5,863 | 149,284 | 24.8 | 24,062 | 15,679 |
| Total loans excluding trade bills | 10,066,010 | 22,571 | 19,764 | 11,656 | 33,297 | 6,333,230 | 62.9 | 78,353 | 64,984 |

The advances to customers are classified by industry sectors based on the industry in which the loans granted were used. In those cases where loans cannot be classified with reasonable certainty, they are classified according to the known principal activity of the borrowers or by reference to the assets financed according to the loan documentation.

Supplementary Information (Unaudited)

NON-BANK MAINLAND EXPOSURES

The following table illustrates the disclosure required to make in respect of its Mainland exposures to non-bank counterparties:

| | On-balance sheet exposure HK\$'million | Off-balance sheet exposure HK\$'million | Total exposures HK\$'million |
|--|--|---|------------------------------------|
| As at 31 December 2007 | | | |
| Mainland entities | 231 | 305 | 536 |
| Companies and individuals outside Mainland where the credit is granted for use in Mainland | 132 | – | 132 |
| Other counterparties the exposures to whom are considered by the Group to be non-bank Mainland exposures | 726 | – | 726 |
| | 1,089 | 305 | 1,394 |

| | On-balance sheet exposure HK\$'million | Off-balance sheet exposure HK\$'million | Total exposures HK\$'million |
|--|--|---|------------------------------------|
| As at 31 December 2006 | | | |
| Mainland entities | 339 | – | 339 |
| Companies and individuals outside Mainland where the credit is granted for use in Mainland | 121 | – | 121 |
| Other counterparties the exposures to whom are considered by the Group to be non-bank Mainland exposures | 513 | – | 513 |
| | 973 | – | 973 |

CROSS-BORDER CLAIMS

The following table illustrates the geographical disclosure of the Group's cross-border claims by type of counterparties on which the ultimate risk lies, and is shown according to the location of the counterparties after taking into account the transfer of risk. An individual country or geographical area is reported if it constitutes 10% or more of the aggregate cross-border claims and was prepared in accordance with the guidelines issued by HKMA.

| | Banks and other financial institutions | Public sector entities | Others | Total |
|--|---|-----------------------------------|---------------------|---------------------|
| | HK\$'million | HK\$'million | HK\$'million | HK\$'million |
| As at 31 December 2007 | | | | |
| 1. Asia Pacific excluding Hong Kong of which: | 3,444 | 4 | 322 | 3,770 |
| Australia | 1,012 | - | - | 1,012 |
| 2. Western Europe of which: | 4,854 | - | 256 | 5,110 |
| Germany | 1,596 | - | 1 | 1,597 |
| United Kingdom | 884 | - | 92 | 976 |
| | Banks and other financial institutions | Public sector entities | Others | Total |
| | HK\$'million | HK\$'million | HK\$'million | HK\$'million |
| As at 31 December 2006 | | | | |
| 1. Asia Pacific excluding Hong Kong of which: | 2,087 | 7 | 154 | 2,248 |
| Australia | 899 | - | 23 | 922 |
| 2. Western Europe | 2,953 | - | 308 | 3,261 |

Supplementary Information (Unaudited)

CURRENCY RISK

Foreign currency exposures with a net position which constitutes not less than 10% of the total net position in all foreign currencies of the Group are as follow:

| | Spot assets | Spot liabilities | Forward purchases | Forward sales | Net long/(short) position | Net structural long position |
|-------------------------------|--------------|------------------|-------------------|---------------|---------------------------|------------------------------|
| As at 31 December 2007 | | | | | | |
| (In HK\$'million) | | | | | | |
| US Dollars | 4,926 | 5,842 | 1,454 | 535 | 3 | |
| Renminbi | 294 | 72 | - | - | 222 | |
| Others | 2,093 | 2,036 | 135 | 194 | (2) | |
| | 7,313 | 7,950 | 1,589 | 729 | 223 | |
| Renminbi | | | | | | 214 |
| | Spot assets | Spot liabilities | Forward purchases | Forward sales | Net long position | Net structural long position |
| As at 31 December 2006 | | | | | | |
| (In HK\$'million) | | | | | | |
| US Dollars | 3,762 | 4,320 | 2,944 | 2,319 | 67 | |
| Renminbi | 260 | 51 | - | - | 209 | |
| Others | 1,072 | 1,768 | 902 | 205 | 1 | |
| | 5,094 | 6,139 | 3,846 | 2,524 | 277 | |
| Renminbi | | | | | | 199 |

LIQUIDITY RATIOS

| | 2007 | 2006 |
|---------------------------------------|---------------|--------|
| Average liquidity ratio for the year: | 46.50% | 51.96% |

The average liquidity ratio for the year is computed in accordance with the Fourth Schedule of the Banking Ordinance.

