2007

集友銀行

Chiyu Banking Corporation Ltd.

中國銀行（香港）有限公司附屬機構

A SUBSIDIARY OF BANK OF CHINA (HONG KONG) LIMITED

Annual Report

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Financial Highlights

	2007	2006	Change
For the year	**HK$'000**	HK$'000	+/(-)%
Net operating income before impairment allowances	**1,177,834**	931,491	+26.45
Operating profit	**930,983**	668,074	+39.35
Profit before taxation	**942,273**	675,018	+39.59
Profit for the year	**774,890**	559,818	+38.42
At year-end	**HK$'000**	HK$'000	+/(-)%
Capital and reserves	**(4,285,141)**	(3,943,453)	+8.66
Issued and fully paid share capital	**(300,000)**	(300,000)	-
Total assets	**39,039,964**	33,985,794	+14.87
Financial ratios	**%**	%	
Return on average capital and reserves[1]	**18.83**	14.48	+4.35
Return on average total assets[2]	**2.12**	1.72	+0.40
Cost to income ratio	**22.93**	24.74	-1.81
Loan to deposit ratio[3]	**41.70**	40.09	+1.61
Average liquidity ratio[4]	**44.63**	42.79	+1.84
Capital adequacy ratio[5]	**19.97**	23.83	-3.86

1. Return on average capital and reserves =

$$= \frac{\text{Profit for the year}}{\text{Average of the beginning and ending balance of capital and reserves}}$$

2. Return on average total assets = $\frac{\text{Profit for the year}}{\text{Average of beginning and ending balance of total assets}}$

3. Loan to deposit ratio is calculated as at year end. Loan represents gross advances to customers. Deposit also includes structured deposits reported as "Financial liabilities designated at fair value through profit or loss".
4. Average liquidity ratio is calculated as the simple average of each calendar month's average liquidity ratio of local offices of Chiyu Banking Corporation Limited for the year.
5. Capital adequacy ratio as at 31 December 2007 is computed on the combined basis that comprises the positions of the Bank's local offices and overseas branches specified by the Hong Kong Monetary Authority ("HKMA") for its regulatory purposes and in accordance with the Banking (Capital) Rules effective from 1 January 2007. The comparatives as at 31 December 2006 are computed in accordance with the Third Schedule of the Banking Ordinance. They are not restated on the ground that different approaches are used to calculate the Bank's capital requirements for the years ended 31 December 2007 and 2006.
6. Certain comparative amounts have been reclassified to conform with the current year's presentation.

Five-Year Financial Summary

The financial information of the Group for the last five years commencing from 1 January 2003 is summarised below:

	2007	2006	2005	2004[3]	2003[3]
For the year	**HK$'000**	HK$'000	HK$'000	HK$'000	HK$'000
Net operating income before impairment allowances	**1,177,834**	931,491	766,592	546,384	560,112
Operating profit	**930,983**	668,074	577,103	543,476	553,417
Profit before taxation	**942,273**	675,018	590,793	565,758	543,937
Profit for the year	**774,890**	559,818	494,167	493,150	485,428
At year-end	**HK$'000**	HK$'000	HK$'000	HK$'000	HK$'000
Advances and other accounts	**13,354,058**	11,101,224	10,890,769	8,822,697	8,877,282
Total assets	**39,039,964**	33,985,794	31,233,146	30,927,079	30,811,436
Deposits from customer[1]	**(31,517,480)**	(27,569,628)	(25,476,311)	(24,764,174)	(24,273,634)
Total liabilities	**(34,754,823)**	(30,042,341)	(27,441,970)	(27,459,782)	(27,585,928)
Issued and fully paid share capital	**(300,000)**	(300,000)	(300,000)	(300,000)	(300,000)
Capital and reserves	**(4,285,141)**	(3,943,453)	(3,791,176)	(3,467,297)	(3,225,508)
Financial ratios	**%**	%	%	%	%
Return on average capital and reserves	**18.83**	14.48	13.62	14.74	14.95
Return on average total assets	**2.12**	1.72	1.59	1.60	1.64
Cost to income ratio	**22.93**	24.74	28.61	27.78	26.5
Loan to deposit ratio[1]	**41.70**	40.09	39.86	35.63	36.57

1. Since 2005, deposits from customers also include structured deposits reported as "Financial liabilities designated at fair value through profit or loss".
2. On 1 January 2005, a number of new and revised HKFRSs and HKASs came into effect. The resulting changes in accounting treatment and presentation of various income statement and balance sheet items may render certain comparative figures for the years 2003 and 2004 not strictly comparable.
3. Certain comparative amounts have been reclassified to conform with the current year's presentation

Report of the Directors

The Directors are pleased to present their report together with the audited consolidated financial statements of Chiyu Banking Corporation Limited (hereinafter referred to as the "Bank") and its subsidiaries (together with the Bank hereinafter referred to as the "Group") for the year ended 31 December 2007.

Principal Activities

The principal activities of the Group are the provision of banking and related financial services. An analysis of the Group's performance for the year by business segments is set out in Note 41 to the financial statements.

Results and Appropriations

The results of the Group for the year are set out in the consolidated income statement on page 13.

The Board declared a first interim dividend of HK$74 per ordinary share, totaling HK$222,000,000 on 21 May 2007.

The Board declared a second interim dividend of HK$90 per ordinary share, totaling HK$270,000,000 on 20 December 2007.

Together with the second interim dividend of HK$90 per share declared in December 2007, the total dividend payout for 2007 would be HK$164 per share.

Reserves

Details of movements in the reserves of the Group and the Bank are set out in the consolidated statement of changes in equity and statement of changes in equity on page 16 and 17 respectively.

Properties, Plant and Equipment

Details of movements in properties, plant and equipment of the Group and the Bank are set out in Note 28 to the financial statements.

Share Capital

Details of the share capital of the Group and the Bank are set out in the Note 34 to the financial statements.

Report of the Directors (continued)

Directors

The Directors of the Bank during the year and up to date of this report are:

Chairman	He Guangbei #
Vice Chairman	Ng Leung Sing #
	Ng Man Kung
Directors	Chan Yiu Fai
	Chen Zhong Xin # (appointed on 21 November 2007)
	Cheung Wai Hing *
	Chiu Ming Wah #
	Liu Yanfen #
	Mao Xiaowei #
	Ouyang Jian#
	Tan Wan Chye #
	To Chi Wing #
	Woo Chia Wei *
	Yu Kwok Chun *
	Zhang Qi Hua # (resigned on 21 November 2007)

Non-executive Directors

* Independent non-executive Directors

In accordance with Article 99 of the Bank's Articles of Association, Mr. Mao Xiaowei and Mr. Chan Yiu Fai retire at the forthcoming annual general meeting and, being eligible, offer themselves for re-election.

Directors' Interests

Pursuant to written resolutions of all the shareholders of the Bank's intermediate holding company, BOC Hong Kong (Holdings) Limited ("BOCHKHL"), passed on 10 July 2002, BOCHKHL has approved and adopted two share option schemes, namely, the Share Option Scheme and the Sharesave Plan. No options have been granted by BOCHKHL pursuant to the Share Option Scheme or the Sharesave Plan during the year.

On 5 July 2002, Mr. He Guangbei, Mr. Ng Leung Sing, Mr. Ng Man Kung, Mr. Chiu Ming Wah, Mr. Mao Xiaowei, Mr. Chan Yiu Fai and Mr. To Chi Wing were granted option by BOC Hong Kong (BVI) Limited ("BOC (BVI)"), the immediate holding company of BOCHKHL, pursuant to a Pre-listing Share Option Scheme to purchase from BOC (BVI) existing issued shares of the BOCHKHL at a price of HK$8.5 per share. These options have a vesting period of four years from 25 July 2002 with a valid exercise period of ten years. Twenty five percent of the shares subject to such options will be vested at the end of the year. Messrs. He Guangbei, Ng Man Kung and Mao Xiaowei exercised options to purchase an aggregate of 600,000 shares of BOCHKHL during the year.

Report of the Directors (continued)

Directors' Interests (continued)

Save as disclosed above, at no time during the year was the Bank, its subsidiaries, its fellow subsidiaries or its holding company a party to any arrangements to enable the directors to acquire benefits by means of the acquisition of shares in, or debentures of the Bank or at any other body corporate.

No contracts of significance, in relation to the Group's business to which the Bank, its holding companies, or any of its subsidiaries or fellow subsidiaries was a party and in which a Director had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

Management Contracts

No contracts concerning the management or administration of the whole or any substantial part of the business of the Bank were entered into or existed during the year.

Compliance with the Banking (Disclosure) Rules

The financial statements for the year ended 31 December 2007 comply with the requirements set out in the Banking (Disclosure) Rules under the Banking Ordinance.

Auditors

The financial statements have been audited by PricewaterhouseCoopers. A resolution for their re-appointment as auditors for the ensuing year will be proposed at the forthcoming annual general meeting.

On behalf of the Board

HE Guangbei

Chairman

Hong Kong, 13 March 2008

Board of Management

Board of Management

Chief Executive

NG Man Kung

Deputy General Manager

CHAN Yiu Fai

Assistant General Manager

CHENG Pik Chuen

FUNG Tak Hee

SIU Lau Kwong

WONG Siu Wah

The Consultant of Board of Directors

TAN Khek Seng

Management Discussion and Analysis

Business review

In 2007, there was a robust growth in the economy of Hong Kong. The GDP growth rate was 6.3% and employment environment has continued to improve. There was a surge in private consumption, external trade and asset prices. Capitalisation and trading activities have been flourishing in the stock market. Amidst the steady growth of Hong Kong economy, the operating environment for banking sector remains challenging and highly competitive.

The principal activities of the Group are the provision of banking and related financial services. During the year, we continued to focus on enriching the variety of wealth management products and enhancing personal banking service standard to fit our customer's risk appetizer and required return. We delegated proper services teams and platforms to match different customer's need, including VIP centre, Wealth management centre and Branch priority counters. We provided a more convenient and economy transaction channel for customers by improving our electronic banking platform.

Our corporate banking division devoted to serving Small and Medium Enterprises (SMEs) with flexible, efficient, tailor-made services. We also facilitate cross border services through our network in Mainland China. We put effort to enhance human resources and management quality of our customer service teams and Mainland branches, aiming to provide better services to corporate customers.

Financial review

For 2007, the Group recorded a profit attributable to shareholders of HK$ 774,890,000, up 38.42% from last year. The return on average shareholders' funds and the return on average total assets were 18.83% and 2.12%, respectively increased by 4.35% and 0.40% against 2006. The Group's profit growth was mainly due to the growth in net interest income and non-interest income, among which wealth management services income, achieved outstanding performance.

Net interest income was HK$791,767,000, increased 17.37% as compared with 2006. Net interest margin was 2.24%, or 11 basis points higher than last year. Non-interest income was HK$386,067,000, up 50.28% from last year. Operating expenses increased by 17.23% to HK$270,125,000, which caused the cost-to-income ratio dropped 1.81% to 22.93% as compared with last year.

The Group has continued to enhance credit risk management, the classified loans ratio dropped from 0.34% to 0.31% compared with the end of 2006. In 2007, net reversal of loan impairment allowances was HK$23,274,000, as compared with net charge of loan impairment allowances HK$33,005,000 last year.

At the end of 2007, the Group recorded an increase in the total consolidated assets by HK$5,054,170,000 or 14.87% to HK$39,039,964,000. Loans and advances to customers increased by 18.90% to HK$13,142,337,000. Deposits from customers increased by 14.32% to HK$31,517,480,000.

Looking forward to 2008, although the growth in US and Europe economies is expected to be slowdown, China and Hong Kong's economies will sustain its growth. The Group will keep improving the customer services standard and enriching the variation of wealth management products, with a mission to enhance customer's returns and establish closer customer relationship. Extensive efforts will also be put in upgrading the branch services and facilities, aiming to offer customers with a convenient and comfortable banking environment. To serve the growing needs of cross-border banking services, we will provide our corporate customers with a better business solution, backed by our experienced staff and network in both Hong Kong and Mainland China. At the same time, significant resources will be allocated to the aspects of risk management and internal control in order to achieve good corporate governance.

Corporate Governance

The Group has compiled with the HKMA's guidelines set out in the Supervisory Policy Manual CG-1 "Corporate Governance of Locally Incorporated Authorized Institutions".

In order to focus on the strategic and material issues that have significant impact on the Group's operation, financial performance, risk management and long-term development, three committees have been established under the Board of Directors to oversee the major areas of the Group. The details of the committees are given below.

Executive Committee ("EC")

The EC has been delegated with authorities from the Board to handle matters which require the Board's review, but arise between board meetings. Its responsibilities include:

- approving policies, implementation plans and management measures to effect the group-wide development strategies and business plans approved by the Board;
- reviewing the implementation progress of the strategies and business plans;
- recommending strategic proposals to the Board for its consideration and approval; and
- approving the Group's rules and regulations according to the policies imposed by the supervisory authorities and the holding companies.

The members of EC are Mr. Ng Man Kung (Chairman), Mr. Chan Yiu Fai and Mr. To Chi Wing. All are Directors of the Bank.

Audit Committee ("AC")

The AC assists the Board in overseeing the auditing activities of the Group and monitoring compliance with approved policies and procedures, so that the effectiveness of financial reporting process and internal control systems of the Group can be assured. Its responsibilities include:

- reviewing and monitoring the effectiveness of the internal control systems, the controls over financial risks and the procedures of financial reporting and auditing;
- assessing independently the effectiveness and efficiency of financial reporting system and its controlling mechanism, and the sufficiency of operating policies and system; and
- monitoring the operation of the Group to ensure the Group is running in compliance with the relevant rules and regulations.

The members of AC are Mr. Chiu Ming Wah (Chairman), Mr. Cheung Wai Hing , Ms. Liu Yanfen, Mr. Tan Wan Chye and Mr. Woo Chia Wei. All are non-executive Directors of the Bank.

Risk Management Committee ("RC")

The RC assists the Board in overseeing the risk management of the Group, formulating the Group's risk management strategies, policies and procedures, and monitoring the implementation of those strategies, policies and procedures. Its responsibilities include:

- assisting the Board to measure and monitor the risk exposures of the Group;
- recommending appropriate risk management strategies to the Board; and
- formulating risk management related policies such as risk management policies and authorities and duties delegation policies in accordance with the requirements set by the Board.

The members of the RC are Mr. Mao Xiaowei (Chairman), Mr. Ng Leung Sing, Mr. Ng Man Kung, Mr. To Chi Wing and Mr. Yu Kwok Chun. All are Directors of the Bank.

Independent Auditor's Report
To the shareholders of Chiyu Banking Corporation Limited

(incorporated in Hong Kong with limited liability)

We have audited the consolidated financial statements of Chiyu Banking Corporation Limited (the "Bank") and its subsidiaries (together, the "Group") set out on pages 13 to 151 which comprise the consolidated and company balance sheets as at 31 December 2007, and the consolidated income statement, the consolidated and company statements 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 consolidated 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.

Auditor's responsibility

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

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 auditor's judgment, 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 auditor considers 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.

Independent Auditor's Report (continued)

Opinion

In our opinion, the consolidated 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.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 13 March 2008

Consolidated Income Statement

For the year ended 31 December	Notes	2007	2006
		HK$'000	HK$'000
Interest income		**1,774,564**	1,552,598
Interest expense		**(982,797)**	(878,001)
Net interest income	5	**791,767**	674,597
Fees and commission income		**380,678**	237,114
Fees and commission expenses		**(64,553)**	(41,220)
Net fees and commission income	6	**316,125**	195,894
Net trading income	7	**80,007**	76,670
Net loss on financial instruments designated at fair value through profit or loss		**(15,796)**	(27,781)
Net gain on investments in securities	8	**-**	6,470
Other operating income	9	**5,731**	5,641
Total operating income		**1,177,834**	931,491
Net operating income before impairment allowances		**1,177,834**	931,491
Net reversal/(charge) of impairment allowances	10	**23,274**	(33,005)
Net operating income		**1,201,108**	898,486
Operating expenses	11	**(270,125)**	(230,412)
Operating profit		**930,983**	668,074
Net gain from disposal of/fair value adjustments on investment properties	12	**11,301**	600
Net (loss)/gain from disposal/revaluation of properties, plant and equipment	13	**(11)**	6,344
Profit before taxation		**942,273**	675,018
Taxation	14	**(167,383)**	(115,200)
Profit for the year		**774,890**	559,818
Dividends	16	**492,000**	408,000

The notes on pages 19 to 151 are an integral part of these financial statements.

Consolidated Balance Sheet

As at 31 December	Notes	2007	2006
		HK$'000	HK$'000
ASSETS			
Cash and balances with banks and other financial institutions	20	**9,751,518**	5,102,028
Placements with banks and other financial institutions maturing between one and twelve months		**7,242,392**	7,582,425
Financial assets designated at fair value through profit or loss	21	**1,036,422**	1,220,977
Derivative financial instruments	22	**176,682**	125,842
Advances and other accounts	23	**13,354,058**	11,101,224
Investment in securities	25	**5,793,716**	7,268,543
Investment properties	27	**64,450**	54,540
Properties, plant and equipment	28	**571,328**	528,843
Deferred tax assets	33	**-**	110
Other assets	29	**1,049,398**	1,001,262
Total assets		**39,039,964**	33,985,794
LIABILITIES			
Deposits and balances of banks and other financial institutions		**1,085,595**	625,868
Financial liabilities designated at fair value through profit or loss	30	**2,485,192**	3,319,205
Derivative financial instruments	22	**51,124**	47,010
Deposits from customers	31	**29,328,028**	24,542,695
Other accounts and provisions	32	**1,659,067**	1,404,438
Current tax liabilities		**78,481**	46,180
Deferred tax liabilities	33	**67,336**	56,945
Total liabilities		**34,754,823**	30,042,341
EQUITY			
Share capital	34	**300,000**	300,000
Reserves	35	**3,985,141**	3,643,453
Total equity		**4,285,141**	3,943,453
Total liabilities and equity		**39,039,964**	33,985,794

The notes on pages 19 to 151 are an integral part of these financial statements.

Approved by the Board of Directors on 13 March 2008 and signed on behalf of the Board by:

HE Guangbei
Director

NG Man Kung
Director

CHIU Ming Wah
Director

PO Yuen Fung
Secretary

Balance Sheet

As at 31 December	Notes	2007	2006
		HK$'000	HK$'000
ASSETS			
Cash and balances with banks and other financial institutions	20	**9,751,518**	5,102,028
Placements with banks and other financial institutions maturing between one and twelve months		**7,242,392**	7,582,425
Financial assets designated at fair value through profit or loss	21	**1,036,422**	1,220,977
Derivative financial instruments	22	**176,682**	125,842
Advances and other accounts	23	**13,354,058**	11,101,224
Investment in securities	25	**5,765,053**	7,248,294
Investment in subsidiaries	26	**3,913**	3,913
Amount due from subsidiaries	26	**20,332**	54,615
Investment properties	27	**64,450**	54,540
Properties, plant and equipment	28	**566,328**	525,643
Other assets	29	**1,049,398**	994,931
Total assets		**39,030,546**	34,014,432
LIABILITIES			
Deposits and balances of banks and other financial institutions		**1,085,595**	625,868
Financial liabilities designated at fair value through profit or loss	30	**2,485,192**	3,319,205
Derivative financial instruments	22	**51,124**	47,010
Deposits from customers	31	**29,360,833**	24,606,429
Amount due to subsidiaries	26	**28,306**	21,319
Other accounts and provisions	32	**1,658,260**	1,404,634
Current tax liabilities		**78,481**	46,180
Deferred tax liabilities	33	**65,861**	56,945
Total liabilities		**34,813,652**	30,127,590
EQUITY			
Share capital	34	**300,000**	300,000
Reserves	35	**3,916,894**	3,586,842
Total equity		**4,216,894**	3,886,842
Total liabilities and equity		**39,030,546**	34,014,432

The notes on pages 19 to 151 are an integral part of these financial statements.

Approved by the Board of Directors on 13 March 2008 and signed on behalf of the Board by:

HE Guangbei

Director

NG Man Kung

Director

CHIU Ming Wah

Director

PO Yuen Fung

Secretary

Consolidated Statement of Changes in Equity

	Attributable to equity holders of the Group					
	Share capital	Premises revaluation reserve	Reserve for fair value changes of available-for-sale securities	Regulatory reserve*	Retained earnings	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
At 1 January 2006	300,000	275,268	742	153,807	3,061,359	3,791,176
Net profit for the year	-	-	-	-	559,818	559,818
Currency translation difference	-	-	-	-	130	130
2006 first interim dividend paid	-	-	-	-	(198,000)	(198,000)
2006 second interim dividend paid	-	-	-	-	(210,000)	(210,000)
Revaluation of premises	-	5,299	-	-	-	5,299
Release upon disposal of premises	-	(4,498)	-	-	4,498	-
Release of reserve upon derecognition of available-for-sale securities	-	-	(885)	-	(4,626)	(5,511)
Release from deferred tax liabilities	-	398	143	-	-	541
Transfer from retained earnings	-	-	-	1,800	(1,800)	-
At 31 December 2006	300,000	276,467	-	155,607	3,211,379	3,943,453
Bank and subsidiaries	300,000	276,467	-	155,607	3,211,379	3,943,453

	Attributable to equity holders of the Group					
	Share capital	**Premises revaluation reserve**	**Reserve for fair value changes of available-for-sale securities**	**Regulatory reserve***	**Retained earnings**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
At 1 January 2007	**300,000**	**276,467**	**-**	**155,607**	**3,211,379**	**3,943,453**
Net profit for the year	**-**	**-**	**-**	**-**	**774,890**	**774,890**
Currency translation difference	**-**	**-**	**-**	**-**	**931**	**931**
2007 first interim dividend paid	**-**	**-**	**-**	**-**	**(222,000)**	**(222,000)**
2007 second interim dividend declared	**-**	**-**	**-**	**-**	**(270,000)**	**(270,000)**
Revaluation of premises	**-**	**57,715**	**-**	**-**	**-**	**57,715**
Release upon disposal of premises	**-**	**(8,598)**	**-**	**-**	**8,598**	**-**
Change in fair value of available-for-sale securities taken to equity	**-**	**-**	**9,662**	**-**	**-**	**9,662**
Release to deferred tax liabilities	**-**	**(8,005)**	**(1,505)**	**-**	**-**	**(9,510)**
Transfer from retained earnings	**-**	**-**	**-**	**16,667**	**(16,667)**	**-**
At 31 December 2007	**300,000**	**317,579**	**8,157**	**172,274**	**3,487,131**	**4,285,141**
Bank and subsidiaries	**300,000**	**317,579**	**8,157**	**172,274**	**3,487,131**	**4,285,141**

* In accordance with the requirements of the HKMA, the amounts are set aside for general banking risks, including future losses or other unforeseeable risks, in addition to the loan impairment allowances recognised under HKAS 39.

The notes on pages 19 to 151 are an integral part of these financial statements.

Statement of Changes in Equity

	Attributable to equity holders of the Bank					
	Share capital	Premises revaluation reserve	Reserve for fair value changes of available-for-sale securities	Regulatory reserve*	Retained earnings	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
At 1 January 2006	300,000	275,268	742	153,807	3,008,787	3,738,604
Net profit for the year	-	-	-	-	555,972	555,972
Currency translation difference	-	-	-	-	130	130
2006 first interim dividend paid	-	-	-	-	(198,000)	(198,000)
2006 second interim dividend paid	-	-	-	-	(210,000)	(210,000)
Revaluation of premises	-	5,065	-	-	-	5,065
Release upon disposal of premises	-	(4,498)	-	-	4,498	-
Release of reserve upon derecognition of available-for-sale securities	-	-	(885)	-	(4,626)	(5,511)
Release from deferred tax liabilities	-	439	143	-	-	582
Transfer from retained earnings	-	-	-	1,800	(1,800)	-
At 31 December 2006	300,000	276,274	-	155,607	3,154,961	3,886,842

	Attributable to equity holders of the Bank					
	Share capital	**Premises revaluation reserve**	**Reserve for fair value changes of available-for-sale securities**	**Regulatory reserve***	**Retained earnings**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
At 1 January 2007	**300,000**	**276,274**	**-**	**155,607**	**3,154,961**	**3,886,842**
Net profit for the year	**-**	**-**	**-**	**-**	**771,939**	**771,939**
Currency translation difference	**-**	**-**	**-**	**-**	**931**	**931**
2007 first interim dividend paid	**-**	**-**	**-**	**-**	**(222,000)**	**(222,000)**
2007 second interim dividend declared	**-**	**-**	**-**	**-**	**(270,000)**	**(270,000)**
Revaluation of premises	**-**	**55,827**	**-**	**-**	**-**	**55,827**
Release upon disposal of premises	**-**	**(8,598)**	**-**	**-**	**8,598**	**-**
Change in fair value of available-for-sale securities taken to equity	**-**	**-**	**1,248**	**-**	**-**	**1,248**
Release to deferred tax liabilities	**-**	**(7,675)**	**(218)**	**-**	**-**	**(7,893)**
Transfer from retained earnings	**-**	**-**	**-**	**16,667**	**(16,667)**	**-**
At 31 December 2007	**300,000**	**315,828**	**1,030**	**172,274**	**3,427,762**	**4,216,894**

* In accordance with the requirements of the HKMA, the amounts are set aside for general banking risks, including future losses or other unforeseeable risks, in addition to the loan impairment allowances recognised under HKAS 39.

The notes on pages 19 to 151 are an integral part of these financial statements.

Consolidated Cash Flow Statement

For the year ended 31 December	Notes	2007	Restated 2006
		HK$'000	HK$'000
Cash flows from operating activities			
Operating cash inflow/(outflow) before taxation	36(a)	**5,635,433**	(1,636,256)
Hong Kong profits tax paid		**(121,970)**	(95,356)
Overseas profits tax paid		**(12,121)**	(9,905)
Net cash inflow/(outflow) from operating activities		**5,501,342**	(1,741,517)
Cash flows from investing activities			
Purchase of properties, plant and equipment		**(11,433)**	(4,526)
Proceeds from disposal of investment properties		**14,891**	-
Proceeds from disposal of properties, plant and equipment		**-**	23,677
Net cash inflow from investing activities		**3,458**	19,151
Cash flows from financing activities			
Dividends paid to equity holders of the Bank		**(432,000)**	(198,000)
Net cash outflow from financing activities		**(432,000)**	(198,000)
Increase/(decrease) in cash and cash equivalents		**5,072,800**	(1,920,366)
Cash and cash equivalents at 1 January		**7,576,757**	9,497,123
Cash and cash equivalents at 31 December	36(b)	**12,649,557**	7,576,757

The notes on pages 19 to 151 are an integral part of these financial statements.

