2008

集友銀行
Chiyu Banking Corporation Ltd.
中銀香港集團成員 A member of BOCHK Group

Annual Report

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Financial Highlights

	2008	2007	Change
For the year	**HK$'000**	HK$'000	+/(-)%
Net operating income before impairment allowances	**1,145,044**	1,177,834	-2.78
Operating profit	**712,176**	930,983	-23.50
Profit before taxation	**714,267**	942,273	-24.20
Profit for the year	**591,183**	774,890	-23.71
At year-end	**HK$'000**	HK$'000	+/(-)%
Capital and reserves	**3,739,557**	4,285,141	-12.73
Issued and fully paid share capital	**300,000**	300,000	-
Total assets	**39,211,049**	39,039,964	+0.44
Financial ratios	**%**	%	
Return on average capital and reserves[1]	**14.73**	18.83	-4.10
Return on average total assets[2]	**1.51**	2.12	-0.61
Cost to income ratio	**36.66**	22.93	+13.73
Loan to deposit ratio[3]	**48.97**	41.70	+7.27
Average liquidity ratio[4]	**42.88**	44.63	-1.75
Capital adequacy ratio[5]	**15.37**	19.97	-4.60

1. Return on average capital and reserves = $\dfrac{\text{Profit for the year}}{\text{Average of beginning and ending balance of capital and reserves}}$

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

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 is computed on the combined basis that comprises the positions of local offices and overseas branches of Chiyu Banking Corporation Limited specified by the Hong Kong Money Authority ("HKMA") for its regulatory purposes and in accordance with the Banking (Capital) Rules.

Five-Year Financial Summary

The financial information of the Group for the last five years commencing from 1 January 2004 is summarised below:

	2008	2007	2006	2005	2004[2]
For the year	**HK$'000**	HK$'000	HK$'000	HK$'000	HK$'000
Net operating income before impairment allowances	**1,145,044**	1,177,834	931,491	766,592	546,384
Operating profit	**712,176**	930,983	668,074	577,103	543,476
Profit before taxation	**714,267**	942,273	675,018	590,793	565,758
Profit for the year	**591,183**	774,890	559,818	494,167	493,150
At year-end	**HK$'000**	HK$'000	HK$'000	HK$'000	HK$'000
Advances and other accounts	**15,908,861**	13,354,058	11,101,224	10,890,769	8,822,697
Total assets	**39,211,049**	39,039,964	33,985,794	31,233,146	30,927,079
Deposits from customer[1]	**32,218,306**	31,517,480	27,569,628	25,476,311	24,764,174
Total liabilities	**35,471,492**	34,754,823	30,042,341	27,441,970	27,459,782
Issued and fully paid share capital	**300,000**	300,000	300,000	300,000	300,000
Capital and reserves	**3,739,557**	4,285,141	3,943,453	3,791,176	3,467,297
Financial ratios	**%**	%	%	%	%
Return on average capital and reserves	**14.73**	18.83	14.48	13.62	14.74
Return on average total assets	**1.51**	2.12	1.72	1.59	1.60
Cost to income ratio	**36.66**	22.93	24.74	28.61	27.78
Loan to deposit ratio[1]	**48.97**	41.70	40.09	39.86	35.63

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 year 2004 not strictly comparable.

Board of Management

Board of Management

Chief Executive	Deputy General Manager	Assistant General Manager
NG Man Kung	CHAN Yiu Fai	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

For the first half of 2008, although the US credit crisis hamper the global economy, Hong Kong's economy managed to sustain its growth due to the rapid development of China's economy. The property market remained active and GDP still showed healthy growth. At the beginning of the year, the Group has taken advantage of the market opportunities to speed up business development. We focused on leveraging our competitive advantages, and we placed more emphasis on China business development and good cost control. As a result, the Group recorded an increase of profit attributable to shareholders by 27.96% compare with the same period last year.

In the second half of 2008, the unprecedented financial tsunami swept over the global economy, many major economies are experiencing sharp downturns, which damaged business confidence throughout the world. Financial markets suffered rapid contraction. Fragile market and customer investment sentiment seriously affected the sales of investment-related products. Under this adverse market condition, the Group has focused on strengthening credit risk management and controlling asset quality. Our prudent approach to business together with the professionalism of our colleagues has helped minimise the impact of the financial crisis.

The Group's core business is to provide personal and corporate banking and related financial services. Striving to provide better and more convenient customer services, a new branch has been opened in Aberdeen during the year. In addition, we extend the scope of our electronic banking service, along with the effort to provide real-time market information, to provide a convenient and comfortable environment for the customers.