CAPITAL DISCLOSURES

The components of the Group and the Bank's total capital base include the following items:

| | 2007 HK\$'000 | 2006 HK\$'000 |
|---|------------------|------------------|
| Core capital: | | |
| Paid up ordinary share capital | 810,000 | 810,000 |
| Share premium account | 43,935 | 43,935 |
| Published reserves | 746,316 | 595,173 |
| Profit and loss account | 210,860 | 188,965 |
| | 1,811,111 | 1,638,073 |
| Less: Deductions from shareholdings in subsidiaries | (33,628) | – |
| Securitisation exposures subject to deduction | (34,053) | – |
| Total core capital after deductions | 1,743,430 | 1,638,073 |
| Supplementary capital: | | |
| Property revaluation reserve | 112,890 | 112,890 |
| Regulatory reserve | 137,123 | 78,286 |
| Collective provisions | 17,059 | 23,358 |
| | 267,072 | 214,534 |
| Less: Deductions from shareholdings in subsidiaries | (33,628) | – |
| Securitisation exposures subject to deduction | (34,054) | – |
| Total supplementary capital after deductions | 199,390 | 214,534 |
| Deductions from capital base | – | (67,257) |
| Capital base | 1,942,820 | 1,785,350 |

Capital adequacy ratio at 31 December 2007 was compiled on solo basis in accordance with the Banking (Capital) Rules under section 98A of the Banking Ordinance for the implementation of the "Basel II" capital accord, which became effective on 1 January 2007.

The capital adequacy ratio at 31 December 2006 was compiled on solo basis in accordance with the Third Schedule of the Banking Ordinance under the "Basel I" capital accord.

Supplementary Information (Unaudited)

CAPITAL DISCLOSURES (Continued)

| Class of exposures | 2007 | | | | | |
|--|--------------------------------|---------------------|-------------------|-----------------------|---------------------|-------------------|
| | Exposures* | | | Risk-weighted amounts | | |
| | Rated [#] HK\$'000 | Unrated HK\$'000 | Total HK\$'000 | Rated HK\$'000 | Unrated HK\$'000 | Total HK\$'000 |
| On-balance sheet: | | | | | | |
| Sovereign | 416,374 | - | 416,374 | - | - | - |
| Public sector entity | - | 397,362 | 397,362 | - | 79,472 | 79,472 |
| Bank | 8,434,245 | 316,276 | 8,750,521 | 2,093,602 | 107,495 | 2,201,097 |
| Securities firm | - | 156,376 | 156,376 | - | 78,188 | 78,188 |
| Corporate | 501,268 | 4,929,153 | 5,430,421 | 513,754 | 4,929,153 | 5,442,907 |
| Cash items | - | 365,892 | 365,892 | - | 17,068 | 17,068 |
| Regulatory retail | - | 2,135,545 | 2,135,545 | - | 1,601,659 | 1,601,659 |
| Residential mortgage | - | 6,748,539 | 6,748,539 | - | 3,370,243 | 3,370,243 |
| Past due exposures | - | 36,783 | 36,783 | - | 46,106 | 46,106 |
| Collective investment scheme exposures | - | 12,262 | 12,262 | - | 12,262 | 12,262 |
| Other non-past due exposures | - | 868,795 | 868,795 | - | 868,795 | 868,795 |
| Off-balance sheet: | | | | | | |
| OTC derivative transactions | | | | | | |
| – foreign exchange contracts | - | 741,382 | 741,382 | - | 866 | 866 |
| – others | - | 400,000 | 400,000 | - | - | - |
| Other off-balance sheet items | - | 4,860,466 | 4,860,466 | - | 390,952 | 390,952 |
| | 9,351,887 | 21,968,831 | 31,320,718 | 2,607,356 | 11,502,259 | 14,109,615 |

The Group did not enter into OTC derivative transactions other than foreign exchange contracts and interest rate swaps and futures with counterparties during years 2007 and 2006. The credit exposures attributed to such transactions are considered insignificant.

* Principal amount or credit equivalent amount, net of individual impairment allowance before and after credit risk mitigation.

Exposures are rated by the Bank's ECAI, Moody's, with ECAI issue specific rating or with ECAI inferred rating. Risk weights are determined based on ECAI ratings pursuant to Banking (Capital) Rules.

CAPITAL DISCLOSURES (Continued)

| Class of exposures | 2006 | |
|---|-----------------------|---|
| | Exposures HK\$'000 | Risk weighted amounts HK\$'000 |
| On-balance sheet: | | |
| Sovereign | 173,282 | 9,922 |
| Public sector entity | 458,228 | 91,646 |
| Bank | 6,092,437 | 1,218,487 |
| Non-bank private sector | 7,014,409 | 7,014,409 |
| Investments in the equity or other capital instruments of other banks | 35,656 | 35,656 |
| Cash items | 365,683 | – |
| Residential mortgage | 2,420,189 | 1,210,095 |
| Other assets | 591,785 | 591,785 |
| Off-balance sheet: | | |
| OTC derivative transactions | | |
| – foreign exchange contracts | 57,907 | 11,584 |
| Other off-balance sheet items | 3,867,078 | 242,010 |
| Deductions from credit risk exposures | – | (128,761) |
| | 21,076,654 | 10,296,833 |

Deduction from the capital base included investment in subsidiaries of which their risk weighted exposures of the Group. The subsidiaries not consolidated into the risk weighted assets of the Bank included Public Bank (Nominees) Limited, PB Finance Limited, Public Investments Limited, Public Realty Limited, Public Credit Limited, Public Futures Limited, Public Pacific Securities Limited and Public Financial Securities Limited.