Notes to the Financial Statements

1. Principal activities

The Group is principally engaged in the provision of banking and related financial services in Hong Kong.

The Bank is a limited liability company incorporated in Hong Kong. The address of its registered office is No.78 Des Vouex Road, Central, Hong Kong.

2. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of the Group have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRS") (HKFRSs is a collective term which includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKAS") and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance.

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale securities, financial assets and financial liabilities (including derivative financial instruments) at fair value through profit or loss, investment properties which are carried at fair value and premises which are carried at fair value or revalued amount less accumulated depreciation and accumulated impairment losses.

The preparation of financial statements in conformity with HKFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 3.

Newly adopted HKFRSs

In 2007, the Group adopted the new / revised HKFRSs as set out below, which are effective for annual accounting periods beginning on or after 1 January 2007 and relevant to its operations.

- HKFRS 7 — Financial Instruments: Disclosures
- HKAS 1 (Amendment) — Presentation of Financial Statements – Capital Disclosures

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

Newly adopted HKFRSs (continued)

The standards introduce certain new disclosures relating to financial instruments while incorporating many of the requirements in HKAS 32. HKFRS 7 supersedes HKAS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and the disclosure requirements of HKAS 32 Financial Instruments: Disclosure and Presentation. The Group has adopted HKFRS 7 and the amendment to HKAS 1. The key impacts are more qualitative and quantitative disclosures primarily relating to fair value measurement, risk management and capital management. Accordingly the adoption of these standards does not result in any changes to the Group's accounting policies and had no effect on the Group's results of operations or financial position.

Interpretations to existing standards that have been early adopted by the Group last year

The following Interpretations to existing standards were assessed to be relevant to the Group's operations and have been early adopted by the Group last year:

- HK(IFRIC) - Int 9 Reassessment of Embedded Derivatives
- HK(IFRIC) - Int 10 Interim Financial Reporting and Impairment

Interpretations to existing standards already effective in 2007 but not relevant to the Group's operations

The following Interpretations to existing standards have already been effective for accounting periods beginning on 1 January 2007 but are not relevant to the Group's operations:

- HK(IFRIC) - Int 7 Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies
- HK(IFRIC) - Int 8 Scope of HKFRS 2

Standards and interpretations to existing standards that are not yet effective and have not been early adopted by the Group

The Group has chosen not to early adopt the following standards and an interpretation to an existing standard that were issued but not yet effective for accounting periods beginning on 1 January 2007:

- HKAS 1 (Revised) Presentation of Financial Statements (effective for annual periods beginning on or after 1 January 2009). HKAS 1 (Revised) affects the presentation of owner changes in equity and of comprehensive income. It does not change recognition, measurement, or disclosure of specific transaction and other events required by other HKFRSs. The expected impact is still being assessed but the probable key impact will be on the manner in which the Group presents financial statements.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

Standards and interpretations to existing standards that are not yet effective and have not been early adopted by the Group (continued)

- HKFRS 8 Operating Segments (effective for annual periods beginning on or after 1 January 2009). HKFRS 8 will supersede HKAS 14 Segment Reporting, under which segments were identified and reported on risk and return analysis. Items were reported on the accounting policies used for external reporting. Under HKFRS 8, which adopts the 'management approach', segments are components of an entity regularly reviewed by the entity's management. Items are presented based on internal reporting. The Group has assessed the impact of HKFRS 8 and concluded that the adoption of the new standard is unlikely to have a significant impact on the Group's results of operations and financial position.

- HK(IFRIC) - Int 13 Customer Loyalty Programmes (effective for annual periods beginning on or after 1 July 2008). HK(IFRIC) - Int 13 clarifies that when an entity provides customers with incentives to buy goods or services under a customer loyalty programme (for example, customers accumulate loyalty points to redeem free or discounted products or service), the fair value of the consideration received or receivable in respect of the initial sale shall be allocated between the award credits and the other components of the sale or service. The Group is still in the process of assessing its impact on its results on operations and financial position.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

Standard and interpretations to existing standards that are not yet effective and have been assessed to be not relevant to the Group's operations

- HKAS 23 (Revised) Borrowing Costs (effective for annual periods beginning on or after 1 January 2009). The revised standard removes the option of recognising as an expense those borrowing costs relating to assets that take a substantial period of time to get ready for their intended use or sale (i.e. qualifying assets). This revised standard applies to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009. This revised standard is not relevant to the Group's operations because the Group does not require external borrowing to finance the development of any qualifying asset.

- HK(IFRIC) - Int 11, HKFRS 2 Group and Treasury Share Transactions (effective for annual periods beginning on or after 1 March 2007). HK(IFRIC) - Int 11 addresses how the share-based payment arrangement should be accounted for in the financial statements for the subsidiary that receives services from the employees. As the Group has not issued equity instruments for payment except those exempted under HKFRS 2, HK(IFRIC) - Int 11 is not relevant to the Group's operations.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

Standard and interpretations to existing standards that are not yet effective and have been assessed to be not relevant to the Group's operations (continued)

- HK(IFRIC) - Int 12, Service Concession Arrangements (effective for annual periods beginning on or after 1 January 2008). HK(IFRIC) - Int 12 applies to companies that participate in service concession arrangements and provides guidance on the accounting by operators in public-to-private service concession arrangements. As the Group is not involved in service concession arrangements, HK(IFRIC) - Int 12 is not relevant to the Group's operations.

- HK(IFRIC) - Int 14, HKAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (effective for annual periods beginning on or after 1 January 2008). HK(IFRIC) - Int 14 provides guidance on assessing the limit in HKAS 19 on the amount of the surplus that can be recognised as an asset. It also explains how the pension asset or liability may be affected by a statutory or contractual minimum funding requirement. HK(IFRIC) - Int 14 is not relevant to the Group's operations because none of the Group's companies provide post-employment defined benefits to employees.

2.2 Consolidation

The consolidated financial statements include the financial statements of the Bank and all of its subsidiaries made up to 31 December.

(1) Subsidiaries

Subsidiaries, are all entities (including special purpose entities) over which the Group controls the composition of the Board of Directors, controls more than half of the voting power, holds more than half of the issued capital or by any other means that entitle the Group to govern the financial and operating policies of the entities. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.2 Consolidation (continued)

(1) Subsidiaries (continued)

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group not under common control. The cost of such an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed as of the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values as of the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the Group's share of the identifiable net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the transaction provides evidence of impairment of the assets transferred. Where necessary, accounting policies of subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

In the Bank's balance sheet the investments in subsidiaries are stated at cost less allowance for impairment losses. The results of subsidiaries are accounted for by the Bank on the basis of dividends received and receivable.

The gain or loss on the disposal of a subsidiary represents the difference between: a) the proceeds of the sale and, b) the Group's share of its net assets including goodwill on acquisition net of any accumulated impairment loss and any related accumulated foreign currency translation difference.

Minority interest represent the interests of outside shareholders in the operating results and net assets of subsidiaries.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.3 Segmental reporting

A business segment is a group of assets and operations engaged in providing products and services and that is subject to risks and returns that are different from those of other business segments. A geographical segment is a group of assets and operations engaged in providing products and services within a particular economic environment and that is subject to risks and returns that are different from those of segments operating in other economic environments.

2.4 Foreign currency translation

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in Hong Kong dollars, which is the Bank's functional and presentation currency.

Foreign exchange gains and losses resulting from the settlement of foreign currency transactions using the exchange rates prevailing at the dates of the transactions and monetary assets and liabilities denominated in foreign currencies translated at the rate of exchange at the balance sheet date are recognised directly in the income statement.

Changes in the fair value of monetary securities denominated in foreign currency classified as available-for-sale are analysed between translation differences resulting from changes in the amortised cost of the securities and other changes in the carrying amount of the securities. Translation differences related to changes in the amortised cost are recognised in the income statement and other changes in the carrying amount are recognised in equity.

Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary financial assets such as equities classified as available-for-sale are included in the available-for-sale reserve in equity.

The results and financial position of all the Group entities that have a functional currency different from Hong Kong dollars are translated into Hong Kong dollars as follows:

- assets and liabilities are translated at the closing rate at the balance sheet date;
- income and expenses are translated at average exchange rates; and
- all resulting exchange differences are recognised in the currency translation reserve in equity.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.4 Foreign currency translation (continued)

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments are taken to shareholders' equity. When a foreign entity is sold, such exchange differences are recognised in the income statement, as part of the gain or loss on sale.

2.5 Derivative financial instruments and hedge accounting

Derivatives are initially recognised at fair value on the date the derivative contract is entered into and are subsequently re-measured at fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and through the use of valuation techniques, including discounted cash flow models and options pricing models, as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Derivatives are categorised as held for trading unless they are designated as hedges and are effective hedging instruments, then they are subject to measurement under the hedge accounting requirements.

The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e., the fair value of the consideration given or received).

Certain derivatives embedded in other financial instruments, such as the conversion option in a convertible bond, are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

The Group documents at inception the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at the hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values of hedged items. These criteria should be met before a hedge can be qualified to be accounted for under hedge accounting.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.5 Derivative financial instruments and hedge accounting (continued)

Changes in the fair value of derivatives that are designated and qualified as effective fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to the income statement over the period to maturity.

For derivative instruments held for trading, changes in their fair value are recognised immediately in the income statement.

2.6 Offsetting financial instruments

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

2.7 Interest income and expense and fees and commission income and expense

Interest income and expense are recognised in the income statement for all financial assets and financial liabilities using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument (e.g. prepayment options or incentives relating to residential mortgage loans) but does not consider future credit losses. The calculation includes fees, premiums or discounts and basis points paid or received between parties to the contract, and directly attributable origination fees and costs which represent an integral part of the effective yield are amortised as interest income or expense over the expected life of the financial instrument.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised on the written down value using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. Subsequent unwinding of the discount allowance is recognised as interest income.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.7 Interest income and expense and fees and commission income and expense (continued)

Fees and commissions that are not an integral part of the effective yield are recognised on an accrual basis ratably over the period when the related service has been provided, such as administrative fee, asset management fee and custody services fee. Loan syndication fees are recognised as revenue when the related syndication arrangement has been completed and the Group has retained no part of the loan package for itself or has retained a part at the same effective interest rate as that of other participants.

2.8 Financial assets

The Group classifies its financial assets into the following categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments and available-for-sale financial assets. Management determines the classification of investments at initial recognition. The classification depends on the purpose for which the financial assets were held. All financial assets are recognised initially at fair value. Except for financial assets carried at fair value through profit or loss, all transaction costs of financial assets are included in their amortised costs.

(1) Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception.

A financial asset which has been acquired or incurred principally for the purpose of selling in the short term or is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking is classified as held-for-trading. Derivatives are also classified as held for trading unless they are designated as effective hedges.

A financial asset, other than one held for trading, will be designated as a financial asset at fair value through profit or loss, if it meets the criteria set out below, and is so designated by management:

- eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as ‘an accounting mismatch’) that would otherwise arise from measuring the financial assets or recognising the gains and losses on them on different bases; or

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.8 Financial assets (continued)

(1) Financial assets at fair value through profit or loss (continued)

- applies to a group of financial assets, financial liabilities or both that is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the key management; or

- relates to financial assets containing one or more embedded derivative that significantly modifies the cash flow resulting from those financial assets.

These assets are recognised initially at fair value, with transaction costs taken directly to the consolidated income statement, and are subsequently re-measured at fair value.

Gains and losses from changes in the fair value of such assets (excluding the interest component) are reported in net trading income or net gain/loss on financial instruments designated at fair value through profit or loss. The interest component is reported as part of interest income. Dividends on equity instruments of this category are recognised in the consolidated income statement when the Group's right to receive payment is established.

(2) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, including placements with and advances to banks and other financial institutions, investment debt securities without an active market and loans and advances to customers. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest rate method less allowances for impairment losses.

(3) Held-to-maturity

Financial assets classified as held-to-maturity are those traded in active markets, with fixed or determinable payments and fixed maturities that the Group's management has both the positive intention and the ability to hold to maturity. Were the Group to sell other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and reclassified as available-for-sale. They are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method less allowances for impairment losses.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.8 Financial assets (continued)

(4) Available-for-sale

Financial assets classified as available-for-sale are those that are either designated as such or are not classified in any of the other categories. They are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Available-for-sale financial assets are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at fair value. Unrealised gains and losses arising from changes in the fair value of investments are recognised directly in equity, until the financial asset is disposed of or impaired at which time the cumulative gain or loss previously recognised in equity should be transferred to the consolidated income statement. However, interest which includes the amortisation of premium and discount is calculated using the effective interest method and is recognised in the consolidated income statement. Dividends on equity instruments classified as available-for-sale are recognised in the consolidated income statement when the Group's right to receive payment is established.

2.9 Financial liabilities

The Group classifies its financial liabilities under the following categories: trading liabilities, financial liabilities designated at fair value through profit or loss, deposits, debt securities in issue and other liabilities. All financial liabilities are classified at inception and recognised initially at fair value.

(1) Trading liabilities

A financial liability is classified as held for trading if it is incurred principally for the purpose of repurchasing in the short term. Derivatives are also classified as held for trading unless they are designated as effective hedges. It is measured at fair value and any gains and losses from changes in fair value are recognised in the income statement.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.9 Financial liabilities (continued)

(2) Financial liabilities designated at fair value through profit or loss

A financial liability can be designated at fair value through profit or loss if it is so designated at inception. Financial liabilities so designated include certain certificates of deposit issued and certain deposits received from customers that are embedded with derivatives. A financial liability is typically so designated if it meets the following criteria:

- eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring the financial liabilities or recognising the gains and losses on them on different bases; or

- applies to a group of financial assets, financial liabilities or both that is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the key management; or

- relates to financial liabilities containing one or more embedded derivative that significantly modifies the cash flow resulting from those financial liabilities.

Financial liabilities designated as at fair value through profit or loss are measured at fair value and any gains and losses from changes in fair value are recognised in the income statement.

(3) Deposits and other liabilities

Deposits other than those classified as trading liabilities or designated at fair value through profit or loss, together with other liabilities are carried at amortised cost or at cost. Any difference (if available) between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period using the effective interest method.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.10 Recognition and de-recognition of financial instruments

Purchases and sales of financial assets at fair value through profit or loss, available-for-sale and held-to-maturity are recognised on the trade date, the date on which the Group purchases or sells the assets. Loans and receivables (except investment securities without an active market) are recognised when cash is advanced to the borrowers. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

Trading liabilities, financial liabilities designated at fair value through profit or loss are recognised on the trade date. Deposits other than trading liabilities are recognised when money is received from customers, other liabilities are recognised when such obligations arise. Financial liabilities are de-recognised from the balance sheet when and only when the obligation specified in the contract is discharged, cancelled or expired. If the Group purchases its own debt, it is removed from the balance sheet, and the difference between the carrying amount of a liability and the consideration paid is included in net trading income.

Securities and bills sold to a counter-party with an obligation to repurchase at a pre-determined price on a specified future date under a repurchase agreement are referred to as Repos. Securities and bills purchased from a counter-party with an obligation to re-sell to the counter-party at a pre-determined price on a specified future date under a resale agreement are referred to as Reverse repos.

Repos are initially recorded as due to banks, placements from banks and other financial institutions, as appropriate, at the actual amount of cash received from the counter-party. The financial assets used to collateralise repurchase agreements are recorded as investment securities or financial assets at fair value through profit or loss. Reverse repos are initially recorded in the balance sheet as cash and due from banks or placements with banks and other financial institutions, as appropriate, at the actual amount of cash paid to the counter-party. The financial assets received as collateral under reverse repurchase agreements are not recorded on the balance sheet. The difference between sale and repurchase price is recognised as interest income or interest expense over the life of the agreements using the effective interest method.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.11 Determination of fair value of financial instruments

The fair values of financial assets and financial liabilities that are quoted in active markets are based on current bid prices and current ask prices respectively. If the market for financial assets and financial liabilities is not active (such as unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

2.12 Impairment of financial assets

The Group assesses as of each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets may be impaired includes observable data that comes to the attention of the Group about the following probable loss events:

(i) significant financial difficulty of the issuer or obligor;

(ii) a breach of contract, such as a default or delinquency in interest or principal payment;

(iii) the Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;

(iv) it becoming probable that the borrower will enter into bankruptcy or other financial reorganisation;

(v) the disappearance of an active market or downgrading below investment grade level for that financial asset because of financial difficulties; or

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.12 Impairment of financial assets (continued)

(vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:

- adverse changes in the payment status of borrowers in the group; or
- national or local economic conditions that correlate with defaults on the assets in the group.

(1) Assets carried at amortised cost

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment together with all other financial assets that are not individually significant or for which impairment has not yet been identified. 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.

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments 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 credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Group may measure impairment on the basis of an instrument's fair value using an observable market price.

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.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.12 Impairment of financial assets (continued)

(1) Assets carried at amortised cost (continued)

For the purposes of a collective assessment of impairment, financial assets are grouped on the basis of similar and relevant credit risk characteristics. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and 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 period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

When a loan is uncollectible, it is written off against the related allowance for impairment losses. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses in the income statement.

If, in a subsequent period, the amount of allowance for impairment losses decreases and the decrease can be related objectively to an event occurring after the impairment loss was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

Loans whose terms have been renegotiated with substantial difference in the terms are no longer considered to be past due but are treated as new loans.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.12 Impairment of financial assets (continued)

(2) Assets classified as available-for-sale

If evidence of impairment exists for available-for-sale financial assets, the cumulative losses, measured as the difference between the acquisition cost or amortised cost and the current fair value, less any impairment loss on that financial asset previously recognised in the income statement, is removed from equity and recognised in the income statement. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale 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. With respect to equity instruments, such reversals are made through the reserve for fair value change of available-for-sale securities within equity.

2.13 Impairment of investment in subsidiaries and non-financial assets

Assets that have an indefinite useful life or are not yet available for use are not subject to amortisation, but are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units). Assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

2.14 Financial guarantee contracts

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a contract between the holder and the debtor.

Financial guarantees are initially recognised as financial liabilities and reported under "Other accounts and provisions" in the financial statements at fair value on the date that the guarantee was given. Subsequent to initial recognition, the Group's liabilities under such guarantees are measured at the higher of (i) the amount determined in accordance with HKAS 37 Provisions, Contingent Liabilities and Contingent Assets and (ii) the amount initially recognised less, where appropriate, cumulative amortisation recognised over the life of the guarantee on a straight-line basis. Any changes in the liability relating to financial guarantees are taken to the income statement.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.15 Fixed assets

(1) Premises, equipment, fixtures and fittings

Premises comprise primarily branches and offices. Premises are shown at fair value based on periodic, but at least annually, valuations by external independent valuers less subsequent depreciation. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. In the intervening periods, the directors review the carrying amount of premises, by reference to the open market value of similar properties, and adjustments are made when there has been a material change. All equipment, fixtures and fittings are stated at historical cost less accumulated depreciation and impairment. Historical cost includes expenditures that are directly attributable to the acquisition and installation of the items.

Subsequent costs are included in an asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to the income statement during the financial period in which they are incurred.

Increases in the carrying amount arising on revaluation of premises are credited to the premises revaluation reserve in shareholders' equity. Decreases that offset previous increases of the same individual asset are charged against premises revaluation reserve directly in equity; all other decreases are expensed in the income statement. Any subsequent increases are credited to the income statement up to the amount previously debited, and then to the premises revaluation reserve. Upon disposal of premises, the relevant portion of the premises revaluation reserve realised in respect of previous valuations is released and transferred from the premises revaluation reserve to retained earnings.

Depreciation is calculated on the straight-line method to write down the cost or revalued amount of such assets over their estimated useful lives as follows:

- Premises Over the remaining period of lease
- Equipment, fixtures and fittings 3-15 years

The useful lives of assets are reviewed, and adjusted if appropriate, as of each balance sheet date.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.15 Fixed assets (continued)

(1) Premises, equipment, fixtures and fittings (continued)

At each balance sheet date, both internal and external sources of information are considered to determine whether there is any indication that premises, equipment, fixtures and fittings are impaired. If any such indication exists, the recoverable amount of the asset is estimated and where relevant, an impairment loss is recognised to reduce the asset to its recoverable amount. Such impairment loss is recognised in the income statement except where the asset is carried at valuation and the impairment loss does not exceed the revaluation surplus for that same asset, in which case it is treated as a revaluation decrease. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use. Impairment loss is reversed through the premises revaluation reserve or income statement as appropriate.

Gains and losses on disposals are determined by comparing proceeds with carrying amount, relevant taxes and expenses. These are included in the income statement.

(2) Property under development

Property under development represents assets under construction or being installed and is stated at cost less impairment losses. Cost includes equipment cost, cost of development, construction, installation, interest and other direct costs attributable to the development. Items classified as property under development are transferred to premises or investment properties when such assets are ready for their intended use, and the depreciation charge commences from the month such assets are transferred to premises.

Impairment losses are recognised for idle projects with respect to which management has determined that resumption in the foreseeable future is not probable. The impairment loss is equal to the extent to which the estimated recoverable amount of a specific project is less than its carrying amount. The recoverable amount is the asset's fair value less costs to sell. Impairment losses or reversals are charged to the income statement.

2.16 Investment properties

Properties that are held for long-term rental yields or for capital appreciation or both, and that are not occupied by the companies in the Group, are classified as investment properties. Properties leased out within group companies are classified as investment properties in individual companies' financial statements and as premises in consolidated financial statements. Land held under operating lease is classified and accounted for as investment property when the rest of the definition of investment property is met. The operating lease is accounted for as if it is a finance lease.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.16 Investment properties (continued)

Investment properties are recognised initially at cost, including related transaction costs. After initial recognition, investment properties are measured at fair value assessed by professional valuers on the basis of open market value. If this information is not available, alternative valuation methods are used such as recent prices on less active markets or discounted cash flow projections. These valuations are performed in accordance with the guidance issued by the International Valuation Standards Committee.

Subsequent expenditure is charged to the asset's carrying amount only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance costs are expensed in the income statement during the financial period in which they are incurred.

Any changes in fair value are reported directly in the income statement. Deferred income tax is provided on revaluation surpluses of investment properties in accordance with HKAS-Int 21 "Income Taxes – Recovery of Revalued Non-Depreciable Assets" on HKAS 12 "Income Taxes".

If an investment property becomes owner-occupied, it is reclassified as premises, and its fair value at the date of reclassification becomes its cost for accounting purposes. If an item of premises becomes an investment property because its use has changed, any difference resulting between the carrying amount and the fair value of this item at the date of transfer is recognised in equity as a revaluation of premises under HKAS 16 "Property, Plant and Equipment". However, if a fair value gain reverses a previous revaluation loss or impairment loss, the gain is recognised in the income statement up to the amount previously debited.

2.17 Leases

(1) Operating leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. The total payments made under operating leases (net of any incentives received from the lessor) which include land use rights with payments that are separately identifiable at inception of the lease are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.17 Leases (continued)

(1) Operating leases (continued)

Where the Group is a lessor, the land and buildings subject to the operating lease are accounted for as investment properties. Rental income from operating leases is recognised on a straight-line basis over the lease term.

(2) Finance leases on properties

Where the land and buildings elements of leasehold properties held for own use can be split reliably at inception of the lease, leasehold land and land use rights are recognised as operating leases if they have indefinite economic lives. The up-front prepayments made or other costs incurred for acquiring the leasehold land and land use rights are expensed in the income statement on a straight-line basis over the period of the lease. Where there is impairment of the up-front prepayments, the impairment is expensed in the income statement immediately. Where the land and buildings cannot be split reliably at inception of the lease, the land and buildings elements will continue to be treated as finance leases and measured at fair value.

Separate measurements of the land and buildings elements are not required when the Group's interest in both land and buildings is classified as investment properties as if they are finance leases and are measured at fair value.

Pursuant to the Bank of China (Hong Kong) Limited (Merger) Ordinance ("Merger Ordinance") 2001, all assets and liabilities of the designated branches and subsidiaries, and the shares of certain entities of the legacy Bank of China Group in Hong Kong were effectively transferred to BOCHK, which was immediately owned by the then newly formed BOC Hong Kong (Holdings) Limited ("the Merger"). This was a significant event and the Group has therefore adopted the valuation at the date of the Merger as the deemed cost for its leasehold properties to reflect the circumstances at the time of the Merger.

On adoption of the deemed cost at the date of Merger, the Group made reference to the independent property valuation conducted as at 31 August 2001 for the purpose of the Merger, which did not split the values of the leasehold properties between the land and buildings elements. Any means of subsequent allocation of the valuation of the leasehold properties at the date of Merger between the land and buildings elements would be notional and therefore would not represent reliable information. It is determined that the values of the land and buildings elements of the Group's leasehold properties cannot be reliably split and the leasehold properties are treated as finance leases. The Group has also adopted the revaluation model under HKAS 16 "Property, Plant and Equipment" by which assets held for own use arising under these finance leases are measured at fair value less any accumulated depreciation and impairment losses.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.18 Cash and cash equivalents

For the purposes of the consolidated cash flow statement, cash and cash equivalents comprise balances with original maturity less than three months from the date of acquisition, including cash, balances with banks and other financial institutions, short-term bills and notes classified as investment securities and certificates of deposit.

2.19 Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

2.20 Employee benefits

(1) Retirement benefit costs

The Group contributes to defined contribution retirement schemes under either recognised ORSO schemes or MPF schemes that are available to the Group's employees. Contributions to the schemes by the Group and employees are calculated as a percentage of employees' basic salaries for the ORSO schemes and in accordance with the MPF rules for MPF schemes. The retirement benefit scheme costs are charged to the income statement as incurred and represent contributions payable by the Group to the schemes. Contributions made by the Group that are forfeited by those employees who leave the ORSO scheme prior to the full vesting of their entitlement to the contributions are used by the Group to reduce the existing level of contributions or to meet its expenses under the trust deed of the ORSO schemes.

The assets of the schemes are held in independently-administered funds separate from those of the Group.

(2) Leave entitlements

Employee entitlements to annual leave and sick leave are recognised when they accrue to employees. A provision is made for the estimated liability for unused annual leave and the amount of sick leave expected to be paid as a result of services rendered by employees up to the balance sheet date.