The Group values join success with its Small and Medium Enterprises ("SME") clients. Our corporate banking sales teams strive to provide total business solutions to our clients. With our branches located in Mainland China, the Group is able to provide a one-stop-service platform in facilitating cross-border businesses.

Management's Discussion and Analysis (continued)

Financial Review

For 2008, the Group recorded a profit attributable to shareholders of HK$ 591,183,000, down 23.71% from last year. The return on average shareholders' funds and the return on average total assets were 14.73% and 1.51%, respectively decreased by 4.10% and 0.61% against 2007.

Net interest income was HK$827,271,000, increased 4.48% as compared with 2007. Net interest margin was 2.25%, or 1 basis point higher than last year. Non-interest income was HK$317,773,000, a drop of 17.69% from last year. Operating expenses rose by 55.40% to HK$419,780,000, mainly due to additional items of HK$135,321,000 in relation to the Lehman-related investment products issue. Should the effect of Lehman-related investment products issue be excluded, the Group's operating expenses would have increased by 5.31% while the cost-to-income ratio would have risen by 1.91 percentage points to 24.84%.

The Group has continued to enhance credit risk management, the classified loans ratio kept at a relatively low of 0.35%. In 2008, net charge of loan impairment allowances was HK$11,332,000, as compared with net reversal of loan impairment allowances of HK$23,274,000 last year.

At the end of 2008, the Group recorded an increase in the total consolidated assets by 0.44% to HK$39,211,094,000. Loans and advances to customers increased by 20.05% to HK$15,777,104,000. Deposits from customers increased by 2.22% to HK$32,218,306,000.

Prospect

Looking ahead, the Financial Tsunami will continue to hamper global economy in 2009. The banking sector's operating environment still filled with uncertainties and challenges. With these challenges ahead, the Group will execute appropriate business strategy to tackle the change of market condition, customer need and regulatory requirements. We will take a cautious yet positive approach to capitalise on our strengths and market opportunities. The Group will continue to develop its service platform in Mainland China for better capturing of business opportunities in the region. Furthermore, we will further expand our scopes of service to our target customers; as well as improving operation efficiency and resource utilisation. At the same time, we will continue to achieve good corporate governance by allocating adequacy resources to the aspects of risk management and internal control.

Management's Discussion and Analysis (continued)

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. Risk Management Committee ("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. Audit Committee ("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.

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

Management's Discussion and Analysis (continued)

Risk Management (continued)

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 and duly followed its Reputation Risk Management Policy. The policy aims to prevent and manage reputation risk proactively at an early stage when an incident occurs. The system entails continuous monitoring of external reputation risk incidents and published failures of risk incidents in 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 procedures, 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.

Management's Discussion and Analysis (continued)

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. Credit Risk Management Division ("CMD") 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'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 members of Executive Committee ("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. The Group's market risk in trading book arises from customer-related business. The risk includes potential losses arising from changes in foreign exchange and interest rates as well as equities and commodities prices. On the other hand, the major market risk in banking book arises from the group's investment portfolio. The risk includes potential losses arising from changes in market parameters such as credit, liquidity, and interest rate risk. These positions are subject to monthly mark-to-market valuation.

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. CMD, 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.

Management's Discussion and Analysis (continued)

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 Asset and Liability Management Committee ("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.

Management's Discussion and Analysis (continued)

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.

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. Strategic Planning and Control Department ("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.

Management's Discussion and Analysis (continued)

Risk Management (continued)

Capital Management

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

To comply with HKMA's requirements as stated in the Supervisory Policy Manual "Supervisory Review Process", the Group has implemented its internal capital adequacy assessment process ("ICAAP"). Using the statutory minimum capital adequacy ratio ("CAR"), 8%, as a starting point, extra capital (capital add-on) needed to cover the risks not captured under Pillar I was assessed. Scorecard methodology has been used to evaluate the Group's risk profile in order to assess the capital add-on and determine the minimum CAR. An Operating CAR Range has also been established which incorporates the need for future business growth and efficiency of capital utilisation.

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.

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 2008.

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 20.

The Board declared a first interim dividend of HK$226 per ordinary share, totaling HK$678,000,000 on 11 June 2008.

The Board declared a second interim dividend of HK$167 per ordinary share, totaling HK$501,000,000 on 28 November 2008.