Supplementary Information (Unaudited)

CAPITAL DISCLOSURES (Continued)

| | 2007 | |
|--|---|--|
| | Risk weighted exposures HK\$'000 | Capital requirements/ charge HK\$'000 |
| Credit risk | 14,109,615 | 14,109,615 |
| Market risk – foreign exchange exposures | 221,763 | 17,741 |
| Operational risk | 717,288 | 57,383 |
| Deduction | (280,167) | (280,167) |
| | 14,768,499 | 13,904,572 |
| | 2006 | |
| | Risk weighted exposures HK\$'000 | Capital requirements/ charge HK\$'000 |
| Credit risk | 10,296,833 | 10,305,412 |
| Market risk – foreign exchange exposures | 231,663 | 18,533 |
| | 10,528,496 | 10,323,945 |

The Group and the Bank have adopted standardised approach for calculation of credit risk weighted exposures and market risk weighted exposures and adopted basic indicator approach for calculation of operational risk weighted exposures during the year 2007.

CORPORATE GOVERNANCE

The Bank is committed to high standards of corporate governance and complies with the guidelines issued by the HKMA in the supervisory policy manual “Corporate Governance of Locally Authorised Institutions” in material aspects. To accomplish this, the Bank exercises corporate governance through the following Committees:

1. Board Executive Committee

The Board Executive Committee consists of executive and non-executive directors and is responsible for the management of the businesses of the Bank in all aspects and the implementation of strategic business plans and policies approved and formulated by the directors.

2. Management Committee

The Management Committee is established by the board to ensure the effectiveness of the daily operations and that the operations are in accordance with the corporate objectives, strategies and the annual budget as well as the policies and business directions that have been approved. It comprises Chief Executive, Alternate Chief Executive, Senior Deputy General Manager, Head of Treasury, Head of Operations, Head of Credit, Financial Controller and Heads of business units.

3. Audit Committee

The Audit Committee is authorised by the directors to review and investigate where necessary any activity within its terms of reference. Its main duties include discussion with external auditors about the nature and scope of the audit, to review the Bank’s financial statements before submission to the directors and to review the Bank’s internal audit programme, internal control and compliance systems. The Audit Committee comprises non-executive directors appointed by the directors, and a majority of them are independent non-executive directors.

4. Credit Committee

The Credit Committee is responsible for making decisions on application for all types of credit facilities within its limits set out in the Credit Policy and in particular, to monitor the lending portfolio for managing the overall credit risk of the Bank. It comprises the Chief Executive, Alternate Chief Executive, Senior Deputy General Manager, Assistant General Managers, and Head of Credit.

5. Asset and Liability Management Committee

The Asset and Liability Management Committee reviews and assesses the risk profile and balance sheet structure of the Bank, sets out the objectives for the asset and liability management function and implements relevant risk management strategy. This is monitored and managed within a framework of approved policies and limits, and is reported regularly to the Board Executive Committee or board of directors. The Asset and Liability Management Committee comprises the Executive Chairman, Chief Executive, Alternate Chief Executive, non-executive directors, Head of Treasury, Financial Controller and Risk Manager.

6. Credit Risk Management Committee

The Credit Risk Management Committee is responsible for establishing the framework for identifying, measuring, monitoring and controlling credit risk of existing and new products, and approving credit risk management policies and credit risk tolerable limits as and when necessary. It comprises Chief Executive, Alternate Chief Executive, Financial Controller and Risk Manager.



Supplementary Information (Unaudited)

CORPORATE GOVERNANCE (Continued)

7. Operational Risk Management Committee

The Operational Risk Management Committee is responsible for the implementation of the operational risk management framework approved by the board of directors, and the development of specific policies, processes and procedures for managing operational risk in the material products, activities, processes and systems. It comprises Chief Executive, Alternate Chief Executive, Head of Information Technology, Head of Operations, Financial Controller and Risk Manager.

8. IT Steering Committee

The IT Steering Committee is responsible for establishing policies and strategies for the computerisation of the Bank, recommending to management on major acquisitions of computer hardware and software, and monitoring the progress of the implementation of all information technology related projects. The Committee comprises the Chief Executive, Alternate Chief Executive, Heads of business units, Head of Internal Audit, Head of Operations, Financial Controller and Head of Information Technology.

9. Finance Committee

The Finance Committee assists the board of directors in the financial planning and budgeting process of the business of the Bank and the review of the business performance, statutory and half year accounts. The Finance Committee comprises the Chief Executive, Alternate Chief Executive, Senior Deputy General Manager, Heads of business units, Head of Credit and Financial Controller.

10. Human Resources Committee

The Human Resources Committee assists the board in formulating and implementing human resources policies including staff recruitment, promotion, career development, performance appraisal and remuneration of all staff. The Human Resources Committee comprises Chief Executive, Alternate Chief Executive, Senior Deputy General Manager and Head of Human Resources.