Compensated absences other than annual leave and sick leave are non-accumulating; they lapse if the current period's entitlement is not used in full and do not entitle employees to a cash payment for unused entitlement on leaving the Group. Such compensated absences are recognised when the absences occur.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.20 Employee benefits (continued)

(3) Bonus plans

The expected cost of bonus payments are recognised as a liability when the Group has a present legal or constructive obligation as a result of services rendered by employees and a reliable estimate of the obligation can be made. Liabilities for bonus plans are expected to be settled within twelve months and are measured at the amounts expected to be paid when they are settled.

2.21 Deferred income taxes

Deferred income tax is provided in full, using the balance sheet liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates and laws that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

The principal temporary differences arise from asset impairment provisions, depreciation of property and equipment, revaluation of certain assets including available-for-sale securities and properties, and tax losses carried forward. However, the deferred income tax is not recognised if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss.

Deferred income tax liabilities are provided in full on all taxable temporary differences and deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Income tax payable on profits, based on the applicable tax law in each jurisdiction, is recognised as an expense in the period in which profits arise.

Deferred income tax is charged or credited in the income statement except for deferred income tax relating to fair value re-measurement of available-for-sale investments and revaluation of premises which are charged or credited directly to equity, in which case the deferred income tax is also credited or charged directly to equity and is subsequently recognised in the income statement together with the realisation of the deferred gain and loss.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.22 Repossessed assets

Repossessed assets are initially recognised at the lower of their fair value less costs to sell or the amortised cost of the related outstanding loans on the date of repossession, and the related loans and advances together with the related impairment allowances are derecognised from the balance sheet. Subsequently, repossessed assets are measured at the lower of their cost or fair values less costs to sell and are reported as 'Non-current assets held for sale' under 'Other assets'.

2.23 Fiduciary activities

The Group commonly acts as a trustee, or in other fiduciary capacities, that result in its holding or managing assets on behalf of individuals, trusts and other institutions. These assets and any income or losses arising thereon are excluded from these financial statements, as they are not assets of the Group.

2.24 Contingent liabilities and contingent assets

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that an outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised as a provision but is disclosed in the notes to the financial statements. When a change in the probability of an outflow occurs so that outflow is probable, it will then be recognised as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Group.

Contingent assets are not recognised but are disclosed in the notes to the financial statements when an inflow of economic benefits is probable. When the inflow is virtually certain, it will be recognised as an asset.

2.25 Related parties

For the purposes of these financial statements, a party is considered to be related to the Group if the Group has the ability, directly and indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control. Related parties may be individuals or entities.

Notes to the Financial Statements (continued)

3. Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Areas susceptible to changes in essential estimates and judgements, which affect the carrying value of assets and liabilities, are set out below. The effect of changes to either the key assumptions or other estimation uncertainties will be presented below if it is practicable to determine. It is possible that actual results may require material adjustments to the estimates referred to below.

3.1 Impairment allowances on loans and advances

The Group reviews its loan portfolios to assess impairment at least on a quarterly 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 advances before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group (e.g. payment delinquency or default), or economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when estimating expected 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.

3.2 Held-to-maturity investments

The Group follows the guidance of HKAS 39 in classifying certain 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 hold these investments to maturity other than for specific circumstances defined in HKAS 39, such as selling an insignificant amount close to maturity, it will be required to reclassify the entire portfolio of assets as available-for-sale. The investments would then be measured at fair value and not amortised cost. As at 31 December 2007, the fair value of the entire portfolio of held-to-maturity investments is approximately equal to its amortised cost.

Notes to the Financial Statements (continued)

4. Financial risk management

The Group is exposed to financial risks as a result of engaging in a variety of business activities. The principal financial risks are credit risk, market risk (including currency risk, interest rate risk and other price risk) and liquidity risk. This note summarises the Group's exposures to these risks, as well as its objectives, policies and processes for managing and the methods used to measure these risks.

Financial risk management framework

The Group's management governance structure is designed to cover all business processes and ensure various risks are properly managed and controlled in the course of conducting business. The Group has a robust risk management organisational structure with a comprehensive set of policies and procedures to identify, measure, monitor and control various risks that may arise. These risk management policies and procedures are regularly reviewed and modified to reflect changes in markets and business strategies. Various groups of risk takers assume their respective responsibilities for risk management.

The Board of Directors, representing the interests of shareholders, is the highest decision making authority of the Group and has the ultimate responsibility for risk management. The Board, with the assistance of the RC, has the primary responsibility for the formulation of risk management strategies and for ensuring that the Group has an effective risk management system to implement these strategies.

The RC, a standing committee established by the Board of Directors, is responsible for overseeing the Group's various types of risks, reviewing and approving high-level risk-related policies and overseeing their implementation, reviewing significant or high risk exposures or transactions and exercising its power of veto if it considers that any transaction should not proceed.

The Chief Executive ("CE") is responsible for managing the Group's various types of risks, approving detailed risk management policies, and approving material risk exposures or transactions within his authority delegated by the Board of Directors. The Head of Strategic Planning and Control Department ("SCD") assists the CE in fulfilling his responsibilities for the day-to-day management of risks. The Head of SCD is responsible for initiating new risk management strategies, projects and measures that will enable the Group to better monitor and manage new risk issues or areas that may arise from time to time from new businesses, products and changes in the operating environment. He may also take appropriate initiatives in response to regulatory changes. The Head of SCD is also responsible for reviewing material risk exposures or transactions within his delegated authority and exercising his power of veto if he believes that any transaction should not proceed.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

Financial risk management framework (continued)

The Group has put in place appropriate internal control systems, including establishment of an organisation structure that sets adequately clear lines of authority and responsibility for monitoring compliance with policies, procedures and limits. Proper reporting lines also provide sufficient independence of the control functions from the business areas, as well as adequate segregation of duties throughout the organisation which helps to promote an appropriate internal control environment.

Product development

To ensure effective risk assessment and monitoring, the Group developed a comprehensive product development and management framework and issued the "Product Development and Management Guideline", which clearly defines the roles and responsibilities of all related units, and the proper risk assessment procedures for the product development process.

In accordance with the strategic objectives set by the Management, the respective product management units are responsible for formulating business and product development plans, and Business Development Division shall ensure the plans are aligned with the Bank's overall strategies. Credit Risk Management Division ("CMD"), Compliance Section, Audit Division and Finance Division etc. are accountable for risk assessment and review.

Apart from product development, the respective business units shall work closely with relevant risk evaluating departments to identify and assess all the related risks. Based on the consideration of segregation of duties, risk evaluating departments shall conduct independent review on risk management procedures and assessment results. Products can only be launched after the risk management procedures are fulfilled and endorsed by all risk evaluating departments.

4.1 Credit Risk

Credit risk is the risk that a customer or counterparty will be unable to or unwilling to meet a commitment it has entered into with the Group. It arises mainly from lending, trade finance, treasury and inter-bank transactions.

Credit risk management framework

The Group has formulated a comprehensive set of credit risk management policies and procedures, and appropriate credit risk limits to manage and control credit risk that may arise. These policies, procedures and credit risk limits are regularly reviewed to cope with changes in market and business strategies.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

The Group’s organisation structure establishes a clear set of authority and responsibility for monitoring compliance with policies, procedures and limits.

The Head of SCD is responsible for the management of credit risk and for the formulation of all credit policies and procedures. Various units of the Group have their respective credit risk management responsibilities. Business units act as the first line of defense while risk management unit, which is independent from the business units, are responsible for the day-to-day management of credit risks. CMD has the primary responsibility for drafting, reviewing and updating credit risk management policies and procedures.

The Board of Directors delegates credit approval authority to the CE. The CE can further delegate to the subordinates within his limit authorised by the Board of Directors. The Group sets the limits of credit approval authority according to the transactions’ nature, customers’/counterparties’ creditworthiness, the level of transaction risk, and the size of the credit exposure.

Credit risk measurement and control

Loans and advances

Different credit approval and control procedures are adopted according to the level of risk associated with the customer, counterparty or transaction. Corporate and financial institution credit applications are independently reviewed and objectively assessed by risk management units. A credit scoring system is used to process retail credit transactions, including residential mortgage loans and personal loans. The Credit Risk Assessment Committee comprising experts from the Group's credit and other functions is responsible for making an independent assessment of all credit facilities which require the approval of Deputy General Manager or above.

The Group identifies credit concentration risks by industry, geography, customer and counterparty risk, The Group monitors changes to counterparties credit risk, quality of credit portfolio and risk concentrations, and reports regularly to the Group’s management.

The Group’s internal loan grading system divides loans into 5 categories with reference to HKMA’s guidelines. CMD provides regular credit management information reports and ad hoc reports to the Board of Management, RC and Board of Directors to facilitate their continuous monitoring on credit risk.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Credit risk measurement and control (continued)

Loans and advances (continued)

“Pass” represents loans where the borrower is current in meeting its repayment obligations and full repayment of interest and principal is not in doubt.

“Special Mention” represents loans where the borrowers are experiencing difficulties which may threaten the Group’s position. Ultimate loss is not expected at this stage but could occur if adverse conditions persist.

“Substandard” represents loans where the borrower displays a definable weakness that is likely to jeopardise repayment.

“Doubtful” represents loans where collection in full is improbable and the Group expects to sustain a loss of principal and/or interest, taking into account the net realisable value of the collateral.

“Loss” represents loans which are considered uncollectible after all collection options (such as the realisation of , collateral or the institution of legal proceedings) have been exhausted.

Debt securities and derivatives

For investment on debt securities, the external credit rating and assessment on credit quality of the underlying assets are used for managing the credit risk involved. Credit limits are established on a customer and security issuer basis. For derivatives, the Group sets customer limits to manage the credit risk involved and follows the same approval and control processes as loans and advances. On-going monitoring and stop-loss procedures are established.

Settlement risk arises from derivatives in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt in cash, securities or equities. Daily settlement limits are established for each counterparty or customer to cover all settlement risk arising from the Group’s market transactions on any single day.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Collateral held as security and other credit enhancements

The valuation and management of collateral have been documented in the policy covering acceptance criteria, validity of collateral, loan-to-value ratio, haircut ratio, valuation and insurance, etc. The collateral is revalued on a regular basis, though the frequency and the method used varies with the type of collateral involved and the nature and the risk of the underlying credit. Collaterals are insured with the Group as the beneficiary. In the personal sector, the main types of collateral are real properties, cash deposits, securities and investment funds. In the commercial and industrial sector, the main types of collateral are real properties, securities, receivables, cash deposits and machinery.

For loans guaranteed by a third party guarantor, the Group will assess the guarantor's financial condition, credit history and ability to meet obligations.

As at 31 December 2007, the Group did not hold any collateral which it is permitted to sell or re-pledge in the absence of default by the borrower (2006: Nil).

Credit exposures

Maximum exposures to credit risk before collateral held or other credit enhancements of the Group are summarised as follows:

	2007	2006
	HK$'000	HK$'000
Credit risk exposures relating to on-balance sheet assets are as follows:		
Cash and balances with banks and other financial institutions	**9,751,518**	5,102,028
Placements with banks and other financial institutions maturing between 1 and 12 months	**7,242,392**	7,582,425
Financial assets designated at fair value through profit or loss		
- debt securities	**1,036,422**	1,220,977
Derivative financial instruments	**176,682**	125,842
Advances and other accounts	**13,354,058**	11,101,224
Investment in securities		
- debt securities - available-for-sale	**89,771**	-
- debt securities - held-to-maturity	**4,666,248**	6,429,759
- debt securities - loans and receivables	**1,007,472**	817,969
Other assets	**1,049,398**	1,001,262
Credit risk exposures relating to off-balance sheet items are as follows:		
Letters of guarantee issued	**1,238,246**	1,047,541
Loan commitment and other credit related liabilities	**4,476,934**	4,698,503
	44,089,141	39,127,530

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Gross loans and advances

Gross loans and advances before loan impairment allowances of the Group are summarised by product type as follows:

	2007	2006
	HK$'000	HK$'000
Advances to customers		
Personal		
- Mortgages	**2,603,353**	2,537,754
- Others	**1,575,490**	1,233,738
Corporate		
- Commercial loans	**7,974,075**	6,384,763
- Trade finance	**989,419**	897,245
	13,142,337	11,053,500
Trade bills	**266,260**	95,398
Total	**13,408,597**	11,148,898

Advances with a specific repayment date are classified as overdue when the principal or interest is past due and remains unpaid. Advances repayable by regular instalments are classified as overdue when an instalment payment is past due and remains unpaid. Advances repayable on demand are classified as overdue either when a demand for repayment has been served on the borrower but repayment has not been made in accordance with the instruction or when the advances have remained continuously outside the approved limit that was advised to the borrower.

A financial asset is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred and that loss event(s) has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

If there is objective evidence that an impairment loss on loans has been incurred, the amount of loss is measured as the difference between the carrying amount and the present value of estimated future cash flows generated by the financial asset. Objective evidence that a financial asset is impaired includes observable data that comes to the attention of the holder of the asset about the loss events.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Gross loans and advances (continued)

The criteria that the Group uses to determine that there is objective evidence of an impairment loss include:

- Significant financial difficulty incurred by the borrower;
- A breach of contract, such as a default or delinquency in interest or principal payment;
- For economic or legal reasons related to the borrower's financial difficulty, the Group has granted to the borrower a concession that it would not otherwise consider;
- Probable that the borrower will become bankrupt or undergo other financial reorganisation; or
- Other observable data indicating that there is a measurable decrease in the estimated future cash flows from such loans and advances.

(a) Advances neither overdue nor impaired

Advances that were neither overdue nor impaired of the Group are analysed by internal credit grades as follows:

	2007			
	Pass	**Special mention**	**Sub-Standard or below**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**
Advances to customers				
Personal				
- Mortgages	**2,541,020**	**24,771**	**1,221**	**2,567,012**
- Others	**1,514,465**	**16,730**	**418**	**1,531,613**
Corporate				
- Commercial loans	**7,727,634**	**112,705**	**3,062**	**7,843,401**
- Trade finance	**941,341**	**33,215**	**-**	**974,556**
	12,724,460	**187,421**	**4,701**	**12,916,582**
Trade bills	**264,069**	**2,191**	**-**	**266,260**
Total	**12,988,529**	**189,612**	**4,701**	**13,182,842**

	2006			
	Pass	Special mention	Sub-Standard or below	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Advances to customers				
Personal				
- Mortgages	2,468,993	11,941	844	2,481,778
- Others	1,181,366	922	267	1,182,555
Corporate				
- Commercial loans	6,002,956	103,152	2,370	6,108,478
- Trade finance	838,700	35,873	661	875,234
	10,492,015	151,888	4,142	10,648,045
Trade bills	94,290	372	-	94,662
Total	10,586,305	152,260	4,142	10,742,707

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Gross loans and advances (continued)

(a) Advances neither overdue nor impaired (continued)

Restructured loans are of "substandard" or lower grades, they are regarded as not being impaired and have been included in the above table.

(b) Advances overdue but not impaired

The gross amount of advances overdue but not impaired of the Group is analysed as follows:

	2007				
	Overdue for 3 months or less	**Overdue for 6 months or less but over 3 months**	**Overdue for 1 year or less but over 6 months**	**Overdue for over 1 year**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
Advances to customers					
Personal					
- Mortgages	**34,961**	**897**	**-**	**483**	**36,341**
- Others	**43,315**	**-**	**-**	**167**	**43,482**
Corporate					
- Commercial loans	**100,076**	**-**	**-**	**3,197**	**103,273**
- Trade finance	**11,774**	**-**	**-**	**-**	**11,774**
Total	**190,126**	**897**	**-**	**3,847**	**194,870**

	2006				
	Overdue for 3 months or less	Overdue for 6 months or less but over 3 months	Overdue for 1 year or less but over 6 months	Overdue for over 1 year	Total
		HK$'000	HK$'000	HK$'000	HK$'000
Advances to customers					
Personal					
- Mortgages	54,161	911	199	705	55,976
- Others	50,172	282	-	185	50,639
Corporate					
- Commercial loans	241,174	5,925	3,298	2,125	252,522
- Trade finance	17,926	588	651	-	19,165
	363,433	7,706	4,148	3,015	378,302
Trade bills	736	-	-	-	736
Total	364,169	7,706	4,148	3,015	379,038

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Gross loans and advances (continued)

(b) Advances overdue but not impaired (continued)

	2007 HK$'000	2006 HK$'000
Current market value of collateral held against the covered portion of advances to customers	**482,785**	881,967
Covered portion of advances to customers	**167,088**	334,398
Uncovered portion of advances to customers	**27,782**	43,904

(c) Impaired advances

Advances individually identified to be impaired of the Group are analysed by product type as follows:

	2007 HK$'000	2006 HK$'000
Advance to customers		
Personal		
- Others	**394**	544
Corporate		
- Commercial loans	**27,401**	23,764
- Trade finance	**3,089**	2,846
Total	**30,884**	27,154
Loan impairment allowances made in respect of such advances	**(10,984)**	(7,525)

The loan impairment allowances were made after taking into account the value of collateral in respect of impaired advances.

	2007 HK$'000	2006 HK$'000
Current market value of collateral held against the covered portion of advances to customers	**26,610**	64,127
Covered portion of advances to customers	**21,806**	12,723
Uncovered portion of advances to customers	**9,078**	14,431

Classified or impaired advances to customers of the Group are analysed as follows:

	2007 HK$'000	2006 HK$'000
Gross classified or impaired advances to customers	**40,550**	37,440
Gross classified or impaired advances to customers as a percentage of gross advances to customers	**0.31%**	0.34%
Individually assessed loan impairment allowances made in respect of such advances	**(10,984)**	(7,525)

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Gross loans and advances (continued)

(c) Impaired advances (continued)

Classified or impaired advances to customers follow the definitions set out in the Banking (Disclosure) Rules and represent advances which are either classified as "substandard", "doubtful" or "loss" under the Group's classification of loan quality, or individually assessed to be impaired.

(d) Advances overdue for more than 3 months

The gross amount of advances overdue for more than 3 months of the Group is analysed as follows:

	2007		2006	
	Amount	**% of gross advances to customers**	Amount	% of gross advances to customers
	HK$'000		HK$'000	
Gross advances to customers which have been overdue for:				
- six months or less but over three months	**897**	**0.01%**	14,124	0.13%
- one year or less but over six months	**10,322**	**0.08%**	4,917	0.04%
- over one year	**22,948**	**0.17%**	19,850	0.18%
Advances overdue for over three months	**34,167**	**0.26%**	38,891	0.35%
Individually assessed loan impairment allowances made in respect of such advances	**(10,244)**		(5,771)	

	2007	2006
	HK$'000	HK$'000
Current market value of collateral held against the covered portion of advances to customers	**39,943**	140,765
Covered portion of advances to customers	**22,501**	17,813
Uncovered portion of advances to customers	**11,666**	21,078

Collateral held against overdue or impaired loans is principally represented by charges over business assets such as commercial and residential premises for corporate loans and mortgages over residential properties for personal loans.

As at 31 December 2007 and 2006, there were no advances to banks and other financial institutions that were overdue for more than three months for the Group.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Gross loans and advances (continued)

(e) Rescheduled advances

	2007		2006	
	Amount	**% of gross advances to customers**	Amount	% of gross advances to customers
	HK$'000		HK$'000	
Rescheduled advances to customers net of amounts included in advances overdue for more than 3 months of the Group	**1,121**	**0.01%**	2,933	0.03%

As at 31 December 2007, the total rescheduled advances to customers during the year amounted to HK$ 3,576,000 (2006: HK$16,342,000) for the Group.

As at 31 December 2007 and 2006, there were no rescheduled advances to banks and other financial institutions for the Group.

Rescheduled advances are those advances that have been restructured or renegotiated because of deterioration in the financial position of the borrower or of the inability of the borrower to meet the original repayment schedule and for which the revised repayment terms, either of interest or of repayment period, are non-commercial. Rescheduled advances, which have been overdue for more than three months under the revised repayment terms, are included in overdue advances.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Gross loans and advances (continued)

(f) Concentration of advances to customers

(i) Sectoral analysis of gross advances to customers

The information concerning gross advances to customers of the Group has been analysed into loans used inside or outside Hong Kong by industry sectors of the borrowers as follows:

	2007					
	Gross advances	% Covered by collateral or other security	Classified or impaired	Overdue*	Individually assessed impairment allowances	Collectively assessed impairment allowances
	HK$'000		HK$'000	HK$'000	HK$'000	HK$'000
Loans for use in Hong Kong						
Industrial, commercial and financial						
- Property development	550,284	27.25%	-	-	-	4,122
- Property investment	2,397,056	94.03%	1,005	22,449	-	10,699
- Financial concerns	498,670	39.91%	-	8,297	-	590
- Stockbrokers	7,357	100.00%	-	-	-	8
- Wholesale and retail trade	600,075	82.82%	7,325	16,869	1,409	3,613
- Manufacturing	687,802	67.90%	11,066	37,263	1,992	3,793
- Transport and transport equipment	62,067	82.76%	-	2,005	-	95
- Recreational activities	1,031	100.00%	-	-	-	3
- Information technology	1,281	100.00%	-	-	-	2
- Others	1,116,337	72.07%	1,986	30,361	33	3,466
Individuals						
- Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	120,060	96.46%	144	2,215	-	70
- Loans for purchase of other residential properties	2,315,317	99.95%	2,127	33,764	-	1,175
- Others	898,326	98.70%	403	18,202	-	439
Total loans for use in Hong Kong	9,255,663	83.72%	24,056	171,425	3,434	28,075
Trade finance	989,455	60.15%	3,124	14,914	1,305	5,462
Loans for use outside Hong Kong	2,897,219	78.67%	13,370	39,021	6,245	10,018
Gross advances to customers	13,142,337	80.83%	40,550	225,360	10,984	43,555

*Advances with a specific repayment date are classified as overdue when the principal or interest is past due and remains unpaid.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Gross loans and advances (continued)

(f) Concentration of advances to customers (continued)

(i) Sectoral analysis of gross advances to customers (continued)

	2006					
	Gross advances	% Covered by collateral or other security	Classified or impaired	Overdue*	Individually assessed impairment allowances	Collectively assessed impairment allowances
	HK$'000		HK$'000	HK$'000	HK$'000	HK$'000
Loans for use in Hong Kong						
Industrial, commercial and financial						
- Property development	343,690	30.65%	-	105,322	-	1,638
- Property investment	2,012,101	96.46%	-	27,157	-	9,826
- Financial concerns	659,308	55.29%	-	-	-	3,147
- Stockbrokers	1,453	100.00%	-	-	-	7
- Wholesale and retail trade	572,035	88.72%	2,485	23,122	92	3,464
- Manufacturing	701,263	77.52%	19,464	39,215	1,770	4,312
- Transport and transport equipment	76,614	71.61%	-	504	-	365
- Recreational activities	1,302	100.00%	-	-	-	6
- Information technology	1,456	100.00%	-	-	-	7
- Others	942,211	69.33%	2,199	46,059	472	2,898
Individuals						
- Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	115,291	98.78%	452	6,250	-	46
- Loans for purchase of other residential properties	2,383,996	99.96%	2,463	49,366	-	834
- Others	791,995	99.33%	799	13,281	60	307
Total loans for use in Hong Kong	8,602,715	86.69%	27,862	310,276	2,394	26,857
Trade finance	896,200	57.34%	3,507	22,011	2,025	5,233
Loans for use outside Hong Kong	1,554,585	59.34%	6,071	73,168	3,106	8,059
Gross advances to customers	11,053,500	80.46%	37,440	405,455	7,525	40,149

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Gross loans and advances (continued)

(f) Concentration of advances to customers (continued)

(i) Sectoral analysis of gross advances to customers (continued)

The amount of new impairment allowances charged to the income statement, and classified or impaired loans written off during the year are shown below:

	2007		2006	
	New impairment allowances	**Classified or impaired loans written off**	New impairment allowances	Classified or impaired loans written off
	HK$'000	**HK$'000**	HK$'000	HK$'000
Loans for use in Hong Kong				
Industrial, commercial and financial				
- Property development	**589**	**-**	1,269	-
- Property investment	**1,529**	**567**	7,609	-
- Financial concerns	**84**	**-**	2,437	-
- Stockbrokers	**1**	**-**	5	-
- Wholesale and retail trade	**2,047**	**568**	2,831	-
- Manufacturing	**2,836**	**1,702**	14,845	15,183
- Transport and transport equipment	**14**	**-**	283	-
- Recreational activities	**-**	**-**	5	-
- Information technology	**-**	**-**	5	-
- Others	**532**	**-**	3,003	-
Individuals				
- Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	**10**	**-**	36	-
- Loans for purchase of other residential properties	**168**	**-**	646	-
- Credit card advances	**-**	**-**	-	-
- Others	**63**	**-**	333	-
Total loans for use in Hong Kong	**7,873**	**2,837**	33,307	15,183
Trade finance	**1,730**	**-**	34,856	25,129
Loans for use outside Hong Kong	**6,627**	**894**	23,982	32,610
Gross advances to customers	**16,230**	**3,731**	92,145	72,922

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Gross loans and advances (continued)

(f) Concentration of advances to customers (continued)

(ii) Geographical analysis of gross advances to customers and overdue advances

The following geographical analysis of gross advances to customers and overdue advances of the Group is based on the location of the counterparties, after taking into account the transfer of risk in respect of such advances where appropriate.

Gross advances to customers

	2007	2006
	HK$'000	HK$'000
Hong Kong	**11,765,150**	9,906,775
Mainland China	**1,377,187**	1,146,725
	13,142,337	11,053,500
Collectively assessed loan impairment allowances in respect of the gross advances to customers		
Hong Kong	**(35,695)**	(35,123)
Mainland China	**(7,860)**	(5,026)
	(43,555)	(40,149)

Overdue advances

	2007	2006
	HK$'000	HK$'000
Hong Kong	**220,004**	398,914
Mainland China	**5,356**	6,541
	225,360	405,455
Individually assessed loan impairment allowances in respect of the overdue advances		
Hong Kong	**(9,171)**	(5,573)
Mainland China	**(1,813)**	(1,952)
	(10,984)	(7,525)
Collectively assessed loan impairment allowances in respect of the overdue advances		
Hong Kong	**(2,441)**	(2,641)
Mainland China	**-**	(6)
	(2,441)	(2,647)

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Gross loans and advances (continued)

(f) Concentration of advances to customers (continued)

(ii) Geographical analysis of gross advances to customers and overdue advances (continued)

Classified or impaired advances

	2007	2006
	HK$'000	HK$'000
Hong Kong	**35,194**	30,899
Mainland China	**5,356**	6,541
	40,550	37,440
Individually assessed loan impairment allowances in respect of the classified or impaired advances		
Hong Kong	**(9,171)**	(5,573)
Mainland China	**(1,813)**	(1,952)
	(10,984)	(7,525)
Collectively assessed loan impairment allowances in respect of the classified or impaired advances		
Hong Kong	**(42)**	(83)
Mainland China	**-**	(6)
	(42)	(89)

Repossessed assets

During the year, the Group obtained assets by taking possession of collateral held as security. The nature and carrying value of such assets are summarised as follows:

	Carrying value	
	2007	2006
	HK$'000	HK$'000
Commercial properties	**3,130**	44,200
Residential properties	**683**	558
	3,813	44,758

The estimated market value of repossessed assets held by the Group as at 31 December 2007 amounted to HK$16,100,000 (2006: HK$121,020,000). They comprise properties in respect of which the Group has acquired access or control (e.g. through court proceedings or voluntary actions by the borrowers concerned) for release in full or in part of the obligations of the borrowers.

When the repossessed assets are not readily convertible into cash, the Group may consider the following alternatives:

- adjusting the selling prices
- selling the loans together with the assets
- arranging loan restructuring

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Debt securities

The following table presents an analysis of the Group's debt securities neither past due nor impaired as at 31 December by rating agency designation, based on Moody's ratings or their equivalent to the respective issues of the debt securities.

	2007				
	Financial assets designated at fair value through profit or loss	**Available-for-sale securities**	**Held-to-maturity securities**	**Loans and receivables**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
Aaa	**512,177**	**-**	**407,154**	**-**	**919,331**
Aa1 to Aa3	**480,815**	**-**	**3,713,914**	**-**	**4,194,729**
A1 to A3	**43,430**	**89,771**	**345,327**	**-**	**478,528**
Unrated	**-**	**-**	**199,853**	**1,007,472**	**1,207,325**
	1,036,422	**89,771**	**4,666,248**	**1,007,472**	**6,799,913**

	2006				
	Financial assets designated at fair value through profit or loss	Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Aaa	302,724	-	1,856,733	-	2,159,457
Aa1 to Aa3	918,253	-	3,993,712	-	4,911,965
A1 to A3	-	-	479,467	-	479,467
Unrated	-	-	99,847	817,969	917,816
	1,220,977	-	6,429,759	817,969	8,468,705

For the above debt securities with no issue credit rating, their issuer ratings are anlaysed as follows:

	2007				
	Financial assets designated at fair value through profit or loss	**Available-for-sale securities**	**Held-to-maturity securities**	**Loans and receivables**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
Aaa	**-**	**-**	**-**	**98,830**	**98,830**
Aa1 to Aa3	**-**	**-**	**199,853**	**908,642**	**1,108,495**
A1 to A3	**-**	**-**	**-**	**-**	**-**
Unrated	**-**	**-**	**-**	**-**	**-**
	-	**-**	**199,853**	**1,007,472**	**1,207,325**

	2006				
	Financial assets designated at fair value through profit or loss	Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Aaa	-	-	-	332,641	332,641
Aa1 to Aa3	-	-	99,847	485,328	585,175
A1 to A3	-	-	-	-	-
Unrated	-	-	-	-	-
	-	-	99,847	817,969	917,816

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Debt securities (continued)

As at 31 December 2007 and 2006, there were no impaired, overdue nor US subprime debt securities.

Note: The Group defines US subprime mortgage related securities as those that are supported by US residential subprime mortgage loans to borrowers with a credit bureau risk score ("FICO" score) of 680 and below.

4.2 Market Risk

Market risk is the risk of loss that results from movements in market rates and prices. The Group's market risk arises from trading positions taken from customer-related business in the above-mentioned financial instruments, which are subject to daily marked-to-market valuation. The risk includes potential losses arising from changes in foreign exchange and interest rates as well as equities and commodities prices.

Market risk management framework

Market risk is managed within various major risk limits approved by the RC, including risk positions and / or risk factor sensitivities. These overall risk limits are divided into sub-limits by reference to different risk products, including interest rate, foreign exchange rate, commodity price and equity products. Transactions are classified into different risk product categories according to the prominent type of risk inherent in the transactions.

The Group's risk management objective is to enhance shareholder value by maintaining risk exposures within acceptable limits. Market risk management framework of the Group comprises three levels. The Board of Directors and the RC are the ultimate decision making authority. Formulation of the risk management procedures and implementation mechanism, and monitoring of the compliance are mainly responsible by senior management (including CE and Head of SCD). CMD, Finance Division and Settlement Section are responsible for the oversight of the Group's market risk to ensure that overall and individual market risks are within the Group's risk tolerance. Risk exposures are monitored on a regular basis to ensure that they are within established risk limits and are regularly reported to the senior management.

The Group's control of market risk is based on restricting individual operations to a list of permissible instruments authorised by senior management, as well as enforcing rigorous new product approval procedures to ensure all risks arising are thoroughly identified, properly measured and adequately controlled.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

Currency risk

The tables below summarise the Group's exposure to foreign currency exchange rate risk as at 31 December. Included in the tables are the Group's assets and liabilities at carrying amounts in HK$ equivalent, categorised by the original currency.

	2007							
	Renminbi	US Dollars	HK Dollars	EURO	Japanese Yen	Pound Sterling	Others	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets								
Cash and balances with banks and other financial institutions	532,488	2,945,456	5,148,579	168,777	43,378	161,176	751,664	9,751,518
Placements with banks and other financial institutions maturing between one and twelve months	64,443	1,790,698	5,212,282	-	-	-	174,969	7,242,392
Financial assets designated at fair value through profit or loss	-	946,840	89,582	-	-	-	-	1,036,422
Derivative financial instruments	-	13,887	162,795	-	-	-	-	176,682
Advances and other accounts	827,419	2,005,274	10,474,688	16,513	29,491	673	-	13,354,058
Investment in securities								
-Available-for-sale securities	89,771	-	29,993	232	-	-	-	119,996
- Held-to-maturity securities	-	635,657	3,680,624	-	-	-	349,967	4,666,248
- Loans and receivables	-	365,554	641,918	-	-	-	-	1,007,472
Investment properties	-	-	64,450	-	-	-	-	64,450
Properties, plant and equipment	-	-	571,328	-	-	-	-	571,328
Other assets (including deferred tax assets)	611	30,485	1,015,259	-	-	-	3,043	1,049,398
Total assets	1,514,732	8,733,851	27,091,498	185,522	72,869	161,849	1,279,643	39,039,964

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

Currency risk (continued)

	2007							
	Renminbi	US Dollars	HK Dollars	EURO	Japanese Yen	Pound Sterling	Others	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Liabilities								
Deposits and balances of banks and other financial institutions	(86,690)	(517,616)	(76,174)	(24,265)	(201,894)	-	(178,956)	(1,085,595)
Financial liabilities designated at fair value through profit or loss	-	(1,460,718)	(1,024,474)	-	-	-	-	(2,485,192)
Derivative financial instruments	-	(11,418)	(39,706)	-	-	-	-	(51,124)
Deposits from customers	(1,197,444)	(6,094,439)	(20,453,766)	(207,545)	(55,402)	(131,840)	(1,187,592)	(29,328,028)
Other accounts and provisions (including current and deferred tax liabilities)	(53,159)	(156,299)	(1,527,712)	(7,490)	(9,346)	(2,466)	(48,412)	(1,804,884)
Total liabilities	(1,337,293)	(8,240,490)	(23,121,832))	(239,300)	(266,642)	(134,306)	(1,414,960)	(34,754,823)
Net on-balance sheet position	177,439	493,361	3,969,666	(53,778)	(193,773)	27,543	(135,317)	4,285,141
Off-balance sheet net notional position*	14,418	6,558	(242,513)	54,812	180,364	(24,080)	135,261	124,820
Contingent liabilities and commitments	99,123	1,595,592	3,852,858	93,712	71,688	2,169	38	5,715,180

* Off-balance sheet net notional position represents the net notional amounts of foreign currency derivative financial instruments, which are principally used to reduce the Group's exposure to currency movements.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

Currency risk (continued)

	2006							
	Renminbi	US Dollars	HK Dollars	EURO	Japanese Yen	Pound Sterling	Others	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets								
Cash and balances with banks and other financial institutions	406,791	952,674	3,050,330	59,976	147,629	90,553	394,075	5,102,028
Placements with banks and other financial institutions maturing between one and twelve months	59,994	2,081,515	5,199,188	-		-	241,728	7,582,425
Financial assets designated at fair value through profit or loss	-	1,132,934	88,043	-	-	-	-	1,220,977
Derivative financial instruments	-	2,382	123,460	-	-	-	-	125,842
Advances and other accounts	382,062	1,477,935	9,184,973	46,615	8,394	606	639	11,101,224
Investment in securities								
- Available-for-sale securities	-	-	20,609	206	-	-	-	20,815
- Held-to-maturity securities	-	814,821	5,098,355	-	-	-	516,583	6,429,759
- Loans and receivables	-	559,177	141,406	-	-	-	117,386	817,969
Investment properties	-	-	54,540	-	-	-	-	54,540
Properties, plant and equipment	-	-	528,843	-	-	-	-	528,843
Other assets (including deferred tax assets)	19,655	12,810	671,509	72,573	120,154	33,529	71,142	1,001,372
Total assets	868,502	7,034,248	24,161,256	179,370	276,177	124,688	1,341,553	33,985,794

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

Currency risk (continued)

	2006							
	Renminbi	US Dollars	HK Dollars	EURO	Japanese Yen	Pound Sterling	Others	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Liabilities								
Deposits and balances of banks and other financial institutions	(90,019)	(112,723)	(45,491)	(15,395)	(202,774)	-	(159,466)	(625,868)
Financial liabilities designated at fair value through profit or loss	-	(1,875,899)	(1,443,306)	-	-	-	-	(3,319,205)
Derivative financial instruments	-	(11,829)	(35,181)	-	-	-	-	(47,010)
Deposits from customers	(556,882)	(4,553,175)	(17,891,100)	(160,096)	(72,777)	(124,449)	(1,184,216)	(24,542,695)
Other accounts and provisions (including current and deferred tax liabilities)	(24,170)	(163,755)	(1,319,638)	-	-	-	-	(1,507,563)
Total liabilities	(671,071)	(6,717,381)	(20,734,716)	(175,491)	(275,551)	(124,449)	(1,343,682)	(30,042,341)
Net on-balance sheet position	197,431	316,867	3,426,540	3,879	626	239	(2,129)	3,943,453
Off-balance sheet net notional position	1,992	(38,238)	(279,102)	83,888	136,660	36,280	152,428	93,908
Contingent liabilities and commitments	68,352	1,414,178	4,132,724	68,978	53,810	915	7,087	5,746,044

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

Interest rate risk

The Bank has formulated an "Interest Rate Risk Management Policy" which sets out the framework and the methodologies to identify, measure, monitor and control interest rate risk.

Both the members of the Asset and Liability Management Committee ("ALCO") and RC are responsible for interest rate risk management. ALCO maintains oversight of interest rate risk and reviews the policies, guidelines and limits proposed by Finance Division. RC sanctions the interest rate risk management policies formulated by ALCO. The interest rate risk is identified and measured on a daily basis. The Treasury Division manages the interest rate risk according to the established policies. The Finance Division closely monitors the related risks and reports the results to ALCO regularly.

The Group's interest rate risk exposures are mainly structural. The major types of interest rate risk from structural positions are:

- repricing risk – mismatches in the maturity or repricing periods of assets and liabilities
- yield curve risk – non-parallel shifts in the yield curve, e.g. steepening or flattening yield curves, causing adverse effects on net interest income or economic value
- basis risk – different pricing basis for different transactions so that yield on assets and cost of liabilities may change by different amounts within the same repricing period
- option risk – exercise of the options embedded in assets, liabilities and Off-Balance Sheet inducing a change in the cashflows of assets and liabilities

Gap analysis is one of the tools used to measure the Group's exposure to repricing risk and yield curve risk. As the risk is complicated by having optionality embedded in certain products, the behavioural assumptions are made to reflect more accurately the interest rate risk exposures. This provides the Group with a static view of the maturity and repricing characteristics of its interest rate sensitive balance sheet positions.

Based on repricing gap, sensitivities of earnings and economic value to interest rate changes (Earnings at Risk and Economic Value at Risk) are assessed through a hypothetical interest rate shock of 200 basis points across the yield curve assuming parallel shifts on both sides. Limits on Earnings at Risk and Economic Value at Risk, which are the risk appetites sanctioned by RC, are controlled respectively within an approved percentage of the projected net interest income for the year and the latest capital base. The results are reported to ALCO and RC on a regular basis respectively.

Yield curve risk is also assessed by the impacts on earnings and economic value arising from steepening or flattening of the yield curve.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

Interest rate risk (continued)

The impact of basis risk is gauged by the projected change in net interest income under scenarios of imperfect correlation in the adjustment of the rates earned and paid on different instruments. Ratios of assets to liabilities with similar pricing basis are established to monitor such risk.

In addition, the impact of optionality on non-maturity liabilities and prepayment of mortgage loans are evaluated under different stress scenarios.

The interest rate risk exposures in the Group are controlled through the use of limits :

1. Earnings at Risk limit.
2. Economic Value at Risk limit.
3. Interest Rate Mismatch Gap limits.

In addition to adopting limits for interest rate risk control, the Group hedges its interest rate exposures by interest rate derivatives, of which plain vanilla interest rate swaps are used in most cases.

Before launching a new product or business, relevant departments are required to go through a risk assessment process, which include assessment of underlying interest rate risk and consideration of the adequacy of current risk management mechanism. Any material impact on interest rate risk noted during the risk assessment process will be reported to the Head of SCD.

The tables below summarise the Group's exposure to interest rate risk as at 31 December. Included in the tables are the Group's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates. Derivative financial instruments are principally used to reduce the Group's exposure to interest rate movements. The carrying amounts are presented under the column captioned 'Non-interest bearing'.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

Interest rate risk (continued)

	2007						
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets							
Cash and balances with banks and other financial institutions	9,243,843	-	-	-	-	507,675	9,751,518
Placements with banks and other financial institutions maturing between one and twelve months	-	5,754,544	1,487,848	-	-	-	7,242,392
Financial assets designated at fair value through profit or loss	868,509	53,031	71,452	43,430	-	-	1,036,422
Derivative financial instruments	-	-	-	-	-	176,682	176,682
Advances and other accounts	10,935,660	526,442	975,356	830,232	86,368	-	13,354,058
Investment in securities							
- Available-for-sale securities	-	-	-	89,771	-	30,225	119,996
- Held-to-maturity securities	1,209,462	1,609,934	1,094,971	751,881	-	-	4,666,248
- Loans and receivables	-	-	1,007,472	-	-	-	1,007,472
Investment properties	-	-	-	-	-	64,450	64,450
Properties, plant and equipment	-	-	-	-	-	571,328	571,328
Other assets (including deferred tax assets)	-	-	-	-	-	1,049,398	1,049,398
Total assets	22,257,474	7,943,951	4,637,099	1,715,314	86,368	2,399,758	39,039,964

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

Interest rate risk (continued)

	2007						
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Liabilities							
Deposits and balances of banks and other financial institutions	(656,635)	(82,078)	(247,679)	-	-	(99,203)	(1,085,595)
Financial liabilities designated at fair value through profit or loss	(2,066,221)	(50,753)	(368,218)	-	-	-	(2,485,192)
Derivative financial instruments	-	-	-	-	-	(51,124)	(51,124)
Deposits from customers	(22,817,178)	(3,511,636)	(1,458,057)	(59,464)	-	(1,481,693)	(29,328,028)
Other accounts and provisions (including current and deferred tax liabilities)	(326,256)	-	-	-	-	(1,478,628)	(1,804,884)
Total liabilities	(25,866,290)	(3,644,467)	(2,073,954)	(59,464)	-	(3,110,648)	(34,754,823)
Interest sensitivity gap	(3,608,816)	4,299,484	2,563,145	1,655,850	86,368	(710,890)	4,285,141

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

Interest rate risk (continued)

	2006						
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets							
Cash and balances with banks and other financial institutions	4,448,543	-	-	-	-	653,485	5,102,028
Placements with banks and other financial institutions maturing between one and twelve months	-	6,183,227	1,399,198	-	-	-	7,582,425
Financial assets designated at fair value through profit or loss	1,067,652	48,255	62,099	42,971	-	-	1,220,977
Derivative financial instruments	-	-	-	-	-	125,842	125,842
Advances and other accounts	9,934,335	676,820	150,640	256,992	82,437	-	11,101,224
Investment in securities							
- Available-for-sale securities	-	-	-	-	-	20,815	20,815
- Held-to-maturity securities	1,262,644	3,639,046	1,178,501	349,568	-	-	6,429,759
- Loans and receivables	-	103,563	714,406	-	-	-	817,969
Investment properties	-	-	-	-	-	54,540	54,540
Properties, plant and equipment	-	-	-	-	-	528,843	528,843
Other assets (including deferred tax assets)	-	-	-	-	-	1,001,372	1,001,372
Total assets	16,713,174	10,650,911	3,504,844	649,531	82,437	2,384,897	33,985,794

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

Interest rate risk (continued)

	2006						
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Liabilities							
Deposits and balances of banks and other financial institutions	(498,211)	(7,576)	(7,341)	-	-	(112,740)	(625,868)
Financial liabilities designated at fair value through profit or loss	(1,907,049)	(1,119,884)	-	(292,272)	-	-	(3,319,205)
Derivative financial instruments	-	-	-	-	-	(47,010)	(47,010)
Deposits from customers	(19,239,567)	(2,400,701)	(1,143,703)	(518,845)	(18,383)	(1,221,496)	(24,542,695)
Other accounts and provisions (including current and deferred tax liabilities)	(343,703)	-	-	-	-	(1,163,860)	(1,507,563)
Total liabilities	(21,988,530)	(3,528,161)	(1,151,044)	(811,117)	(18,383)	(2,545,106)	(30,042,341)
Interest sensitivity gap	(5,275,356)	7,122,750	2,353,800	(161,586)	64,054	(160,209)	3,943,453

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

Sensitivity analysis to market risk exposure of the Group

- Interest rate risk

The Group is principally exposed to HKD and USD in terms of interest rate risk. At 31 December 2007, if HKD and USD market interest rates had been 100 basis points lower with other variables held constant, profit before tax for the year would have been HK$15,500,000 (2006: HK$4,500,000) lower by HKD and USD assets liabilities structure. The impact on reserves would be insignificant.

Interest rate exposures in banking book

The following is a summary of possible effects of market interest rates shocks on the Group's interest rate exposure in its banking book. Subsidiaries are excluded from the analysis below:

	Impact on positions at 31 December	
	2007	2006
Earnings perspective	**HK$'000**	HK$'000
Scenarios		
Down 100 basis points parallel shift in HK dollar yield curves	**(20,000)**	(14,000)
Up 100 basis points parallel shift in US dollar yield curves	**(4,500)**	(9,500)

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market risk (continued)

Sensitivity analysis to market risk exposure of the Group (continued)

Interest rate exposures in banking book (continued)

The projections illustrate that stressful changes in market interest rates in response to exceptional but plausible events would have adverse effects both on earnings over the next twelve months and economic value. While the possible effect of interest rates shock on earnings is assessed by changes in net interest income, the possible impact on economic value is measured in terms of expected net future cash flow discounted by projected market rates. To construct stressful scenarios, severe assumptions are made, including a change in the correlation between HK dollar and US dollar interest rates, on the two separate perspectives of earnings and economic value. Simplified assumptions are also made on the projections, such as a parallel movement of interest rates for the banking book positions of all repricing or maturity dates. In the absence of actions that would be taken to mitigate the impact of interest rates shock, all positions are assumed to run to maturity and reprice or mature simultaneously within a given time band.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market risk (continued)

Sensitivity analysis to market risk exposure of the Group (continued)

- Foreign exchange risk

At 31 December 2007, if HKD had weakened/strengthened by 1% against USD with all other variable held constant, the profit before taxation for the year would have been HK$4,294,000 higher/lower, mainly as a result of foreign exchange gain/loss on translation of USD denominated financial assets larger than foreign exchange gain/loss on translation of USD denominated financial liabilities. If HKD had weakened/strengthened by 5% against CNY with all other variable held constant, the profit before taxation for the year would have been HK$9,593,000 higher/lower, mainly as a result of foreign exchange gain/loss on translation of CNY denominated financial assets larger than foreign exchange gain/loss on translation of CNY denominated financial liabilities.

At 31 December 2006, if HKD had weakened/strengthened by 1% against USD with all other variable held constant, the profit before taxation for the year would have been HK$3,094,000 higher/lower, mainly as a result of foreign exchange gain/loss on translation of USD denominated financial assets larger than foreign exchange gain/loss on translation of USD denominated financial liabilities. If HKD had weakened/strengthened by 5% against CNY with all other variable held constant, the profit before taxation for the year would have been HK$9,986,000 higher/lower, mainly as a result of foreign exchange gain/loss on translation of CNY denominated financial assets larger than foreign exchange gain/loss on translation of CNY denominated financial liabilities.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk

Liquidity risk is the risk that the Group may not be able to fund increases in assets or meet obligations as they fall due without incurring unacceptable losses.

Liquidity risk management framework

The liquidity risk management framework of the Group comprises three levels. The Board of Directors and the RC are the ultimate decision making authority and are responsible for the compliance with regulatory requirements. Formulation of the risk management procedures and implementation mechanism and monitoring of the compliance are mainly the responsibilities of senior management (including CE, Head of SCD and the Asset and Liability Management Committee). Daily management of liquidity is carried out by the Treasury Division, which is assisted by other functional departments, including the Finance Division which monitor the liquidity risk and provide regular reports to the management and local regulatory bodies.

The Group funds its operations principally by accepting deposits from retail and corporate depositors. In addition, the Group may issue certificates of deposit to secure long-term funds. Funding may also be secured through adjusting the asset mix in the Group's investment portfolio. The Group uses the majority of funds raised to extend loans, to purchase debt securities or to conduct inter-bank placements.

The Group has developed a robust liquidity risk management mechanism which aims at enabling the Group to meet, even under adverse market conditions, all its maturing repayment obligations on time, and to fund all its asset growth and strategic opportunities without forced liquidation of its assets at short notice. The objective is achieved through maintenance of a highly-liquefiable assets portfolio and establishment of a diversified portfolio of liabilities.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

Liquidity risk management framework (continued)

Risk management process includes:

- Perform cash-flow projections under normal and stressed scenarios, using the net mismatch gap between assets and liabilities to estimate the prospective net funding requirements;
- Maintain a minimum mismatch ratio to control the size of the cumulative net mismatch positions;
- Maintain strong liquidity ratios to comply with both internal and external regulatory requirements;
- Ensure sound and sufficient funding sources and maintain stable and diversified core deposits;
- Maintain a proper level of highly liquid assets to serve as a liquidity buffer for emergency needs;
- Monitor the structure and stability of the deposit portfolio;
- Assess the ability to borrow from the inter-bank money market and monitor the portfolio of lenders to avoid over-reliance on the money market for funding;
- Maintain a proper contingency plan, which includes setting early warning signals (including internal indicators and market indicators) with timely monitoring procedures and establishing a management reporting system and contingency procedures.

The Group has set up three Key Risk Indicators: 1-month liquidity ratio, 1-month mismatch ratio and loan-to-deposit ratio which are used as the major tools in the identification, measurement, monitoring and control of the liquidity risk by setting limits on, assess and monitor the ratios on a regular basis. The Group also utilises cash flow analysis, and monitors deposit stability, concentration of deposits from large depositors and liquidity profile of the investment portfolio.

Before launching a new product or business, relevant departments are required to go through a risk assessment process, which includes assessment of underlying liquidity risk and consideration of the adequacy of the current risk management mechanism. Any material impact on liquidity risk noted during the risk assessment process will be reported to the Head of SCD.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(a) Analysis of undiscounted cash flows by contractual maturities

Non-derivative cash flows

The table below presents the cash flows payable by the Group as at 31 December for non-derivative financial liabilities by remaining contractual maturities.

	2007					
	Up to 1 month	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
Deposits and balances of banks and other financial institutions	**(757,407)**	**(84,108)**	**(254,682)**	**-**	**-**	**(1,096,197)**
Financial liabilities designated at fair value through profit or loss	**(76,186)**	**(401,323)**	**(1,027,896)**	**(901,666)**	**(363,881)**	**(2,770,952)**
Deposits from customers	**(24,312,224)**	**(3,533,999)**	**(1,487,233)**	**(73,070)**	**-**	**(29,406,526)**
Other financial liabilities	**(1,355,199)**	**(270,404)**	**(2)**	**(4,700)**	**-**	**(1,630,305)**
	(26,501,016)	**(4,289,834)**	**(2,769,813)**	**(979,436)**	**(363,881)**	**(34,903,980)**

	2006					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Deposits and balances of banks and other financial institutions	(611,316)	(7,688)	(7,443)	-	-	(626,447)
Financial liabilities designated at fair value through profit or loss	(159,044)	(376,438)	(834,717)	(1,922,623)	(376,825)	(3,669,647)
Deposits from customers	(20,471,045)	(2,415,197)	(1,157,746)	(542,868)	(18,464)	(24,605,320)
Other financial liabilities	(1,162,635)	(210,404)	(4)	(4,700)	-	(1,377,743)
	(22,404,040)	(3,009,727)	(1,999,910)	(2,470,191)	(395,289)	(30,279,157)

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(a) Analysis of undiscounted cash flows by contractual maturities (continued)

Derivative cash flows

(i) Derivatives settled on a net basis

The Group's derivatives that will be settled on a net basis include:

- Foreign exchange derivatives: non-deliverable OTC currency options, non-deliverable currency forwards; and

- Interest rate derivatives: interest rate swaps

The tables below analyse the Group's derivative financial liabilities as at 31 December that will be settled on a net basis into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows of derivatives with net negative fair value.

	2007					
	Up to 1 month	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
Derivatives settled on a net basis						
- Foreign exchange derivatives	**(25,517)**	**(123)**	**(8,083)**	**-**	**-**	**(33,723)**
- Interest rate derivatives	**40**	**(878)**	**(3,251)**	**(2,022)**	**-**	**(6,111)**
	(25,477)	**(1,001)**	**(11,334)**	**(2,022)**	**-**	**(39,834)**

	2006					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Derivatives settled on a net basis						
- Foreign exchange derivatives	(14,909)	-	(3)	-	-	(14,912)
- Interest rate derivatives	(2,166)	(3,708)	(7,120)	(5,187)	-	(18,181)
	(17,075)	(3,708)	(7,123)	(5,187)	-	(33,093)

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(a) Analysis of undiscounted cash flows by contractual maturities (continued)

Derivative cash flows (continued)

(ii) Derivatives settled on a gross basis

The Group's derivatives that will be settled on a gross basis include OTC currency options, currency forwards and OTC equity options.

The tables below analyse the Group's derivative financial instruments as at 31 December that will be settled on a gross basis into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the gross contractual undiscounted cash flows for all derivatives that are settled on a gross basis

	2007					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Derivatives settled on a gross basis						
- Foreign exchange derivatives:						
- Outflow	(67,416)	(9,960)	(46,618)	-	-	(123,994)
- Inflow	67,307	9,904	46,731	-	-	123,942
	(109)	(56)	113	-	-	(52)
- Equity derivatives:						
- Outflow	(4,252)	(506)	-	-	-	(4,758)
- Inflow	4,252	506	-	-	-	4,758
	-	-	-	-	-	-
Total outflow	(71,668)	(10,466)	(46,618)	-	-	(128,752)
Total inflow	71,559	10,410	46,731	-	-	128,700

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Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(a) Analysis of undiscounted cash flows by contractual maturities (continued)

Derivative cash flows (continued)

(ii) Derivatives settled on a gross basis (continued)

	2006					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Derivatives settled on a gross basis						
- Foreign exchange derivatives:						
- Outflow	(149,567)	(8,264)	(3,152)	-	-	(160,983)
- Inflow	149,624	8,329	3,190	-	-	161,143
	57	65	38	-	-	160
- Equity derivatives:						
- Outflow	(80)	-	-	-	-	(80)
- Inflow	80	-	-	-	-	80
	-	-	-	-	-	-
Total outflow	(149,647)	(8,264)	(3,152)	-	-	(161,063)
Total inflow	149,704	8,329	3,190	-	-	161,223

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(a) Analysis of undiscounted cash flows by contractual maturities (continued)

Off-balance sheet items

Loan commitments

The contractual amounts of the Group's off-balance sheet financial instruments as at 31 December 2007 that commit it to extend credit to customers and other facilities amounting to HK$ 4,476,934,000 (2006: HK$4,698,503,000) are maturing no later than 1 year.

Financial guarantees and other financial facilities

Financial guarantees of the Group as at 31 December 2007 amounting to HK$1,238,246,000 (2006: HK$1,047,541,000) are maturing no later than 1 year.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(b) Maturity analysis

Tables below analyse assets and liabilities of the Group as at 31 December into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date.

	2007							
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets								
Cash and balances with banks and other financial institutions	820,585	8,930,933	-	-	-	-	-	9,751,518
Placements with banks and other financial institutions maturing between one and twelve months	-	-	5,754,544	1,487,848	-	-	-	7,242,392
Financial assets designated at fair value through profit or loss								
– debt securities designated at fair value through profit or loss								
- certificates of deposit held	-	-	-	119,207	205,738	-	-	324,945
- others	-	-	113,932	-	289,362	308,183	-	711,477
Derivative financial instruments	149,236	434	371	7,904	18,737	-	-	176,682
Advances and other accounts								
– advances to customers	1,263,494	723,060	1,072,182	2,366,444	3,752,135	3,860,954	49,529	13,087,798
– trade bills	1,835	111,795	150,886	1,744	-	-	-	266,260
Investment in securities								
– debt securities held for available-for-sales								
- others	-	-	-	-	89,771	-	-	89,771
- equity securities held for available-for-sale	-	-	-	-	-	-	30,225	30,225
– debt securities held for held-to-maturity								
- certificates of deposit held	-	-	-	21,045	-	-	-	21,045
- others	-	552,852	997,441	2,343,029	751,881	-	-	4,645,203
– debt securities held for loans and receivables	-	-	-	1,007,472	-	-	-	1,007,472
Investment properties	-	-	-	-	-	-	64,450	64,450
Properties, plant and equipment	-	-	-	-	-	-	571,328	571,328
Other assets (including deferred tax assets)	347,805	697,107	-	560	3,487	-	439	1,049,398
Total assets	2,582,955	11,016,181	8,089,356	7,355,253	5,111,111	4,169,137	715,971	39,039,964

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(b) Maturity analysis (continued)

	2007							
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Liabilities								
Deposits and balances of banks and other financial institutions	(111,715)	(644,123)	(82,078)	(247,679)	-	-	-	(1,085,595)
Financial liabilities designated at fair value through profit or loss								
– certificates of deposit issued	-	-	-	(295,740)	-	-	-	(295,740)
– others	-	(69,552)	(379,017)	(676,438)	(755,495)	(308,950)	-	(2,189,452)
Derivative financial instruments	(25,286)	(578)	(765)	(13,397)	(11,098)	-	-	(51,124)
Deposits from customers	(13,910,579)	(10,388,292)	(3,511,636)	(1,458,057)	(59,464)	-	-	(29,328,028)
Other accounts and provisions (including current and deferred tax liabilities)	(650,685)	(733,337)	(270,404)	(79,927)	(70,531)	-	-	(1,804,884)
Total liabilities	(14,698,265)	(11,835,882)	(4,243,900)	(2,771,238)	(896,588)	(308,950)	-	(34,754,823)
Net liquidity gap	(12,115,310)	(819,701)	3,845,456	4,584,015	4,214,523	3,860,187	715,971	4,285,141

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(b) Maturity analysis (continued)

	2006							
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets								
Cash and balances with banks and other financial institutions	836,948	4,265,080	-	-	-	-	-	5,102,028
Placements with banks and other financial institutions maturing between one and twelve months	-	-	6,183,227	1,399,198	-	-	-	7,582,425
Financial assets designated at fair value through profit or loss								
– debt securities designated at fair value through profit or loss								
- certificates of deposit held	-	-	-	-	333,254	-	-	333,254
- others	-	-	-	22,486	563,592	301,645	-	887,723
Derivative financial instruments	108,565	326	113	1,529	15,309	-	-	125,842
Advances and other accounts								
– advances to customers	1,139,102	785,615	843,091	1,474,622	3,044,707	3,606,068	112,621	11,005,826
– trade bills	-	62,861	20,320	12,217	-	-	-	95,398
Investment in securities								
– debt securities held for available-for-sales								
- equity securities held for availabl-for-sale	-	-	-	-	-	-	20,815	20,815
– debt securities held for held-to-maturity								
- certificates of deposit held	-	-	186,393	395,321	57,121	-	-	638,835
- others	-	99,847	1,609,891	933,066	3,148,120	-	-	5,790,924
– debt securities held for loans and receivables	-	-	103,563	714,406	-	-	-	817,969
Investment properties	-	-	-	-	-	-	54,540	54,540
Properties, plant and equipment	-	-	-	-	-	-	528,843	528,843
Other assets (including deferred tax assets)	313,170	593,970	-	85,106	4,474	-	4,652	1,001,372
Total assets	2,397,785	5,807,699	8,946,598	5,037,951	7,166,577	3,907,713	721,471	33,985,794

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(b) Maturity analysis (continued)

	2006							
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Liabilities								
Deposits and balances of banks and other financial institutions	(251,621)	(359,330)	(7,576)	(7,341)	-	-	-	(625,868)
Financial liabilities designated at fair value through profit or loss – certificates of deposit issued	-	-	-	-	(292,272)	-	-	(292,272)
– others	-	(149,511)	(354,197)	(763,515)	(1,458,065)	(301,645)	-	(3,026,933)
Derivative financial instruments	(14,817)	(563)	(1,902)	(7,601)	(22,127)	-	-	(47,010)
Deposits from customers	(12,317,632)	(8,143,431)	(2,400,701)	(1,143,703)	(518,845)	(18,383)	-	(24,542,695)
Other accounts and provisions (including current and deferred tax liabilities)	(578,545)	(613,221)	(229,864)	(24,288)	(61,645)	-	-	(1,507,563)
Total liabilities	(13,162,615)	(9,266,056)	(2,994,240)	(1,946,448)	(2,352,954)	(320,028)	-	(30,042,341)
Net liquidity gap	(10,764,830)	(3,458,357)	5,952,358	3,091,503	4,813,623	3,587,685	721,471	3,943,453

The above maturity classifications have been prepared in accordance with relevant provisions under the Banking (Disclosure) Rules. The Group has reported assets such as advances which have been overdue for not more than one month as "Repayable on demand". In the case of an asset that is repayable by different payments or instalments, only that portion of the asset that is actually overdue is reported as overdue. Any part of the asset that is not due is reported according to the residual maturity unless the repayment of the asset is in doubt in which case the amount is reported as "Indefinite". The above assets are stated after deduction of provisions, if any.

The analysis of debt securities by remaining period to maturity is disclosed in order to comply with relevant provisions under the Banking (Disclosure) Rules. The disclosure does not imply that the securities will be held to maturity.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.4 Capital management

The major objective of the Group's capital management is to maximise total shareholders' return while maintaining a capital adequacy position in relation to the Group's overall risk profile. The Group periodically reviews its capital structure and adjusts the capital mix where appropriate to achieve the required rate of return on capital.

The Group has developed and maintained a sound framework of policies and controls on capital management to support the development of the Group's business and to meet the statutory capital adequacy ratio. ALCO monitors the Group's capital adequacy. The Group has complied with all the statutory capital standards for all the periods.

For the implementation of Basel II in 2007, the Group has adopted the standardised approach under Pillar one to calculate the capital charge on credit risk, market risk and operational risk in compliance with the Banking (Capital) Rules. This new regulatory capital framework aligns regulatory capital requirements more closely with the inherent risks.

In 2007, the Group has established its internal capital adequacy assessment process (ICAAP). Through this process, each material risk from the Group's main activities is assessed by pre-defined assessment models, and a comprehensive judgment of the overall risk profile is decided subsequently by taking into account the Group's governance culture. Finally, the minimum CAR is defined through the procedures to relate the Group's overall risk profile to its capital adequacy. The minimum CAR aims to cover the various material risks undertaken by the Group. The Group considers this ICAAP process as an on-going process for capital management and periodically reviews its capital structure and adjusts the capital structure in relation to the overall risk profile.

In addition, the annual capital plans of the Group are drawn up and discussed by the ALCO and submitted to the board for approval. The Plan built up by assessing the impacts by various factors upon CAR such as the business strategies, return on equity, risk appetite, credit rating, as well as regulatory requirements, and based on this study to derive our future capital demand and the way to obtain the capital sources. The plan is to ensure the Group's capital adequacy and achieve optimal capital structure in order to align with our business development and risk profile.

(a) Capital adequacy ratio

	2007	2006
Capital adequacy ratio	**19.97%**	23.83%
Core capital ratio	**18.92%**	23.48%

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.4 Capital management (continued)

(a) Capital adequacy ratio (continued)

The capital ratios as at 31 December 2007 are computed on the combined basis that comprises the positions of the Bank's local offices and oversea branches specified by the HKMA for its regulatory purposes and in accordance with the Banking (Capital) Rules effective from 1 January 2007. The comparatives as at 31 December 2006 are computed in accordance with the Third Schedule of the Banking Ordinance. They are not restated on the ground that different approaches are used to calculate the Bank's capital requirements for the years ended 31 December 2007 and 2006.

(b) Components of capital base after deductions

The combined capital base after deductions used in the calculation of the above capital adequacy ratio as at 31 December and reported to the HKMA is analysed as follows:

	2007	2006
	HK$'000	HK$'000
Core capital:		
Paid up ordinary share capital	**300,000**	300,000
Reserves	**3,064,743**	3,068,902
Profit and loss account	**327,277**	125,052
	3,692,020	3,493,954
Deductions from core capital	**(13,181)**	-
Core capital	**3,678,839**	3,493,954
Supplementary capital:		
Reserves on revaluation of premises and investment properties	**224**	224
Reserves on revaluation of holdings of available-for-sale securities	**562**	-
Reserves on revaluation of holdings of securities not held for trading	**-**	(56,843)
Collective loan impairment allowances	**43,555**	34,151
Regulatory reserve	**172,274**	155,607
	216,615	133,139
Deductions from supplementary capital	**(13,181)**	-
Supplementary capital	**203,434**	133,139
Deductions from total capital base	**-**	(80,949)
Total capital base after deductions	**3,882,273**	3,546,144

The comparatives are not restated on the ground that different approaches are used to calculate the Group's regulatory capital for the years ended 31 December 2007 and 2006.

Subsidiaries which are not included in the consolidation group for the calculation of capital adequacy ratios are denoted in Note 26. Investment costs in such subsidiaries are deducted from the capital base.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.4 Capital management (continued)

(c) Capital charge for credit, market and operational risks

The capital adequacy ratios shown above are calculated on the combined basis for regulatory purposes in accordance with the Banking (Capital) Rules. The table below summaries the capital requirements and capital charge calculated by applying 8% on the risk-weighted amounts, computed on the same combined basis for credit, market, and operational risks. As different approaches are used to calculate the capital requirements since adoption of the Banking (Capital) Rules in 2007, presentation of the comparative quantitative information is exempted.

	2007
	HK$'000
Credit risk	1,440,138
Market risk	11,118
Operational risk	135,823
	1,587,079

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.4 Capital management (continued)

(c) Capital charge for credit, market and operational risks (continued)

(i) Capital requirements for credit risk

	2007					
	Total exposures	Exposures after CRM*		Risk-weighted amount		Capital requirement**
		Rated	Unrated	Rated	Unrated	
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
On-balance sheet exposures						
Sovereign	517,279	522,476	-	16,021	-	1,282
Public sector entity	708,507	819,266	-	163,853	-	13,108
Bank	22,654,447	22,607,532	46,915	5,748,938	39,487	463,074
Corporate	7,269,291	45,150	6,694,717	29,093	6,694,717	537,905
Cash items	150,690	-	150,690	-	-	-
Regulatory retail	1,494,530	-	1,317,726	-	988,294	79,064
Residential mortgage loans	3,506,218	-	3,338,708	-	1,645,247	131,620
Other exposures which are not past due	1,526,822	-	1,435,782	-	1,435,782	114,863
Past due exposures	24,325	-	24,325	-	31,989	2,559
Total for on-balance sheet exposures	37,852,109	23,994,424	13,008,863	5,957,905	10,835,516	1,343,475
Off-balance sheet exposures						
Off-balance sheet exposures other than OTC derivative transactions or credit derivative contracts	1,267,708	18,510	1,249,198	18,510	1,176,647	95,613
OTC derivative transactions	24,131	15,088	9,043	4,087	9,043	1,050
Total for off-balance sheet exposures	1,291,839	33,598	1,258,241	22,597	1,185,690	96,663
	39,143,948	24,028,022	14,267,104	5,980,502	12,021,206	1,440,138

* Recognised credit risk mitigation satisfying the requirements and conditions set out in the Banking (Capital) Rules

** For disclosure purposes, capital requirement is calculated by applying 8% on the risk-weighted amount, which may differ from the Bank's actual regulatory capital.

The Bank used the standardised (credit risk) approach ("STC approach") for calculation of credit risk

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.4 Capital management (continued)

(c) Capital charge for credit, market and operational risks (continued)

(i) Capital requirements for credit risk (continued)

The External credit assessment institutions ("ECAI") recognised by the Group includes Standard & Poor's, Moody's and Fitch. The Group adopted external rating based approach to determine the risk weight of the following classes of exposures, including those of securitisation exposures:

- Sovereign
- Public sector entity
- Multilateral development bank
- Bank
- Securities firm
- Corporate

The process the Bank used to map ECAI issuer ratings to exposures booked in the banking book is a process prescribed in Part 4 of the Banking (Capital) Rules.

Counterparty credit risk exposures

Counterparty credit risk in trading book is subject to the same risk management framework as in banking book. The Group established credit limit through formal credit approval procedures to control the pre-settlement credit risk arising from derivatives transactions and settlement limit to control the settlement risk arising from foreign exchange-related transactions in both the trading book and banking book. The Group monitors the risk exposures due to fluctuations in the market value by determining the current exposure value of the transactions.

As the Group has not implemented capital allocation policy, there is no internal capital assigned for counterparty credit exposures.

The Group's policy for securing and managing collateral is applicable in managing counterparty credit risk. Besides, we established prudent eligibility criteria and haircut policy of debt securities secured as collateral for repo-style transactions.

The Group formulated policy for classification of credit assets according to the probability of default of individual counterparty and the period of overdue. If there is objective evidence that an impairment loss has been incurred, impairment allowance will be provided according to regulatory and HK accounting requirements.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.4 Capital management (continued)

(c) Capital charge for credit, market and operational risks (continued)

(i) Capital requirements for credit risk (continued)

Counterparty credit risk exposures (continued)

The following table summarises the Group's exposures to counterparty credit risk arising from OTC derivative transactions:

	2007 HK$'000
Gross total positive fair value	16,229
Credit equivalent amounts net of recognised collateral	24,131
Net credit equivalent amounts analysed by type of issuer:	
Bank	15,088
Corporate	8,749
Others	294
	24,131
Risk weighted amounts analysed by type of issuer:	
Bank	4,087
Corporate	8,749
Others	294
	13,130
Notional amount of recognised credit derivative contracts which provide credit protection	-

There is no effect of bilateral netting agreement on the credit equivalent amounts of the derivative transactions.

There are no outstanding repo-style transactions or credit derivative contracts as at 31 December 2007.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.4 Capital management (continued)

(c) Capital charge for credit, market and operational risks (continued)

(i) Capital requirements for credit risk (continued)

Credit risk mitigation

For those collaterals recognised under capital management, the Group has well-defined policies and procedures for collateral valuation and management which is compliant with the operational requirements for recognised collateral for credit risk mitigation stated in Banking (Capital) Rules.

The main types of recognised collaterals include cash deposit, gold bullion, debt securities, equities and funds for non past-due exposures. Those collaterals taken by the Group are compliant with the comprehensive approach in its treatment of recognised collateral for credit risk mitigation in capital calculation as mentioned in Banking (Capital) Rules.

According to Banking (Capital) Rules, the recognised guarantees for credit risk mitigation under STC approach includes the guarantee given by sovereign, public sector entity, multilateral development bank, bank, securities firm with a lower risk weights than the counterparty; or corporate with external credit rating A- or above.

The concentration risk management for collaterals is embedded in the collateral management policy, including stress testing.

Up to the date of report, the Group has not used any recognised credit derivative contracts on- or off-balance sheet recognised netting for credit risk mitigation yet.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.4 Capital management (continued)

(c) Capital charge for credit, market and operational risks (continued)

(i) Capital requirements for credit risk (continued)

Exposures, other than those arising from OTC derivative transactions and repo-style transactions, covered by recognised credit risk mitigation are analysed as follows:

	2007	
	Covered by recognised collateral	Covered by recognised guarantees or credit derivative contracts
	HK$'000	HK$'000
On-balance sheet exposures		
Corporate	529,424	-
Regulatory retail	171,607	5,197
Residential mortgage loans	56,750	110,760
Other exposures which are not past due	91,040	-
Past due exposures	2,999	-
Off-balance sheet exposures	532,207	-
	1,384,027	115,957

Asset securitisation

The Bank has not acted as an originating institution in respect of securitisation transactions during the year.

(ii) Capital charge for market risk

	2007
	HK$'000
Interest rate exposures	350
Foreign exchange exposures	10,768
	11,118

The Bank used the standardised (market risk) approach ("STM approach") for calculation of market risk.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.4 Capital management (continued)

(c) Capital charge for credit, market and operational risks (continued)

(ii) Capital charge for market risk (continued)

The Bank's positions covered by STM approach are as follows:

	2007	
	Long	Short
	HK$'000	HK$'000
Interest rate exposures	583,591	584,921
Foreign exchange exposures (Net)	134,600	-
	718,191	584,921

Equity exposures in banking book

Equity holdings in other entities are accounted for in accordance with the underlying intentions of holdings, at the outset of the acquisition of the respective equity exposures. Bookings for the equity holdings taken for relationship and strategic reasons will be separated from the bookings for equity holdings taken for other reasons (including the reason of capital appreciation).

Gains or losses related to equity exposures are summarised below:

	2007	2006
	HK$'000	HK$'000
Realised gains from sales or liquidations	**-**	6,470

(iii) Capital charge for operational risk

	2007
	HK$'000
Capital charge for operational risk	**135,823**

The Bank used the standardised (operational risk) approach ("STO approach") for calculation of operational risk.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.5 Fair values of financial assets and liabilities

Fair value estimates are made at a specific point in time based on relevant market information and information about various financial instruments. The following methods and assumptions have been used to estimate the fair value of each class of financial instrument as far as practicable.

Balances with banks and other financial institutions and Trade bills

The maturities of these financial assets and liabilities are within one year and the carrying value approximates fair value.

Advances to customers

Substantially all the advances to customers are on floating rate terms, bear interest at prevailing market interest rates and their carrying value approximates fair value.

Held-to-maturity securities

Fair value for held-to-maturity securities is based on market prices or broker/dealer price quotations. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics. Their carrying value approximates fair value.

Loans and receivables, Certificates of deposit issued

A discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity and their carrying value approximates fair value.

Deposits from customers

Substantially all the deposits from customers mature within one year from balance sheet date and their carrying value approximates fair value.

Notes to the Financial Statements (continued)

5. Net interest income

	2007	2006
	HK$'000	HK$'000
Interest income		
Cash and due from banks and other financial institutions	**657,942**	598,655
Advances to customers	**748,169**	703,876
Listed investments	**3,634**	3,293
Unlisted investments	**347,031**	237,686
Others	**17,788**	9,088
	1,774,564	1,552,598
Interest expense		
Due to banks, customers and other financial institutions	**(945,687)**	(822,140)
Debt securities in issue	**(9,544)**	(10,354)
Others	**(27,566)**	(45,507)
	(982,797)	(878,001)
Net interest income	**791,767**	674,597

Included within interest income is HK$3,778,000 (2006: HK$5,810,000) of interest with respect to income recognised on advances classified as impaired for the year ended 31 December 2007.

Included within interest income and interest expense are HK$1,725,639,000 (2006: HK$1,499,831,000) and HK$835,044,000 (2006: HK$788,221,000) for financial assets and financial liabilities that are not recognised at fair value through profit or loss respectively.

Notes to the Financial Statements (continued)

6. Net fees and commission income

	2007	2006
	HK$'000	HK$'000
Fees and commission income		
Securities brokerage		
- Stockbroking	**206,366**	96,186
- Bonds	**24,863**	7,020
Credit cards	**120**	118
Bills commissions	**39,757**	38,867
Loan commissions	**14,233**	13,913
Payment services	**19,803**	18,236
Insurance	**13,255**	11,135
Asset management	**25,173**	12,602
Guarantees	**584**	1,465
Others		
- currency exchange	**267**	298
- safe deposit box	**9,971**	9,787
- information search	**1,944**	1,538
- correspondent banking	**2,016**	2,138
- low deposit balance accounts	**1,270**	1,691
- BOC cards	**1,065**	1,086
- postage and telegrams	**2,087**	1,674
- agency services	**314**	484
- dormant accounts	**868**	974
- sundries	**16,722**	17,902
	380,678	237,114
Fees and commission expenses	**(64,553)**	(41,220)
Net fees and commission income	**316,125**	195,894
Of which arise from		
- financial assets or financial liabilities not at fair value through profit or loss		
- Fees and commission income	**16,581**	16,637
- Fees and commission expenses	**(894)**	(3,306)
	15,687	13,331
- trust and other fiduciary activities		
- Fees and commission income	**5,169**	4,430
- Fees and commission expenses	**(4,147)**	(2,672)
	1,022	1,758

7. Net trading income

	2007	2006
	HK$'000	HK$'000
Net gain from:		
- foreign exchange and foreign exchange products	**63,615**	49,916
- interest rate instruments	**16,398**	26,754
- equity instruments	**(1)**	-
- commodities	**(5)**	-
	80,007	76,670

Comparatives for the year ended 31 December 2006 have been reclassified as a result of excluding gains and losses related to financial instruments at fair value through profit or loss other than those held for trading, which are shown as net loss on financial instruments designated at fair value through profit or loss on the consolidated income statement on page 13.

Notes to the Financial Statements (continued)

8. Net gain on investments in securities

	2007	2006
	HK$'000	HK$'000
Net gain from disposal of available-for-sale securities	**-**	6,470

9. Other operating income

	2007	2006
	HK$'000	HK$'000
Dividend income from investments in securities		
- listed investments	**-**	144
- unlisted investments	**3,042**	1,762
Gross rental income from investment properties	**2,563**	2,335
Less: Outgoings in respect of investment properties	**(50)**	(39)
Others	**176**	1,439
	5,731	5,641

No direct operating expenses related to investment properties that were not let during the year is included in the "Outgoings in respect of investment properties" (2006: HK$ Nil).

Notes to the Financial Statements (continued)

10. Net reversal/(charge) of impairment allowances

	2007	2006
	HK$'000	HK$'000
Advances to customers		
Individually assessed		
- new allowances	(10,005)	(61,054)
- releases	1,856	17,945
- recoveries	37,648	41,195
Net reversal/(charge) of individually assessed loan impairment allowances (Note 24)	29,499	(1,914)
Collectively assessed		
- new allowances	(6,225)	(31,091)
Net charge of collectively assessed loan impairment allowances (Note 24)	(6,225)	(31,091)
Net reversal/(charge) of loan impairment allowances	23,274	(33,005)

11. Operating expenses

	2007	2006
	HK$'000	HK$'000
Staff costs (including directors' emoluments)		
- salaries and other costs	155,257	135,595
- pension cost	11,356	10,901
	166,613	146,496
Premises and equipment expenses (excluding depreciation)		
- rental of premises	17,002	14,267
- information technology	30,194	23,807
- others	4,437	4,348
	51,633	42,422
Depreciation (Note 28)	13,154	12,223
Auditors' remuneration		
- audit services	3,104	2,846
- non-audit services	97	103
Other operating expenses	35,524	26,322
	270,125	230,412

Notes to the Financial Statements (continued)

12. Net gain from disposal of/fair value adjustments on investment properties

	2007	2006
	HK$'000	HK$'000
Net gain on disposal of investment properties	1,391	-
Net gain on fair value adjustments on investment properties (Note 27)	9,910	600
	11,301	600

13. Net (loss)/gain from disposal/revaluation of properties, plant and equipment

	2007	2006
	HK$'000	HK$'000
Net gain on disposal of premises	-	9,721
Net loss on disposal of other fixed assets	(11)	(5)
Reversal of impairment losses on premises (Note 28)	-	138
Impairment losses on other fixed assets (Note 28)	-	(3,510)
	(11)	6,344

Notes to the Financial Statements (continued)

14. Taxation

Taxation in the income statement represents:

	2007	2006
	HK$'000	HK$'000
Hong Kong profits tax		
- current year taxation	149,500	110,166
Deferred tax charge (Note 33)	991	(5,226)
Hong Kong profits tax	150,491	104,940
Overseas taxation	16,892	10,260
	167,383	115,200

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. Taxation on overseas profits has been calculated on the estimated assessable profits for the year at the rates of taxation prevailing in the countries in which the Group operates.

The taxation on the Group's profit before taxation that differs from the theoretical amount that would arise using the taxation rate of Hong Kong is as follows:

	2007	2006
	HK$'000	HK$'000
Profit before taxation	942,273	675,018
Calculated at a taxation rate of 17.5% (2006: 17.5%)	164,898	118,128
Effect of different taxation rates in other countries	1,346	(2,821)
Income not subject to taxation	(3,517)	(3,967)
Expenses not deductible for taxation purposes	4,656	3,860
Taxation charge	167,383	115,200
Effective tax rate	17.76%	17.07%

15. Profit attributable to equity holders of the Bank

The profit of the Bank for the year ended 31 December 2007 attributable to equity holders of the Bank and dealt with in the financial statements of the Bank amounted to HK$771,939,000 (2006: HK$555,972,000).

Notes to the Financial Statements (continued)

16. Dividends

	2007		2006	
	Per share HK$	**Total HK$'000**	Per share HK$	Total HK$'000
First interim dividend paid	**74**	**222,000**	66	198,000
Second interim dividend declared	**90**	**270,000**	70	210,000
	164	**492,000**	136	408,000

At a meeting held on 21 May 2007, the Board declared a first interim dividend of HK$74 per ordinary share for the first half of 2007 amounting to HK$222,000,000.

At a meeting held on 20 December 2007, the Board declared a second interim dividend of HK$90 per ordinary share for second half of 2007 amounting to HK$270,000,000.

17. Retirement benefit costs

The principal defined contribution schemes for the Group's employees are ORSO schemes exempted under the MPF Schemes Ordinance and the BOC-Prudential Easy Choice MPF Scheme. Under the ORSO schemes, employees make monthly contributions to the ORSO schemes equal to 5% of their basic salaries, while the employer makes monthly contributions equal to 5% to 15% of the employees' monthly basic salaries, depending on years of service. The employees are entitled to receive 100% of the employer's contributions upon termination of employment after completing 20 years of service, or at a scale ranging from 20% to 95% for employees who have completed between 3 to 20 years of service, on conditions of retirement, early retirement, permanent incapacity and ill-health or termination of employment other than summary dismissal.

With the implementation of the MPF Schemes Ordinance on 1 December 2000, the Group also participates in the BOC-Prudential Easy Choice MPF Scheme, of which the trustee is BOCI-Prudential Trustee and the investment manager is BOCI-Prudential Manager, which are related parties of the Bank.

The Group's total contributions made to the ORSO schemes for the year ended 31 December 2007 amounted to approximately HK$9,954,000 (2006: approximately HK$9,334,000), after a deduction of forfeited contributions of approximately HK$770,000 (2006: approximately HK$655,000). For the MPF Scheme, the Group contributed approximately HK$1,083,000 (2006: approximately HK$701,000) for the year ended 31 December 2007.

Notes to the Financial Statements (continued)

18. Share option schemes

(a) Share Option Scheme and Sharesave Plan

The principal terms of the Share Option Scheme and the Sharesave Plan were approved and adopted by written resolutions of all the shareholders of the Bank's intermediate holding company, BOC Hong Kong (Holdings) Limited ("BOCHKHL"), dated 10 July 2002.

The purpose of the Share Option Scheme is to provide the participants with the opportunity to acquire proprietary interests in BOCHKHL. The Board of BOCHKHL (the "BOCHKHL Board") may, in its absolute discretion, offer to grant options under the Share Option Scheme to any person as the BOCHKHL Board may select. The subscription price for the shares shall be determined on the date of grant by the BOCHKHL Board as an amount per share calculated on the basis of established rules. An option may be exercised in whole or in part at any time after the date prescribed by the BOCHKHL Board and from time to time as specified in the offer and on or before the termination date prescribed by the BOCHKHL Board.

The purpose of the Sharesave Plan is to encourage broad-based employee ownership of the shares of BOCHKHL. The amount of the monthly contribution under the savings contract to be made in connection with an option shall be the amount which the relevant eligible employee is willing to contribute, which amount shall not be less than 1% and not more than 10% of the eligible employee's monthly salary as at the date of application or such other maximum or minimum amounts as permitted by the BOCHKHL Board. When an option is exercised during an exercise period, it may be exercised in whole or in part.

No options were granted pursuant to the Share Option Scheme or the Sharesave Plan during the year 2007 (2006: NIL).

(b) Pre-Listing Share Option Scheme

On 5 July 2002, several Directors of the Group were granted options by BOC Hong Kong (BVI) Limited ("BOC (BVI)"), the immediate holding company of BOCHKHL, pursuant to a Pre-Listing Share Option Scheme to purchase from BOC (BVI) an aggregate of 3,652,800 existing issued shares of BOCHKHL. The Group has taken advantage of the transitional provisions set out in paragraph 53 of HKFRS 2 under which the new recognition and measurement policies have not been applied to all options granted to employees on or before 7 November 2002.

Notes to the Financial Statements (continued)

18. Share option schemes (continued)

(b) Pre-Listing Share Option Scheme (continued)

Details of the share options outstanding as at 31 December 2007 are disclosed as follows:

	Total number of share options to Directors of the Group	**Average Exercise price (HK$ per share)**
At 1 January 2007	**1,534,300**	
Less: Share options exercised during the year	**(600,000)**	**8.5**
At 31 December 2007	**934,300**	
Exercisable at 31 December 2007	**934,300**	

	Total number of share options to Directors of the Group	Average Exercise price (HK$ per share)
At 1 January 2006	2,019,800	
Less: Share options exercised during the year	(485,500)	8.5
At 31 December 2006	1,534,300	
Exercisable at 31 December 2006	1,534,300	

Share options were exercised on a regular basis throughout the year, the weighted average share price during the year was HK$18.89 (2006: HK$16.39).

The options granted under this scheme can be exercised at HK$8.50 per share in respect of the option price of HK$1.00. These options have a vesting period of four years from the date on which dealings in the shares commenced on the Stock Exchange with a valid exercise period of ten years. No offer to grant any options under the Pre-Listing Share Option Scheme will be made on or after the date on which dealings in the shares commenced on the Stock Exchange.

Notes to the Financial Statements (continued)

19. Directors' and senior management's emoluments

Directors' emoluments

Details of the emoluments paid to or receivable by the Directors of the Bank in respect of their services rendered for the Bank and managing the subsidiaries within the Group during the year are as follows:

	2007	2006
	HK$'000	HK$'000
Fees	**980**	910
Other emoluments		
- basic salaries and allowances	**2,794**	2,562
- discretionary bonuses	**1,270**	587
- others (including pension contributions)	**497**	524
	5,541	4,583

Fees of HK$210,000 (2006: HK$140,000) were paid to the Independent Non-Executive Directors during the year.

In July 2002, options were granted to several Directors of the Group by BOC (BVI), the immediate holding company of BOCHKHL under the Pre-Listing Share Option Scheme as set out in Note 18(b). Full details of the scheme are stated in Note 18. During the year, certain options were exercised, but no benefits arising from the granting of these share options were included in the Directors' emoluments disclosed above or recognised in the income statement.

Notes to the Financial Statements (continued)

20. Cash and balances with banks and other financial institutions

	The Group and the Bank	
	2007	2006
	HK$'000	HK$'000
Cash	**150,690**	139,937
Balances with central banks	**274,055**	133,935
Balances with banks and other financial institutions	**395,840**	563,076
Placements with banks and other financial institutions maturing within one month	**8,930,933**	4,265,080
	9,751,518	5,102,028

21. Financial assets designated at fair value through profit or loss

	The Group and the Bank	
	2007	2006
	HK$'000	HK$'000
At fair value		
Debt securities		
- Unlisted	**1,036,422**	1,220,977

Financial assets designated at fair value through profit or loss are analysed by type of issuer as follows:

	The Group and the Bank	
	2007	2006
	HK$'000	HK$'000
Sovereigns	**43,430**	42,971
Banks and other financial institutions	**992,992**	1,178,006
	1,036,422	1,220,977

Financial assets designated at fair value through profit or loss are analysed as follows:

	The Group and the Bank	
	2007	2006
	HK$'000	HK$'000
Certificates of deposit held	**324,945**	333,254
Other financial assets designated at fair value through profit or loss	**711,477**	887,723
	1,036,422	1,220,977

Notes to the Financial Statements (continued)-

22. Derivative financial instruments

The Group enters into the following equity, foreign exchange amd interest rate related derivative financial instruments for trading and risk management purposes:

Currency forwards represent commitments to purchase and sell foreign currency on a future date.

Currency and interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an exchange of currencies or interest rates (for example, fixed rate for floating rate) or a combination of all these (i.e. cross-currency interest rate swaps). Except for certain currency swap contracts, no exchange of principal takes place.

Foreign currency, interest rate and equity options are contractual agreements under which the seller (writer) grants the purchaser (holder) the right, but not the obligation, either to buy (a call option) or sell (a put option) at or by a set date or during a set period, a specific amount of the financial instrument at a predetermined price. In consideration for the assumption of foreign exchange and interest rate risk, the seller receives a premium from the purchaser. Options are negotiated over-the-counter ("OTC") between the Group and its counterparty or traded through the stock exchange (for example, exchange-traded stock option).

The contract/notional amounts and fair values of derivative financial instruments held by the Group are set out in the following tables. The contract/notional amounts of these instruments indicate the volume of transactions outstanding at the balance sheet dates and certain of them provide a basis for comparison with fair value instruments recognised on the consolidated balance sheet. However, they do not necessarily indicate the amounts of future cash flows involved or the current fair values of the instruments and, therefore, do not indicate the Group's exposure to credit or market risks. The derivative financial instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates, foreign exchange rates or equity prices relative to their terms. The aggregate fair values of derivative financial instruments assets and liabilities can fluctuate significantly from time to time.

Notes to the Financial Statements (continued)

22. Derivative financial instruments (continued)

The Group trades OTC derivative products mainly for customer business. The Group strictly follows risk management policies in providing derivative products to our customers.

Derivatives are also used to manage the interest rate risk of the banking book. A derivative instrument must be included in the approved product list before any transactions for that instrument can be made. There are limits to control the notional amount of exposure arising from derivative transactions, and the maximum tenor of the deal and management alert limit (MAL) in profit and loss is set.

The following tables summarise the contract/notional amounts of each significant type of derivative financial instrument as at 31 December:

	The Group and the Bank		
	2007		
	Trading	**Not qualified for hedge accounting***	**Total**
	HK$'000	**HK$'000**	**HK$'000**
Exchange rate contracts			
Spot and forwards	**2,945,219**	**-**	**2,945,219**
Foreign currency option contracts			
- Options purchased	**26,888**	**-**	**26,888**
- Options written	**26,888**	**-**	**26,888**
	2,998,995	**-**	**2,998,995**
Interest rate contracts			
Swaps	**-**	**1,611,033**	**1,611,033**
	-	**1,611,033**	**1,611,033**
Equity contracts			
Equity option contracts			
- Options purchased	**10,555**	**-**	**10,555**
- Options written	**10,555**	**-**	**10,555**
	21,110	-	**21,110**
Total	**3,020,105**	**1,611,033**	**4,631,138**

* Derivative transactions which do not qualify as hedged for accounting purposes but are managed in conjunction with the financial instruments designated at fair value through profit or loss are separately disclosed in compliance with the requirements set out in the Banking (Disclosure) Rules.

Notes to the Financial Statements (continued)

22. Derivative financial instruments (continued)

	The Group and the Bank		
	2006		
	Trading	Not qualified for hedge accounting*	Total
	HK$'000	HK$'000	HK$'000
Exchange rate contracts			
Spot and forwards	1,822,498	-	1,822,498
Foreign currency option contracts			
- Options purchased	22,804	-	22,804
- Options written	22,804	-	22,804
	1,868,106	-	1,868,106
Interest rate contracts			
Swaps	-	2,222,163	2,222,163
	-	2,222,163	2,222,163
Equity contracts			
Equity option contracts			
- Options purchased	17,894	-	17,894
- Options written	17,894	-	17,894
	35,788	-	35,788
Total	1,903,894	2,222,163	4,126,057

Notes to the Financial Statements (continued)

22. Derivative financial instruments (continued)

The following tables summarise the fair values of each class of derivative financial instrument as at 31 December:

	The Group and the Bank					
	2007					
	Fair value assets			Fair value liabilities		
	Trading	Not qualified for hedge accounting	Total	Trading	Not qualified for hedge accounting	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Exchange rate contracts						
Spot and forwards	155,770	-	155,770	31,957	-	31,957
Foreign currency option contracts						
- Options purchased	174	-	174	-	-	-
- Options written	-	-	-	174	-	174
	155,944	-	155,944	32,131	-	32,131
Interest rate contracts						
Swaps	-	20,432	20,432	-	18,687	18,687
Equity contracts						
Equity option contracts						
- Options purchased	306	-	306	-	-	
- Options written	-	-	-	306	-	306
	306	-	306	306	-	306
Total	156,250	20,432	176,682	32,437	18,687	51,124

	The Group and the Bank					
	2006					
	Fair value assets			Fair value liabilities		
	Trading	Not qualified for hedge accounting	Total	Trading	Not qualified for hedge accounting	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Exchange rate contracts						
Spot and forwards	108,797	-	108,797	14,927	-	14,927
Foreign currency option contracts						
- Options purchased	160	-	160	-	-	-
- Options written	-	-	-	160	-	160
	108,957	-	108,957	15,087	-	15,087
Interest rate contracts						
Swaps	-	16,838	16,838	-	31,876	31,876
Equity contracts						
Equity option contracts						
- Options purchased	47	-	47	-	-	-
- Options written	-	-	-	47	-	47
	47	-	47	47	-	47
Total	109,004	16,838	125,842	15,134	31,876	47,010

Notes to the Financial Statements (continued)

22. Derivative financial instruments (continued)

The credit risk weighted amounts of the above derivative financial instruments are as follows:

	The Group and the Bank	
	2007	2006
	HK$'000	HK$'000
Exchange rate contracts		
Forwards	**10,654**	92
Foreign currency option contracts		
- Options purchased	**8**	-
Interest rate contracts		
Swaps	**2,468**	1,246
	13,130	1,338

The credit risk weighted amounts are the amounts that have been calculated in accordance with the Banking (Capital) Rules. The comparative figures are computed in accordance with the Third Schedule of the Companies Ordinance. The amounts calculated are dependent upon the status of the counterparty and the maturity characteristics of each type of contract.

There is no effect of bilateral netting agreement on the fair values or the credit risk-weighted amounts of the derivative financial instruments.

Approximately 44% (2006: 59%) of the Group's transactions in derivative contracts are conducted with other financial institutions.

Notes to the Financial Statements (continued)

23. Advances and other accounts

	The Group and the Bank	
	2007	2006
	HK$'000	HK$'000
Personal loans and advances	**4,178,843**	3,771,492
Corporate loans and advances	**8,963,494**	7,282,008
Advances to customers	**13,142,337**	11,053,500
Loan impairment allowances		
- Individually assessed	**(10,984)**	(7,525)
- Collectively assessed	**(43,555)**	(40,149)
	(54,539)	(47,674)
Trade bills	**266,260**	95,398
Total	**13,354,058**	11,101,224

As at 31 December 2007, advances to customers include accrued interest on gross advances of HK$34,339,000 (2006: HK$36,423,000).

24. Loan impairment allowances

	The Group and the Bank		
	2007		
	Individual assessment		
	Personal	**Corporate**	**Total**
	HK$'000	**HK$'000**	**HK$'000**
At 1 January 2007	**531**	**6,994**	**7,525**
Credited to income statement (Note 10)	**(92)**	**(29,407)**	**(29,499)**
Loans written off during the year as uncollectible	**(581)**	**(3,150)**	**(3,731)**
Recoveries	**178**	**37,470**	**37,648**
Unwind of discount on allowance	**-**	**(959)**	**(959)**
At 31 December 2007	**36**	**10,948**	**10,984**

	The Group and the Bank		
	2007		
	Collective assessment		
	Personal	**Corporate**	**Total**
	HK$'000	**HK$'000**	**HK$'000**
At 1 January 2007	**1,316**	**38,833**	**40,149**
Charged to income statement (Note 10)	**1,262**	**4,963**	**6,225**
Unwind of discount on allowance	**(142)**	**(2,677)**	**(2,819)**
At 31 December 2007	**2,436**	**41,119**	**43,555**

Notes to the Financial Statements (continued)

24. Loan impairment allowances (continued)

	The Group and the Bank		
	2006		
	Individual assessment		
	Personal	Corporate	Total
	HK$'000	HK$'000	HK$'000
At 1 January 2006	-	41,918	41,918
Charged to income statement (Note 10)	854	1,060	1,914
Loans written off during the year as uncollectible	-	(72,922)	(72,922)
Recoveries	-	41,195	41,195
Unwind of discount on allowance	(323)	(4,257)	(4,580)
At 31 December 2006	531	6,994	7,525

	The Group and the Bank		
	2006		
	Collective assessment		
	Personal	Corporate	Total
	HK$'000	HK$'000	HK$'000
At 1 January 2006	2,752	7,536	10,288
Charged to income statement (Note 10)	-	31,091	31,091
Unwind of discount on allowance	(1,436)	206	(1,230)
At 31 December 2006	1,316	38,833	40,149

Notes to the Financial Statements (continued)

25. Investment in securities

	The Group	
	2007	2006
	HK$'000	HK$'000
(a) Available-for-sale securities		
Debt securities		
- Unlisted	**89,771**	-
Equity securities		
- Unlisted	**30,225**	20,815
	119,996	20,815
(b) Held-to-maturity securities		
Listed, at amortised cost		
- outside Hong Kong	**78,306**	78,356
Unlisted, at amortised cost	**4,587,942**	6,351,403
	4,666,248	6,429,759
(c) Loans and receivables		
Unlisted, at amortised cost	**1,007,472**	817,969
Total	**5,793,716**	7,268,543
Market value of listed held-to-maturity securities	**77,953**	78,070

	The Bank	
	2007	2006
	HK$'000	HK$'000
(a) Available-for-sale securities		
Debt securities		
- Unlisted	**89,771**	-
Equity securities		
- Unlisted	**1,562**	566
	91,333	566
(b) Held-to-maturity securities		
Listed, at amortised cost		
- outside Hong Kong	**78,306**	78,356
Unlisted, at amortised cost	**4,587,942**	6,351,403
	4,666,248	6,429,759
(c) Loans and receivables		
Unlisted, at amortised cost	**1,007,472**	817,969
Total	**5,765,053**	7,248,294
Market value of listed held-to-maturity securities	**77,953**	78,070

Notes to the Financial Statements (continued)

25. Investment in securities (continued)

Investment in securities is analysed by type of issuer as follows:

	The Group 2007			
	Available-for-sale securities	**Held-to-maturity securities**	**Loans and receivables**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**
Sovereigns	**-**	**199,852**	**-**	**199,852**
Public sector entities	**-**	**708,507**	**-**	**708,507**
Banks and other financial institutions	**89,771**	**3,757,889**	**1,007,472**	**4,855,132**
Corporate entities	**30,225**	**-**	**-**	**30,225**
	119,996	**4,666,248**	**1,007,472**	**5,793,716**

	The Group 2006			
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Sovereigns	-	99,847	-	99,847
Public sector entities	-	702,818	-	702,818
Banks and other financial institutions	-	5,627,094	817,969	6,445,063
Corporate entities	20,815	-	-	20,815
	20,815	6,429,759	817,969	7,268,543

	The Bank 2007			
	Available-for-sale Securities	**Held-to-maturity securities**	**Loans and receivables**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**
Sovereigns	**-**	**199,852**	**-**	**199,852**
Public sector entities	**-**	**708,507**	**-**	**708,507**
Banks and other financial institutions	**89,771**	**3,757,889**	**1,007,472**	**4,855,132**
Corporate entities	**1,562**	**-**	**-**	**1,562**
	91,333	**4,666,248**	**1,007,472**	**5,765,053**

	The Bank 2006			
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Sovereigns	-	99,847	-	99,847
Public sector entities	-	702,818	-	702,818
Banks and other financial institutions	-	5,627,094	817,969	6,445,063
Corporate entities	566	-	-	566
	566	6,429,759	817,969	7,248,294

Notes to the Financial Statements (continued)

25. Investment in securities (continued)

The movements in investment in securities are summarised as follows:

	The Group		
	2007		
	Available-for-sale securities	**Held-to-maturity securities**	**Loans and receivables**
	HK$'000	**HK$'000**	**HK$'000**
At 1 January 2007	**20,815**	**6,429,759**	**817,969**
Additions	**85,240**	**1,955,495**	**1,999,570**
Disposals, redemptions and maturity	**-**	**(3,798,885)**	**(1,891,748)**
Amortisation	**1,060**	**28,079**	**63,075**
Change in fair value	**9,662**	**-**	**-**
Exchange differences	**3,219**	**51,800**	**18,606**
At 31 December 2007	**119,996**	**4,666,248**	**1,007,472**

	The Group		
	2006		
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables
	HK$'000	HK$'000	HK$'000
At 1 January 2006	26,952	6,470,849	316,647
Additions	-	4,675,347	803,782
Disposals, redemptions and maturity	(6,158)	(4,748,956)	(318,500)
Amortisation	-	2,112	10,483
Exchange differences	21	30,407	5,557
At 31 December 2006	20,815	6,429,759	817,969

Notes to the Financial Statements (continued)

25. Investment in securities (continued)

	The Bank 2007 Available-for-sale securities HK$'000	The Bank 2007 Held-to-maturity securities HK$'000	The Bank 2007 Loans and receivables HK$'000
At 1 January 2007	**566**	**6,429,759**	**817,969**
Additions	**85,240**	**1,955,495**	**1,999,570**
Disposals, redemptions and maturity	**-**	**(3,798,885)**	**(1,891,748)**
Amortisation	**1,060**	**28,079**	**63,075**
Change in fair value	**1,248**	**-**	**-**
Exchange differences	**3,219**	**51,800**	**18,606**
At 31 December 2007	**91,333**	**4,666,248**	**1,007,472**

	The Bank 2006 Available-for-sale securities HK$'000	The Bank 2006 Held-to-maturity securities HK$'000	The Bank 2006 Loans and receivables HK$'000
At 1 January 2006	6,703	6,470,849	316,647
Additions	-	4,675,347	803,782
Disposals, redemptions and maturity	(6,158)	(4,748,956)	(318,500)
Amortisation	-	2,112	10,483
Exchange differences	21	30,407	5,557
At 31 December 2006	566	6,429,759	817,969

Available-for-sale and held-to-maturity securities are analysed as follows:

	The Group			
	2007	2006	**2007**	2006
	Available-for-sale securities		**Held-to-maturity securities**	
	HK$'000	HK$'000	**HK$'000**	HK$'000
Treasury bills	**-**	-	**199,852**	99,847
Certificates of deposit held	**-**	-	**21,045**	638,835
Others	**119,996**	20,815	**4,445,351**	5,691,077
	119,996	20,815	**4,666,248**	6,429,759

	The Bank			
	2007	2006	**2007**	2006
	Available-for-sale securities		**Held-to-maturity securities**	
	HK$'000	HK$'000	**HK$'000**	HK$'000
Treasury bills	**-**	-	**199,852**	99,847
Certificates of deposit held	**-**	-	**21,045**	638,835
Others	**91,333**	566	**4,445,351**	5,691,077
	91,333	566	**4,666,248**	6,429,759

Notes to the Financial Statements (continued)

26. Investment in subsidiaries

	The Bank	
	2007	2006
	HK$'000	HK$'000
Unlisted shares, at cost	**3,913**	3,913
Amount due from subsidiaries (Note)	**20,332**	54,615
Amount due to subsidiaries (Note)	**(28,306)**	(21,319)
	(4,061)	37,209

Note: Amounts due from/to subsidiaries are unsecured, interest-free and have no fixed terms of repayment.

The following is a list of subsidiaries as at 31 December 2007:

Name	Place of incorporation	Particulars of issued share capital	Interest held	Principal activities
Chiyu Banking Corporation (Nominees) Limited	Hong Kong	1,000 shares of HK$100 each	100%	Nominee service and investment holding
Seng Sun Development Company Limited	Hong Kong	2,800 shares of HK$1,000 each	100%	Investment holding and leasing of properties to group companies
Pacific Trend Profits Corporation	The British Virgin Islands	1 share of US$1 each	100%	Investment holding
Glory Cardinal Limited	Hong Kong	2 shares of HK$1 each	*100%	Investment holding
Glister Company Limited	Hong Kong	2 shares of HK$1 each	*100%	Investment holding
Grace Charter Limited	Hong Kong	2 shares of HK$1 each	*100%	Investment holding

* Shares held indirectly by the Bank

Remarks:

All the subsidiaries listed in the above table are not included in the combined basis for regulatory purposes in respect of capital adequacy. The Bank's Hong Kong Offices and overseas branches specified by the HKMA form the combined basis for its regulatory purposes in accordance with the Banking (Capital) Rules. For accounting purposes, subsidiaries are consolidated in accordance with the accounting standards issued by the HKICPA.

Notes to the Financial Statements (continued)

27. Investment properties

	The Group and the Bank	
	2007	2006
	HK$'000	HK$'000
At 1 January	**54,540**	53,940
Disposals	**(13,500)**	-
Fair value gains (Note 12)	**9,910**	600
Reclassification from properties, plant and equipment (Note 28)	**13,500**	-
At 31 December	**64,450**	54,540

As at 31 December 2007, investment properties are included in the consolidated balance sheet at valuation carried out at 31 December 2007 on the basis of their fair value by an independent firm of chartered surveyors, Savills Valuation and Professional Services Limited.

The carrying value of investment properties is analysed based on the remaining terms of the leases as follows:

	The Group and the Bank	
	2007	2006
	HK$'000	HK$'000
Held in Hong Kong		
On long-term lease (over 50 years)	**60,630**	50,920
Held outside Hong Kong		
On medium-term lease (10 – 50 years)	**3,820**	3,620
	64,450	54,540

Notes to the Financial Statements (continued)

28. Properties, plant and equipment

	The Group			
	Premises	Property under development	Equipment, fixtures and fittings	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Net book value at 1 January 2007	**502,570**	**-**	**26,273**	**528,843**
Additions	**-**	**-**	**11,433**	**11,433**
Disposals	**-**	**-**	**(11)**	**(11)**
Revaluation	**57,715**	**-**	**-**	**57,715**
Depreciation for the year (Note 11)	**(5,655)**	**-**	**(7,499)**	**(13,154)**
Reclassification to investment properties (Note 27)	**(13,500)**	**-**	**-**	**(13,500)**
Exchange adjustments	**-**	**-**	**2**	**2**
Net book value at 31 December 2007	**541,130**	**-**	**30,198**	**571,328**
At 31 December 2007				
Cost or valuation	**541,130**	**-**	**104,697**	**645,827**
Accumulated depreciation and impairment	**-**	**-**	**(74,499)**	**(74,499)**
Net book value at 31 December 2007	**541,130**	**-**	**30,198**	**571,328**
Net book value at 1 January 2006	509,530	10,670	28,373	548,573
Additions	-	-	4,526	4,526
Disposals	(6,796)	(7,160)	(4)	(13,960)
Revaluation	5,437	-	-	5,437
Depreciation for the year (Note 11)	(5,601)	-	(6,622)	(12,223)
Provision for impairment losses (Note 13)	-	(3,510)	-	(3,510)
Net book value at 31 December 2006	502,570	-	26,273	528,843
At 31 December 2006				
Cost or valuation	502,570	-	96,224	598,794
Accumulated depreciation and impairment	-	-	(69,951)	(69,951)
Net book value at 31 December 2006	502,570	-	26,273	528,843

The analysis of cost or valuation of the above assets is as follows:

	Premises	Property under development	Equipment, fixtures and fittings	Total
At 31 December 2007				
At cost	**-**	**-**	**104,697**	**104,697**
At valuation	**541,130**	**-**	**-**	**541,130**
	541,130	**-**	**104,697**	**645,827**
At 31 December 2006				
At cost	-	-	96,224	96,224
At valuation	502,570	-	-	502,570
	502,570	-	96,224	598,794

Notes to the Financial Statements (continued)

28. Properties, plant and equipment (continued)

	The Bank		
	Premises	Equipment, fixtures and fittings	Total
	HK$'000	HK$'000	HK$'000
Net book value at 1 January 2007	**499,370**	**26,273**	**525,643**
Additions	**-**	**11,433**	**11,433**
Disposals	**-**	**(11)**	**(11)**
Revaluation	**55,827**	**-**	**55,827**
Depreciation for the year	**(5,567)**	**(7,499)**	**(13,066)**
Reclassification to investment properties (Note 27)	**(13,500)**	**-**	**(13,500)**
Exchange adjustments	**-**	**2**	**2**
Net book value at 31 December 2007	**536,130**	**30,198**	**566,328**
At 31 December 2007			
Cost or valuation	**536,130**	**104,697**	**640,827**
Accumulated depreciation and impairment	**-**	**(74,499)**	**(74,499)**
Net book value at 31 December 2007	**536,130**	**30,198**	**566,328**
Net book value at 1 January 2006	506,630	28,373	535,003
Additions	-	4,526	4,526
Disposals	(6,796)	(4)	(6,800)
Revaluation	5,065	-	5,065
Depreciation for the year	(5,529)	(6,622)	(12,151)
Net book value at 31 December 2006	499,370	26,273	525,643
At 31 December 2006			
Cost or valuation	499,370	96,224	595,594
Accumulated depreciation and impairment	-	(69,951)	(69,951)
Net book value at 31 December 2006	499,370	26,273	525,643

The analysis of cost or valuation of the above assets is as follows:

	Premises	Equipment, fixtures and fittings	Total
At 31 December 2007			
At cost	**-**	**104,697**	**104,697**
At valuation	**536,130**	**-**	**536,130**
	536,130	**104,697**	**640,827**
At 31 December 2006			
At cost	-	96,224	96,224
At valuation	499,370	-	499,370
	499,370	96,224	595,594

Notes to the Financial Statements (continued)

28. Properties, plant and equipment (continued)

The carrying value of premises is analysed based on the remaining terms of the leases as follows:

	The Group	
	2007	2006
	HK$'000	HK$'000
Held in Hong Kong		
On long-term lease (over 50 years)	**362,270**	338,220
On medium-term lease (10 – 50 years)	**168,050**	153,840
Held outside Hong Kong		
On long-term lease (over 50 years)	**9,330**	9,130
On medium-term lease (10 – 50 years)	**1,480**	1,380
	541,130	502,570

	The Bank	
	2007	2006
	HK$'000	HK$'000
Held in Hong Kong		
On long-term lease (over 50 years)	**362,270**	338,220
On medium-term lease (10 – 50 years)	**163,050**	150,640
Held outside Hong Kong		
On long-term lease (over 50 years)	**9,330**	9,130
On medium-term lease (10 – 50 years)	**1,480**	1,380
	536,130	499,370

As at 31 December 2007, premises are included in the consolidated balance sheet at valuation carried out at 31 December 2007 on the basis of their fair value by an independent firm of chartered surveyors, Savills Valuation and Professional Services Limited.

As a result of the above-mentioned revaluations, changes in value of the Group's and the Bank's premises were recognised in the Group's and the Bank's premises revaluation reserve and the income statement respectively as follows:

	The Group	
	2007	2006
	HK$'000	HK$'000
Increase in valuation credited to premises revaluation reserve	**57,715**	5,299
Increase in valuation credited to income statement (Note 13)	**-**	138
	57,715	5,437

	The Bank	
	2007	2006
	HK$'000	HK$'000
Increase in valuation credited to premises revaluation reserve	**55,827**	5,065

As at 31 December 2007, the net book value of premises that would have been included in the Group's consolidated balance sheet had the assets been carried at cost less accumulated depreciation and impairment losses was HK$ 162,415,000 (2006: HK$168,709,000).

Notes to the Financial Statements (continued)

29. Other assets

	The Group	
	2007	2006
	HK$'000	HK$'000
Repossessed assets	**7,543**	84,538
Accounts receivable and prepayments	**1,041,855**	916,724
	1,049,398	1,001,262

	The Bank	
	2007	2006
	HK$'000	HK$'000
Repossessed assets	**7,543**	84,538
Accounts receivable and prepayments	**1,041,855**	910,393
	1,049,398	994,931

30. Financial liabilities designated at fair value through profit or loss

	The Group and the Bank	
	2007	2006
	HK$'000	HK$'000
Structured deposits (Note 31)	**2,189,452**	3,026,933
Certificates of deposit issued	**295,740**	292,272
	2,485,192	3,319,205

The amount of change in their fair values, during the year and cumulatively, attributable to changes in credit risk is insignificant. The carrying amount of financial liabilities designated at fair value through profit or loss as at 31 December 2007 is less than the amount that the Group and the Bank would be contractually required to pay at maturity to the holder by HK$7,982,000 (2006: HK$65,232,000).

Notes to the Financial Statements (continued)

31. Deposits from customers

	The Group	
	2007	2006
	HK$'000	HK$'000
Current, savings and other deposit accounts (per consolidated balance sheet)	**29,328,028**	24,542,695
Structured deposits reported as financial liabilities designated at fair value through profit or loss (Note 30)	**2,189,452**	3,026,933
	31,517,480	27,569,628
Analysed by :		
Demand deposits and current accounts		
- corporate customers	**1,270,123**	1,339,087
- individual customers	**306,926**	304,615
	1,577,049	1,643,702
Savings deposits		
- corporate customers	**3,117,766**	2,025,832
- individual customers	**9,169,330**	8,625,635
	12,287,096	10,651,467
Time, call and notice deposits		
- corporate customers	**3,663,655**	1,893,309
- individual customers	**11,800,228**	10,354,217
	15,463,883	12,247,526
	29,328,028	24,542,695

Notes to the Financial Statements (continued)

31. Deposits from customers (continued)

	The Bank	
	2007	2006
	HK$'000	HK$'000
Current, savings and other deposit accounts (per consolidated balance sheet)	**29,360,833**	24,606,429
Structured deposits reported as financial liabilities designated at fair value through profit or loss (Note 30)	**2,189,452**	3,026,933
	31,550,285	27,633,362
Analysed by :		
Demand deposits and current accounts		
- corporate customers	**1,286,984**	1,355,157
- individual customers	**306,926**	304,615
	1,593,910	1,659,772
Savings deposits		
- corporate customers	**3,133,710**	2,073,496
- individual customers	**9,169,330**	8,625,635
	12,303,040	10,699,131
Time, call and notice deposits		
- corporate customers	**3,663,655**	1,893,309
- individual customers	**11,800,228**	10,354,217
	15,463,883	12,247,526
	29,360,833	24,606,429

32. Other accounts and provisions

	The Group		The Bank	
	2007	2006	**2007**	2006
	HK$'000	HK$'000	**HK$'000**	HK$'000
Dividend payable	**270,404**	210,404	**270,404**	210,404
Accruals and other payables	**1,388,663**	1,194,034	**1,387,856**	1,194,230
	1,659,067	1,404,438	**1,658,260**	1,404,634

Notes to the Financial Statements (continued)

33. Deferred taxation

Deferred tax is recognised in respect of the temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements in accordance with HKAS 12 "Income Taxes".

The major components of deferred tax assets and liabilities recorded in the consolidated balance sheet, and the movements during the year are as follows:

	The Group 2007					
	Accelerated tax depreciation	Asset revaluation	Losses	Provisions	Other temporary differences	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
At 1 January 2007	5,835	58,372	(346)	(7,026)	-	56,835
Charged/(credited) to income statement (Note 14)	376	1,733	(29)	(1,089)	-	991
Charged to equity	-	9,510	-	-	-	9,510
At 31 December 2007	6,211	69,615	(375)	(8,115)	-	67,336

	The Group 2006					
	Accelerated tax depreciation	Asset revaluation	Losses	Provisions	Other temporary differences	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
At 1 January 2006	5,417	58,807	(314)	(1,824)	516	62,602
Charged/(credited) to income statement (Note 14)	418	106	(32)	(5,202)	(516)	(5,226)
Credited to equity	-	(541)	-	-	-	(541)
At 31 December 2006	5,835	58,372	(346)	(7,026)	-	56,835

	The Bank 2007				
	Accelerated tax depreciation	Asset revaluation	Provisions	Other temporary differences	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
At 1 January 2007	5,641	58,330	(7,026)	-	56,945
Charged/(credited) to income statement	379	1,733	(1,089)	-	1,023
Charged to equity	-	7,893	-	-	7,893
At 31 December 2007	6,020	67,956	(8,115)	-	65,861

	The Bank 2006				
	Accelerated tax depreciation	Asset revaluation	Provisions	Other temporary differences	Total
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
At 1 January 2006	5,220	58,807	(1,824)	516	62,719
Charged/(credited) to income statement	421	105	(5,202)	(516)	(5,192)
Credited to equity	-	(582)	-	-	(582)
At 31 December 2006	5,641	58,330	(7,026)	-	56,945

Notes to the Financial Statements (continued)

33. Deferred taxation (continued)

Deferred tax assets and liabilities are offset on an individual entity basis when there is a legal right to set off current tax assets against current tax liabilities and when the deferred taxation relates to the same authority. The following amounts, determined after appropriate offsetting, are shown in the consolidated balance sheet:

	The Group		The Bank	
	2007	2006	**2007**	2006
	HK$'000	HK$'000	**HK$'000**	HK$'000
Deferred tax assets	**-**	110	**-**	-
Deferred tax liabilities	**(67,336)**	(56,945)	**(65,861)**	(56,945)
	(67,336)	(56,835)	**(65,861)**	(56,945)

	The Group	
	2007	2006
	HK$'000	HK$'000
Deferred tax assets to be recovered after more than twelve months	**-**	110
Deferred tax liabilities to be settled after more than twelve months	**(65,831)**	(56,945)
	(65,831)	(56,835)

	The Bank	
	2007	2006
	HK$'000	HK$'000
Deferred tax assets to be recovered after more than twelve months	**-**	-
Deferred tax liabilities to be settled after more than twelve months	**(65,643)**	(56,945)
	(65,643)	(56,945)

The deferred tax charged/(credited) to equity during the year is as follows:

	The Group	
	2007	2006
	HK$'000	HK$'000
Fair value reserves in shareholders' equity:		
- premises	**8,005**	(398)
- available-for-sale securities	**1,505**	(143)
	9,510	(541)

	The Bank	
	2007	2006
	HK$'000	HK$'000
Fair value reserves in shareholders' equity:		
- premises	**7,675**	(439)
- available-for-sale securities	**218**	(143)
	7,893	(582)

Notes to the Financial Statements (continued)

34. Share capital

	2007	2006
	HK$'000	HK$'000
Authorised:		
3,000,000 ordinary shares of HK$100 each	**300,000**	300,000
Issued and fully paid:		
3,000,000 ordinary shares of HK$100 each	**300,000**	300,000

35. Reserves

The Group's and the Bank's reserves and the movements therein for the current and prior years are presented in the consolidated statement of changes in equity and statement of changes in equity respectively on pages 16 to 17 of the financial statements.

Notes to the Financial Statements (continued)

36. Notes to consolidated cash flow statement

(a) Reconciliation of operating profit to operating cash inflow before taxation:

	2007	2006
	HK$'000	HK$'000
Operating profit	930,983	668,074
Depreciation	13,154	12,223
Net (reversal)/charge of impairment allowances	(23,274)	33,005
Unwind of discount on impairment	(3,778)	(5,810)
Advances written off net of recoveries	33,917	(31,727)
Change in cash and balances with banks and other financial institutions with original maturity over three months	310,534	(343,835)
Change in placements with banks and other financial institutions with original maturity over three months	352,803	(3,195,124)
Change in financial assets designated at fair value through profit or loss	184,555	(83,860)
Change in derivative financial instruments	(46,726)	(3,925)
Change in advances and other accounts	(2,259,699)	(205,923)
Change in investment in securities	1,584,495	(359,760)
Change in other assets	(48,136)	(558,230)
Change in deposits and balances of banks and other financial institutions	459,727	(7,932)
Change in financial liabilities designated at fair value through profit or loss	(834,013)	342,148
Change in deposits from customers	4,785,333	1,682,593
Change in other accounts and provisions	194,629	421,697
Exchange difference	929	130
Operating cash inflow/(outflow) before taxation	5,635,433	(1,636,256)
Cash flows from operating activities included:		
- Interest received	1,716,843	1,526,294
- Interest paid	(968,526)	(843,280)
- Dividend received	3,042	1,906

(b) Analysis of the balances of cash and cash equivalents

	2007	2006
	HK$'000	HK$'000
Cash and balances with banks and other financial institutions with original maturity within three months	9,404,893	4,444,872
Placements with banks and other financial institutions with original maturity within three months	3,044,811	3,032,038
Treasury bills with original maturity within three months	199,853	99,847
	12,649,557	7,576,757

Notes to the Financial Statements (continued)

37. Contingent liabilities and commitments

The following is a summary of the contractual amounts of each significant class of contingent liability and commitment and the corresponding aggregate credit risk weighted amount:

	2007	2006
	HK$'000	HK$'000
Direct credit substitutes	**20,100**	20,295
Transaction-related contingencies	**120,791**	105,282
Trade-related contingencies	**1,097,355**	921,964
Other commitments with an original maturity of		
- up to one year	**3,809,005**	3,787,253
- over one year	**667,929**	911,250
	5,715,180	5,746,044
Credit risk weighted amount	**1,195,157**	649,015

The calculation basis of credit risk weighted amount has been set out in Note 22 to the financial statements. The 2006 comparative figures are computed in accordance with the Third Schedule of the Banking Ordinance.

38. Capital commitments

The Group and the Bank have the following outstanding capital commitments not provided for in the financial statements:

	2007	2006
	HK$'000	HK$'000
Authorised and contracted for but not provided for	**-**	1,854
Authorised but not contracted for	**-**	1,053
	-	2,907

The above capital commitments mainly relate to commitments to purchase computer equipment and software, and to renovate the Group's and the Bank's premises.

Notes to the Financial Statements (continued)

39. Operating lease commitments

(a) As lessee

The Group and the Bank have commitments to make the following future minimum lease payments under non-cancellable operating leases:

	2007	2006
	HK$'000	HK$'000
Land and buildings		
- not later than one year	**14,886**	11,402
- later than one year but not later than five years	**24,482**	12,554
	39,368	23,956

Certain non-cancellable operating leases included in the tables above were subject to renegotiation and rent adjustment with reference to market rates prevailing at specified agreed dates.

(b) As lessor

The Group and the Bank have contracted with tenants for the following future minimum lease receivables under non-cancellable operating leases:

	2007	2006
	HK$'000	HK$'000
Land and buildings		
- not later than one year	**1,252**	2,502
- later than one year but not later than five years	**90**	929
	1,342	3,431

The Group and the Bank lease its investment properties (Note 27) under operating lease arrangements, with leases typically for a period from one to three years. The terms of the leases generally require the tenants to pay security deposits and provide for periodic rent adjustments according to the prevailing market conditions. None of the leases includes contingent rentals.

40. Litigation

The Group is currently being served a number of claims and counterclaims by various independent parties. These claims and counterclaims are in relation to the normal commercial activities of the Group.

No material provision was made against these claims and counterclaims because the directors believe that the Group has meritorious defences against the claimants or the amounts involved in these claims are not expected to be material.

Notes to the Financial Statements (continued)

41. Segmental reporting

The Group engages in many businesses in several regions. For segmental reporting purposes, information is solely provided in respect of business segments. Geographical segment information is not presented because over 90% of the Group's revenues, profits before tax and assets are derived from Hong Kong.

Information about four business segments is provided in segmental reporting. They are Personal Banking, Corporate Banking, Treasury and Investment Activities.

Both Personal Banking and Corporate Banking segments provide general banking services. Personal Banking serves individual customers while Corporate Banking deals with non individual customers. The Treasury segment is responsible for managing the capital, liquidity, and the interest rate and foreign exchange positions of the Group in addition to proprietary trades. Investment Activities include the Group's holdings of premises and investment properties. "Others" refers to those items related to the Group as a whole but independent of the other four business segments.

Revenues, expenses, assets and liabilities of any business segment mainly include items directly attributable to the segment. In relation to occupation of the Group's premises, rentals are internally charged on market rates according to the areas occupied. For management overheads, allocations are made on reasonable bases. During the period, the Group has revised the allocation bases and comparative amounts have been reclassified to conform with the current year's presentation. There is no impact on the Group's income statement and balance sheet. Inter-segment funding is charged according to the internal funds transfer pricing mechanism of the Group. The charge on any such funding is mainly made by reference to the corresponding money market rate.

Notes to the Financial Statements (continued)

41. Segmental reporting (continued)

	2007							
	Personal HK$'000	Corporate HK$'000	Treasury HK$'000	Investment HK$'000	Others HK$'000	Subtotal HK$'000	Eliminations HK$'000	Consolidated HK$'000
Net interest (expenses)/income								
- external	(501,213)	383,532	909,448	-	-	791,767	-	791,767
- inter-segment	868,066	(167,779)	(673,922)	(26,365)	-	-	-	-
	366,853	215,753	235,526	(26,365)	-	791,767	-	791,767
Net fees and commission income /(expenses)	245,067	71,309	(409)	-	158	316,125	-	316,125
Net trading income	29,445	25,640	23,786	1,136	-	80,007	-	80,007
Net loss on financial instruments designated at fair value through profit or loss	-	-	(15,796)	-	-	(15,796)	-	(15,796)
Other operating income	163	354	-	30,257	-	30,774	(25,043)	5,731
Net operating income before impairment allowances	641,528	313,056	243,107	5,028	158	1,202,877	(25,043)	1,177,834
Net (charge)/reversal of impairment allowances	(879)	24,153	-	-	-	23,274	-	23,274
Net operating income	640,649	337,209	243,107	5,028	158	1,226,151	(25,043)	1,201,108
Operating expenses	(192,920)	(56,265)	(6,085)	(8,777)	(31,121)	(295,168)	25,043	(270,125)
Operating profit/(loss)	447,729	280,944	237,022	(3,749)	(30,963)	930,983	-	930,983
Net gain from disposal of/fair value adjustments on investment properties	-	-	-	11,301	-	11,301	-	11,301
Net loss from disposal/revaluation of properties, plant and equipment	-	-	-	(11)	-	(11)	-	(11)
Profit/(loss) before taxation	447,729	280,944	237,022	7,541	(30,963)	942,273	-	942,273
Assets								
Segment assets	5,999,026	9,104,001	23,308,905	621,613	6,419	39,039,964	-	39,039,964
Liabilities								
Segment liabilities	28,228,054	5,346,562	737,849	272,416	169,942	34,754,823	-	34,754,823
Other information								
Additions of properties, plant and equipment	-	-	-	11,433	-	11,433	-	11,433
Depreciation	6,165	1,206	79	5,447	257	13,154	-	13,154
Amortisation of securities	-	-	92,214	-	-	92,214	-	92,214

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Notes to the Financial Statements (continued)

41. Segmental reporting (continued)

	2006							
	Personal	Corporate	Treasury	Investment	Others	Subtotal	Eliminations	Consolidated
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Net interest (expenses)/income								
- external	(487,436)	387,864	774,169	-	-	674,597	-	674,597
- inter-segment	789,831	(170,864)	(595,676)	(23,291)	-	-	-	-
	302,395	217,000	178,493	(23,291)	-	674,597	-	674,597
Net fees and commission income /(expenses)	130,549	65,651	(451)	-	145	195,894	-	195,894
Net trading income	27,262	17,970	31,422	16	-	76,670	-	76,670
Net loss on financial instruments designated at fair value through profit or loss	-	-	(27,781)	-	-	(27,781)	-	(27,781)
Net gain on investments in seucrities	-	-	-	6,470	-	6,470	-	6,470
Other operating income	1,294	488	1	27,708	-	29,491	(23,850)	5,641
Net operating income before impairment allowances	461,500	301,109	181,684	10,903	145	955,341	(23,850)	931,491
Provision for impairment allowances	(11,300)	(21,705)	-	-	-	(33,005)	-	(33,005)
Net operating income	450,200	279,404	181,684	10,903	145	922,336	(23,850)	898,486
Operating expenses	(166,423)	(48,853)	(5,601)	(8,404)	(24,981)	(254,262)	23,850	(230,412)
Operating profit/(loss)	283,777	230,551	176,083	2,499	(24,836)	668,074	-	668,074
Net gain from disposal of/fair value adjustments on investment properties	-	-	-	600	-	600	-	600
Net gain from disposal/revaluation of properties, plant and equipment	-	-	-	6,344	-	6,344	-	6,344
Profit/(loss) before taxation	283,777	230,551	176,083	9,443	(24,836)	675,018	-	675,018
Assets								
Segment assets	5,040,030	7,434,002	20,934,784	570,825	6,153	33,985,794	-	33,985,794
Liabilities								
Segment liabilities	25,586,676	3,450,517	666,087	210,939	128,122	30,042,341	-	30,042,341
Other information								
Additions of properties, plant and equipment	-	-	-	4,526	-	4,526	-	4,526
Depreciation	5,020	1,370	64	5,601	168	12,223	-	12,223
Amortisation of securities	-	-	12,595	-	-	12,595	-	12,595

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Notes to the Financial Statements (continued)

42. Loans to directors and officers

Particulars of advances made to directors and officers of the Bank pursuant to section 161B of the Hong Kong Companies Ordinance are as follows:

	2007	2006
	HK$'000	HK$'000
Aggregate amount of relevant loans outstanding at year end	**1,306**	1,519
Maximum aggregate amount of relevant loans outstanding during the year	**1,519**	1,726

43. Significant related party transactions

Related parties are those parties that have the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control. Related parties may be individuals or other entities.

The Group provides loans and credit facilities to related parties in the normal course of business. Such transactions are conducted with terms that are no more favourable than those contracted with third party customers of the Group.

Transactions with related parties, which the Group entered into during the year are summarised as follows:

(a) Summary of transactions entered into during the ordinary course of business with BOC group companies

The aggregate income and expenses arising from related party transactions with the immediate holding Bank, Bank of China (Hong Kong) Limited, the intermediate holding companies of the Bank as well as subsidiaries and associates of BOC are summarised as follows:

		2007	
	Notes	**Immediate and intermediate holding companies**	**Other related parties[1]**
		HK$'000	**HK$'000**
Income statement items:			
Interest income	(i)	**82,686**	**13,724**
Interest expense	(ii)	**(40,269)**	**(3,900)**
Insurance commission received (net)	(iii)	**-**	**8,459**
Administrative services fees paid/ payable	(iv)	**(36,262)**	**(1,911)**
Credit card commission received/ receivable (net)	(v)	**-**	**121**
Securities brokerage commission paid/payable (net)	(v)	**-**	**(22,210)**
Rental, property management and letting agency fees paid/payable	(v)	**(1,413)**	
Funds selling commission received	(vi)	**-**	**8,084**
Net trading gains		**2,350**	**-**

Notes to the Financial Statements (continued)

43. Significant related party transactions (continued)

(a) Summary of transactions entered into during the ordinary course of business with BOC group companies (continued)

	Notes	2006 Immediate and intermediate holding companies	2006 Other related parties[1]
		HK$'000	HK$'000
Income statement items:			
Interest income	(i)	73,746	16,472
Interest expense	(ii)	(21,000)	(3,214)
Insurance commission received (net)	(iii)	-	9,540
Administrative services fees paid/ payable	(iv)	(29,574)	(1,875)
Credit card commission received/ receivable (net)	(v)	-	118
Securities brokerage commission paid/payable (net)	(v)	-	(8,671)
Rental, property management and letting agency fees paid/payable	(v)	(1,187)	-
Funds selling commission received	(vi)	-	932
Net trading gains		4,299	-

	Notes	**2007 Immediate and intermediate holding companies**	**2007 Other related parties[1]**
		HK$'000	**HK$'000**
Balance sheet items:			
Cash and balances with banks and other financial institutions	(i)	**1,061,458**	**272,160**
Placements with banks and other financial institutions maturing between one and twelve months	(i)	**1,969,313**	**-**
Derivative financial instruments assets	(vii)	**779**	**-**
Advances and other accounts	(viii)	**-**	**250,880**
Investment in securities		**21,711**	**-**
Other assets	(viii)	**214,264**	**303,845**
Deposits and balances of banks and other financial institutions	(ii)	**(677,461)**	**(335,127)**
Deposits from customers	(ii)	**-**	**(51,771)**
Derivative financial instruments liabilities	(vii)	**(10,266)**	**-**
Other accounts and provisions	(viii)	**(399,264)**	**-**
Off-balance sheet items:			
Contingent liabilities and commitments	(ix)	**-**	**2,703**

Notes to the Financial Statements (continued)

43. Significant related party transactions (continued)

(a) Summary of transactions entered into during the ordinary course of business with BOC group companies (continued)

	Notes	2006 Immediate and intermediate holding companies	2006 Other related parties[1]
		HK$'000	HK$'000
Balance sheet items:			
Cash and balances with banks and other financial institutions	(i)	502,369	353
Placements with banks and other financial institutions maturing between one and twelve months	(i)	1,203,372	-
Derivative financial instruments assets	(vii)	684	-
Advances and other accounts	(viii)	-	250,803
Other assets		159,053	247,646
Deposits and balances of banks and other financial institutions	(ii)	(566,410)	-
Deposits from customers	(ii)	-	(52,294)
Derivative financial instruments liabilities	(vii)	(5,435)	-
Other accounts and provisions	(viii)	(310,902)	(250,869)
Off-balance sheet items:			
Contingent liabilities and commitments	(ix)	-	2,703

[1] Subsidiaries and associates of BOC and post-employment benefit plans for the benefit of employees of the Bank are collectively disclosed as other related parties and certain of which are state-controlled entities.

Notes:

(i) Interest income

In the ordinary course of business, the Group enters into various transactions with BOC and its subsidiaries and associates including deposit of cash and balances with banks and other financial institutions, placement of interbank deposits and provision of loans and credit facilities. The transactions were conducted at prices and terms that are no more favourable than those charged to and contracted with other third party customers of the Group.

(ii) Interest expense

In the ordinary course of business, the Group accepts interbank deposits and current, fixed, savings and other deposits from the immediate holding company, intermediate holding companies and subsidiaries and associates of BOC at the relevant market rates at the time of the transactions.

(iii) Insurance commission received (net)

In the ordinary course of business, the Group provides insurance agency services to and purchases general insurance policies from subsidiaries of BOC at the relevant market rates at the time of the transactions.

Notes to the Financial Statements (continued)

43. Significant related party transactions (continued)

(a) Summary of transactions entered into during the ordinary course of business with BOC group companies (continued)

Notes：(continued)

(iv) Administrative services fees and rental fees paid/payable

In the ordinary course of business, the Group pays administrative services fees for the provision of various administrative services including internal audit, technology, human resources support and training to BOC group companies mainly on the basis of cost plus a margin of 5%, and receives office premises rental fees from BOC group companies at the relevant market rates at the time of the transactions.

(v) Commission, property management, letting agency fees and rental fees paid/payable

In the ordinary course of business, the Group pays commission fees for credit card administrative and promotional services, securities brokerage services, property management and letting agency fees to BOC group companies. The Group also pays rental fees to subsidiaries of BOC. These transactions have been entered into in the ordinary course of business and were priced at the relevant market rates at the time of the transactions.

(vi) Funds selling commission received

In the ordinary course of business, the Group receives commission for engaging in promotion and sale of fund products of a fellow subsidiary to customers of the Group at the relevant market rates at the time of the transactions.

(vii) Derivative financial instruments assets/liabilities

In the ordinary course of business, the Group enters into foreign exchange contracts and interest rate contracts with BOC group companies. As at 31 December 2007 the aggregate notional amount of such derivative transactions amounted to HK$ 676,178,000 (2006: HK$ 395,056,000) whilst the corresponding derivative financial instruments assets and liabilities amounted to HK$ 779,000 (2006: HK$ 684,000) and HK$ 10,266,000 (2006: HK$ 5,435,000) respectively. These transactions are executed at the relevant market rates at the time of the transactions.

(viii) Other assets and other accounts and provisions

Included within “Other assets” and “Other accounts and provisions” are receivables from and payables to BOC group companies. The amounts mainly represent the account receivables from and payables to a subsidiary of BOC in relation to dealing in securities trading transactions on behalf of the Group’s customers. The receivables and payables arose from transactions carried out in the normal course of business.

Notes to the Financial Statements (continued)

43. Significant related party transactions (continued)

(a) Summary of transactions entered into during the ordinary course of business with BOC group companies (continued)

Notes：(continued)

(ix) Contingent liabilities and commitments

In the ordinary course of business, the Group provides loan facilities and trade finance services to, and guarantees for the obligations of BOC and its subsidiaries and associates on normal commercial terms.

(b) Key management personnel

Key management are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, including directors and senior management. The Group accepts deposits from and grants loans and credit facilities to key management personnel in the ordinary course of business. During both the current and prior years, no material transaction was conducted with key management personnel of BOCHK, its holding companies and parties related to them.

The key management compensation for the year ended 31 December 2007 and 31 December 2006 is detailed as follows:

	2007	2006
	HK$'000	HK$'000
Salaries and other short-term employee benefits	**5,541**	4,583

(c) Transactions with Ministry of Finance and The People's Bank of China

The Group enters into banking transactions with these entities in the normal course of business. These include purchases and redemption of treasury bonds and money market transactions. The outstanding balances at the year end, and the related income and expenses for the year are as follows:

	2007		2006	
	Interest income/ (expense)	**Outstanding balance at end of the year**	Interest income/ (expense)	Outstanding balance at end of the year
	HK$'000	**HK$'000**	HK$'000	HK$'000
Treasury bonds	**2,653**	**41,824**	2,678	38,881
Due from banks and other financial institutions	**1,776**	**128,225**	1,230	129,888

Notes to the Financial Statements (continued)

43. Significant related party transactions (continued)

(d) Transactions with Central SAFE and other companies controlled by Central SAFE

Central SAFE is the controlling entity of BOC. Central SAFE is approved by the State Council of the PRC to assume the rights and obligations of the equity owner on behalf of the State. Accordingly, Central SAFE, acting on behalf of the State, has become the ultimate holding company of the Bank by virtue of its interest in BOC.

The Group did not have any balances or enter into any transactions with Central SAFE for the year ended 31 December 2007 (2006: Nil).

Central SAFE has controlling equity interests in certain other banks in the PRC. The Group enters into banking transactions with these companies in the normal course of business. These include loans, investment securities and money market transactions. The outstanding balances at the year end, and the related income and expenses for the year are as follows:

	2007		2006	
	Interest income/ (expense)	**Outstanding balance at end of the year**	Interest income/ (expense)	Outstanding balance at end of the year
	HK$'000	**HK$'000**	HK$'000	HK$'000
Due from banks and other financial institutions	**10,354**	**136,383**	9,151	217,734

Notes to the Financial Statements (continued)

43. Significant related party transactions (continued)

(e) Transactions with other state-controlled entities

The state-controlled entities are those, other than BOC (the intermediate holding Bank and its subsidiaries) and Central SAFE and its controlled companies over which the PRC government directly or indirectly holds over 50% of the outstanding shares or voting rights, and has the ability to control or the power to govern their financial or operational policies through its government authorities, agencies and affiliates. The Group has extensive transactions with other state controlled entities. These transactions, conducted in the ordinary course of business, may include, but are not limited to, the following:

- lending, provision of credits and guarantees and deposit taking;
- inter-bank balance taking and placing;
- sale, purchase, underwriting and redemption of bonds issued by other state-controlled entities;
- rendering of foreign exchange, remittance, investment related services;
- provision of fiduciary activities; and
- purchase of utilities, transport, telecommunication and postal services.

Utilities, transport, telecommunication and postal services are charged by service providers at market rates. Management believes that, based on their assessment, the amounts of such related party transactions are insignificant for the year and therefore are not disclosed.

Details of other transactions and balances with state-controlled entities conducted in the ordinary course of business are set forth below:

(i) Financial assets/financial liabilities

	2007		2006	
	Interest income /(expense)	**Outstanding balance at end of the year**	Interest income/ (expense)	Outstanding balance at end of the year
	HK$'000	**HK$'000**	HK$'000	HK$'000
Advances to customers/banks and other financial institutions(Gross)	**22,989**	**272,567**	30,852	478,608
Individually assessed loan impairment allowances	**-**	**-**	(64)	-
Investment in securities	**885**	**67,072**	-	-
Due from banks and other financial institutions	**33,932**	**730,404**	30,945	432,649
Due to banks and other financial institutions	**(7,085)**	**15,930**	(501)	42,658
Deposits from customers	**(13,119)**	**391,686**	(7,498)	295,492

	2007	2006
	HK$'000	HK$'000
(ii) Contingent liabilities and commitments (including guarantees)	**382,789**	656,038

Notes to the Financial Statements (continued)

44. Liquidity ratio

	2007	2006
Average liquidity ratio	**44.63%**	42.79%

The average liquidity ratio is calculated as the simple average of each calendar month's average liquidity ratio of the Bank for the year.

The liquidity ratio is computed on the solo basis (the Hong Kong offices only) and is in accordance with the Fourth Schedule of the Banking Ordinance.

45. Currency concentrations

The following is a summary of the major foreign currency exposures arising from trading, non-trading and structural positions.

	2007							
	Equivalent in thousand of HK$							
	US Dollars	**Japanese Yen**	**Pound Sterling**	**Australian Dollars**	**New Zealand Dollars**	**Renminbi Yuan**	**Others**	**Total**
Spot assets	**8,889,950**	**73,258**	**166,282**	**806,708**	**347,922**	**1,540,365**	**313,664**	**12,138,149**
Spot liabilities	**(8,388,859)**	**(266,914)**	**(138,737)**	**(753,623)**	**(330,335)**	**(1,470,476)**	**(573,388)**	**(11,922,332)**
Forward purchases	**471,805**	**214,805**	**27,581**	**37,070**	**13,615**	**319,211**	**291,622**	**1,375,709**
Forward sales	**(543,499)**	**(34,441)**	**(51,661)**	**(88,721)**	**(32,652)**	**(261,326)**	**(30,862)**	**(1,043,162)**
Net long/(short) position	**429,397**	**(13,292)**	**3,465**	**1,434**	**(1,450)**	**127,774**	**1,036**	**548,364**
Net structural position	**-**	**-**	**-**	**-**	**-**	**64,082**	**-**	**64,082**

	2006							
	Equivalent in thousand of HK$							
	US Dollars	Japanese Yen	Euro	Australian Dollars	New Zealand Dollars	Renminbi Yuan	Others	Total
Spot assets	7,231,041	164,236	105,502	706,323	425,858	840,751	233,998	9,707,709
Spot liabilities	(6,853,253)	(300,240)	(188,274)	(672,276)	(425,162)	(736,875)	(454,728)	(9,630,808)
Forward purchases	154,071	146,296	109,046	6,149	4,117	22,829	234,208	676,716
Forward sales	(223,407)	(9,636)	(25,158)	(38,872)	(4,480)	(230)	(12,413)	(314,196)
Net long/(short) position	308,452	656	1,116	1,324	333	126,475	1,065	439,421
Net structural position	-	-	-	-	-	59,755	-	59,755

Notes to the Financial Statements (continued)

46. Cross-border claims

The information on cross-border claims discloses exposures to foreign counterparties on which the ultimate risk lies, and is derived according to the location of the counterparties after taking into account any transfer of risk. In general, such transfer of risk takes place if the claims are guaranteed by a party in a country, which is different from that of the counterparty, or if the claims are on an overseas branch of a bank whose head office is located in another country. Only regions constituting 10% or more of the aggregate cross-border claims are analysed by geographical areas and disclosed as follows:

	Banks	**Public sector entities**	**Others**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**
At 31 December 2007				
Asia, other than Hong Kong				
- Mainland China	**3,656,000**	**305,000**	**553,000**	**4,514,000**
- Others	**4,565,000**	**-**	**637,000**	**5,202,000**
	8,221,000	**305,000**	**1,190,000**	**9,716,000**
Western Europe				
- Germany	**2,923,000**	**-**	**-**	**2,923,000**
- United Kingdom	**2,537,000**	**-**	**17,000**	**2,554,000**
- Others	**6,811,000**	**-**	**37,000**	**6,848,000**
	12,271,000	**-**	**54,000**	**12,325,000**
Total	**20,492,000**	**305,000**	**1,244,000**	**22,041,000**

	Banks	Public sector entities	Others	Total
	HK$'000	HK$'000	HK$'000	HK$'000
At 31 December 2006				
Asia, other than Hong Kong				
- Mainland China	2,161,000	170,000	615,000	2,946,000
- Others	4,509,000	-	569,000	5,078,000
	6,670,000	170,000	1,184,000	8,024,000
Western Europe				
- Germany	1,983,000	-	1,000	1,984,000
- Others	9,287,000	-	243,000	9,530,000
	11,270,000	-	244,000	11,514,000
Total	17,940,000	170,000	1,428,000	19,538,000

Notes to the Financial Statements (continued)

47. Non-bank Mainland China exposures

Non-bank counterparties are identified in accordance with the definitions set out in the prudential return "Quarterly Analysis of Loans and Advances and Provisions" issued by the HKMA. Exposures in Mainland China to non-bank counterparties at 31 December are summarised as follows:

	2007			
	On-balance sheet exposure	**Off-balance sheet exposure**	**Total exposure**	**Individually assessed impairment allowances**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**
Mainland China entities	**1,957,468**	**935,996**	**2,893,464**	**-**
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China	**1,568,188**	**623,478**	**2,191,666**	**5,842**
Other non-bank Mainland China exposures	**130,971**	**68,425**	**199,396**	**-**
	3,656,627	**1,627,899**	**5,284,526**	**5,842**

	2006			
	On-balance sheet exposure	Off-balance sheet exposure	Total exposure	Individually assessed impairment allowances
	HK$'000	HK$'000	HK$'000	HK$'000
Mainland China entities	1,280,035	948,341	2,228,376	-
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China	622,014	504,770	1,126,784	947
Other non-bank Mainland China exposures	108,476	52,641	161,117	-
	2,010,525	1,505,752	3,516,277	947

48. Ultimate holding company

Central SAFE, acting on behalf of the State, is the ultimate holding company of the Bank whilst BOC is the Bank's intermediate holding company.

49. Comparative amounts

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

50. Approval of financial statements

The financial statements were approved and authorised for issue by the Board of Directors on 13 March 2008.

Notes to the Financial Statements (continued)

51. Risk management

Overview

The Group believes that sound risk management is a key success factor for any organisation. In its daily operation, the Group attaches a high degree of importance to risk management and emphasises that a balance must be struck between risk control and business growth and development. The principal types of risk inherent in the Group's businesses are reputation risk, legal and compliance risk, strategic risk, credit risk, market risk, interest rate risk, liquidity risk and operational risk. The Group's risk management objective is to enhance shareholder value by maintaining risk exposures within acceptable limits.

Risk Management Governance Structure

The Group's risk management governance structure is designed to cover the whole process of all businesses and ensure various risks are properly managed and controlled in the course of conducting business. The Group has a sound risk management organisational structure as well as comprehensive policies and procedures to identify measure, monitor and control various risks that may arise for the organisation. These risk management policies and procedures are regularly reviewed and modified to reflect changes in markets and business strategies. Various groups of risk takers assume their respective responsibilities for risk management.

The Board of Directors, representing the interests of shareholders, is the highest decision making authority of the Bank and has the ultimate responsibility for risk management. The Board, with the assistance of its committees, has the primary responsibility for the determination of risk management strategies and for ensuring that the Group has an effective risk management system to implement these risk management strategies. RC, a standing committee established by the Board of Directors, is responsible for overseeing the Group's various types of risks, reviewing and approving high level risk related policies and overseeing their implementation, reviewing significant or high risk exposures or transactions and exercising its power of veto if it believes that the transaction shall not proceed. AC assists the Board in fulfilling its role on overseeing internal control system.

To achieve the Group's risk management goals, the Group has established a centralised risk management structure that involves the following elements:

- a corporate governance structure to provide active oversight and participation by the Board of Directors, committees and senior management;
- reporting lines that are independent of the Group's Business Units;
- uniform risk management policies, procedures and limits by which the Group identifies, measures, monitors and controls inherent risks;
- improved risk measurement, monitoring and management information systems to support business activities and risk management; and
- clearly defined risk management responsibilities and accountability.

Notes to the Financial Statements (continued)

51. Risk management (continued)

Risk Management Governance Structure (continued)

The Group faces the same types of inherent business risks and adopts consistent risk management strategies and policies as its immediate holding company, BOCHK. The Group executes its risk management strategy independently and functionally reports to BOCHK on a regular basis.

Reputation Risk Management

Reputation risk is the risk that negative publicity regarding the Group's business practices, whether genuine or not, will cause a potential decline in the customer base or lead to costly litigation or revenue erosion. Reputation risk is inherent in every aspect of business operation and covers a wide spectrum of issues.

In order to mitigate reputation risk, the Group has formulated its Reputation Risk Management Policy that is diligently implemented. This policy establishes standards to prevent and to manage reputation risk proactively at an early stage. It requires constant monitoring of external reputation risk incidents and published failures of risk incidents within the financial industry.

Legal and compliance risk management

Legal risk is the risk that unenforceable contracts, lawsuits or adverse judgments may disrupt or otherwise negatively affect the operation or financial condition of the Group. Compliance risk is the risk of penalty arising from any failure to comply with relevant regulations governing the conduct of businesses in specific countries. By establishing and maintaining appropriate policies and guidelines, the Compliance Section is responsible for proactively identifying and managing these risks.

Strategic Risk Management

Strategic risk generally refers to the risks that may induce immediate or future negative impact on the financial and market positions of the Group because of poor strategic decisions, improper implementation of strategies and lack of response to the market. The Group has developed a Strategic Risk Management Policy that clearly defines the management and oversight of such risks.

Notes to the Financial Statements (continued)

51. Risk management (continued)

Credit Risk Management

Credit risk is the risk that a customer or counterparty will be unable to or unwilling to meet a commitment it has entered into. CRMD, provides centralised management of credit risk within the Group. Different credit approval and control procedures are adopted according to the level of risk associated with the customer or transaction. Corporate credit applications and retail credit transactions, including residential mortgage loans and personal loans are independently reviewed and objectively assessed by risk management units.

The Group adopts an eight-grade facility grading structure according to HKMA's loan classification requirement. CRMD provides regular credit management information reports and ad hoc reports to members of EC, RC, AC and Board of Directors.

Market Risk Management

Market risk is the risk of loss that results form movements in the market rates and prices. The Group's market risk arises from customer-related business. Market risk is managed within the risk limits approved by the RC. The overall risk limits are divided into sub-limits by reference to different risk factors, including interest rate, foreign exchange rate, commodity price and equity price.

CRMD, Finance Division and Settlement Section are responsible for the regularly oversight of the Group's market risk to ensure that overall and individual market risks are within the Group's risk tolerance. Risk exposures are monitored on a regular basis to ensure that they are within established risk limits.

The Group has met the "de minimis" criteria set out in the Maintenance of Adequate Capital Against Market Risk guideline issued by the HKMA. As a result, the Group considers that the market risk arising from its trading book is not material and no further qualitative or quantitative disclosure is made of market risk in these accounts.

Notes to the Financial Statements (continued)

51. Risk management (continued)

Interest Rate Risk Management

The Group's interest rate risk exposures are mainly structural. The major types of interest rate risk from structural positions are:

repricing risk – mismatches in the maturity or repricing periods of assets and liabilities

basis risk – different pricing basis for different transactions so that yield on assets and cost of liabilities may change by different amounts within the same repricing period

The Group's ALCO maintains oversight of interest rate risk and RC sanctions the interest rate risk management policies formulated by ALCO. The interest rate risk is identified and measured on a regular basis. The Treasury Division manages the interest rate risk according to the established policies. The Finance Division closely monitors the related risks and the results are reported to RC and ALCO regularly.

Gap analysis is one of the tools used to measure the Group's exposure to repricing risk. This provides the Group with a static view of the maturity and repricing characteristics of its balance sheet positions. The Group uses interest rate derivatives to hedge its interest rate exposures and in most cases, plain vanilla interest rate swaps are used.

Sensitivities of earnings and economic value to interest rate changes (Earnings at Risk and Economic Value at Risk) are assessed through hypothetical interest rate shock of 200 basis points across the yield curve on both sides. Earnings at Risk and Economic Value at Risk are controlled respectively within an approved percentage of the projected net interest income for the year and the latest capital base as sanctioned by RC. The results are reported to ALCO and RC on a regular basis.

The impact of basis risk is gauged by the projected change in net interest income under scenarios of imperfect correlation in the adjustment of the rates earned and paid on different instruments. Ratios of assets to liabilities with similar pricing basis are established to monitor such risk.

Notes to the Financial Statements (continued)

51. Risk management (continued)

Liquidity Risk Management

The aim of liquidity management is to enable the Group, even under adverse market conditions, to meet all its maturing repayment obligations on time and to fund all of its asset growth and strategic opportunities without forced liquidation of its assets at short notice.

The Group funds its operations principally by accepting deposits from retail and corporate depositors. In addition, the Group may issue certificates of deposit to secure long-term funds. Funding may also be secured through adjusting the asset mix in the Group's investment portfolio. The Group uses the majority of funds raised to extend loans, to purchase debt securities or to conduct interbank placements.

The Group monitors the liquidity risks using cash flow analysis and by examining deposit stability, concentration risk, mismatch ratios, loan-to-deposit ratio and liquidity profile of the investment portfolio. The primary objective of the Group's asset and liability management strategy is to achieve optimal return while ensuring adequate levels of liquidity and capital within an effective risk control framework and ALCO is responsible for establishing these policy directives (including the liquidity contingency plan), and RC sanctions the liquidity management policies. The Treasury Department manages the liquidity risk according to the established policies. The Finance Division monitors the Group's liquidity risks and reports to the management and ALCO regularly.

Notes to the Financial Statements (continued)

51. Risk management (continued)

Operational Risk Management

Operational risk relates to the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. SCD oversees the entire operational risk management framework of the Group.

The Group has put in place an effective internal control process which requires the establishment of detailed policies and control procedures for all the key activities. Proper segregation of duties and independent authorisation are the fundamental principles followed by the Group. Business line management is responsible for managing and reporting operational risks specific to their business units by identifying, assessing and controlling the risks inherent in their business processes, activities and products. These are followed by periodic monitoring and ongoing review of changes by SCD. SCD formulates corporate-level policies and procedures concerning operational risk management which are approved by RC. SCD evaluates the operational risk profile, records operational risk data and reports operational risk issues to RC and senior management.

Business continuity plans are in place to support business operations in the event of emergency or disaster. Adequate backup facilities are maintained and periodic drills are conducted. The Group also arranges insurance cover to reduce potential losses in respect of operational risk.

Capital Management

The major objective of capital management is to maximise total shareholders' return while maintaining a capital adequacy position in relation to the Group's overall risk profile. The Group periodically reviews its capital structure and adjusts the capital mix where appropriate to achieve the lowest overall cost of capital. ALCO monitors the Group's capital adequacy. The Group has complied with all the statutory capital standards for all the periods presented in the report.

Stress Testing

The Group supplements the analysis of various types of risks with stress testing. Stress testing is a risk management tool for estimating the Group's risk exposures under stressed conditions arising from extreme but plausible market or macroeconomic movements. These tests are conducted on a regular basis and ALCO monitors the results against limits approved by RC. Stress test results are also reported to the Board and RC regularly.

Branch Network

BRANCH (Br.)	ADDRESS	TELEPHONE
HONG KONG ISLAND		
Central Br.	78, Des Voeux Road Central, Hong Kong	2843 0187
North Point Br.	390-394, King's Road, North Point, Hong Kong	2570 6381
Wanchai Br.	325, Hennessy Road, Wanchai, Hong Kong	2572 2823
Sheung Wan Br.	22-24, Bonham Strand West, Hong Kong	2544 1678
Western Br.	443, Queen's Road West, Hong Kong	2548 2298
Quarry Bay Br.	967-967A, King's Road, Quarry Bay, Hong Kong	2811 3131
KOWLOON		
Hung Hom Br.	23-25, Gillies Avenue, Hung Hom, Kowloon	2362 0051
Kwun Tong Br.	42-44, Mut Wah Street, Kwun Tong, Kowloon	2343 4174
Sham Shui Po Br.	235-237, Laichikok Road, Kowloon	2789 8668
San Po Kong Br.	61-63, Hong Keung Street, San Po Kong, Kowloon	2328 5691
Yau Ma Tei Br.	117-119, Shanghai Street, Yaumatei, Kowloon	2332 2533
Castle Peak Road Br.	G/F, 226-228 Castle Peak Road, Kowloon	2720 5187
Kowloon Bay Br.	G/F, Shop 10, Kai Lok House, Kai Yip Estate, Kowloon Bay, Kowloon	2796 8968
Tokwawan Br.	G/F, Shop 11-13, 78 Tokwawan Road, Kowloon	2765 6118
Tsz Wan Shan Br.	Shop 703A, 7/F., Tsz Wan Shan Shopping Centre, 23 Yuk Wah ST., Tsz Wan Shan, Kowloon	2322 3313
NEW TERRITORIES		
Tuen Mun Yau Oi Estate Br.	Shop 103-104, G/F Restaurant Block Yau Oi Estate Tuen Mun N. T.	2452 3666
Kwai Hing Estate Br.	Shop 1, G/F, Hing Yat House, Kwai Hing Estate, Kwai Chung, N. T.	2487 3332
Tai Po Tai Wo Estate Br.	Shop 112-114, G/F., On Wo House, Tai Wo Estate, Tai Po, N. T.	2656 3386
Belvedere Garden Br.	Shop 5A, G/F., Belvedere Square, Tsuen Wan, N.T	2411 6789
Tsuen Wan Br.	Shop 1 and 1D, Level 2, Discovery Park Commercial Centre, Tsuen Wan, N.T.	2413 8111
Shatin Sui Wo Court Br.	Shop F7, Commercial Centre, Sui Wo Court, Shatin, N.T.	2601 5888
Ma On Shan Br.	Shop 313, Level 3, Ma On Shan Plaza Bayshore Tower, Ma On Shan, N.T.	2640 0733
Sheung Tak Estate Br.	Shop 238, Sheung Tak Shopping Centre, Sheung Tak Est., Tseung Kwan O, N.T.	2178 2278
THE MAINLAND OF CHINA		
Xiamen Branch	1/F, 859 Xiahe Road, Xiamen, Fujian Province, China	(86-592) 585 1691
Fuzhou Branch	1/F, International Bldg., 210 Wusi Road, Fuzhou, Fujian Province, China	(86-591) 8781 0078