Together with the second interim dividend of HK$167 per share declared in November 2008, the total dividend payout for 2008 would be HK$393 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 23 and 24 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 #
	Cheung Wai Hing *
	Chiu Ming Wah #
	Liu Yanfen #
	Mao Xiaowei #
	Ouyang Jian#
	Tan Wan Chye #
	To Chi Wing #
	Woo Chia Wei *
	Yu Kwok Chun *

Non-executive Directors

* Independent non-executive Directors

In accordance with Article 99 of the Bank's Articles of Association, Mr. Ng Man Kung and Mr. To Chi Wing 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 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. Messrs. Ng Man Kung and Chan Yiu Fai exercised the options to purchase an aggregate of 155,400 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 2008 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, 11 March 2009

Corporate Governance

The Group has complied with the HKMA's guidelines set out in the Supervisory Policy Manual CG-1 "Corporate Governance of Locally Incorporated Authorised 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 20 to 150 which comprise the consolidated and company balance sheets as at 31 December 2008, 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 2008 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, 11 March 2009

Consolidated Income Statement

For the year ended 31 December	Notes	2008	2007
		HK$'000	HK$'000
Interest income		1,316,490	1,774,564
Interest expense		(489,219)	(982,797)
Net interest income	5	827,271	791,767
Fees and commission income		293,317	380,678
Fees and commission expenses		(47,692)	(64,553)
Net fees and commission income	6	245,625	316,125
Net trading income	7	55,158	80,007
Net gain/(loss) on financial instruments designated at fair value through profit or loss		9,031	(15,796)
Net gain on investments in securities	8	131	-
Other operating income	9	7,828	5,731
Total operating income		1,145,044	1,177,834
Net operating income before impairment allowances		1,145,044	1,177,834
Net (charge)/ reversal of impairment allowances	10	(13,088)	23,274
Net operating income		1,131,956	1,201,108
Operating expenses	11	(419,780)	(270,125)
Operating profit		712,176	930,983
Net gain from disposal of/fair value adjustments on investment properties	12	2,100	11,301
Net loss from disposal of properties, plant and equipment	13	(9)	(11)
Profit before taxation		714,267	942,273
Taxation	14	(123,084)	(167,383)
Profit for the year		591,183	774,890
Dividends	16	1,179,000	492,000

The notes on pages 26 to 150 are an integral part of these financial statements.

Consolidated Balance Sheet

As at 31 December	Notes	2008	2007
		HK$'000	HK$'000
ASSETS			
Cash and balances with banks and other financial institutions	20	**8,585,754**	9,751,518
Placements with banks and other financial institutions maturing between one and twelve months		**8,721,608**	7,242,392
Financial assets designated at fair value through profit or loss	21	**369,757**	1,036,422
Derivative financial instruments	22	**385,945**	176,682
Advances and other accounts	23	**15,908,861**	13,354,058
Investment in securities	25	**3,933,003**	5,793,716
Investment properties	27	**80,050**	64,450
Properties, plant and equipment	28	**584,477**	571,328
Other assets	29	**641,594**	1,049,398
Total assets		**39,211,049**	39,039,964
LIABILITIES			
Deposits and balances of banks and other financial institutions		**1,072,082**	1,085,595
Financial liabilities designated at fair value through profit or loss	30	**768,509**	2,485,192
Derivative financial instruments	22	**208,845**	51,124
Deposits from customers	31	**31,449,797**	29,328,028
Other accounts and provisions	32	**1,896,809**	1,659,067
Current tax liabilities		**22,067**	78,481
Deferred tax liabilities	33	**53,383**	67,336
Total liabilities		**35,471,492**	34,754,823
EQUITY			
Share capital	34	**300,000**	300,000
Reserves	35	**3,439,557**	3,985,141
Total equity		**3,739,557**	4,285,141
Total liabilities and equity		**39,211,049**	39,039,964

The notes on pages 26 to 150 are an integral part of these financial statements.

Approved by the Board of Directors on 11 March 2009 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	2008	2007
		HK$'000	HK$'000
ASSETS			
Cash and balances with banks and other financial institutions	20	**8,585,754**	9,751,518
Placements with banks and other financial institutions maturing between one and twelve months		**8,721,608**	7,242,392
Financial assets designated at fair value through profit or loss	21	**369,757**	1,036,422
Derivative financial instruments	22	**385,945**	176,682
Advances and other accounts	23	**15,908,861**	13,354,058
Investment in securities	25	**3,893,832**	5,765,053
Investment in subsidiaries	26	**3,913**	3,913
Amount due from subsidiaries	26	**20,340**	20,332
Investment properties	27	**80,050**	64,450
Properties, plant and equipment	28	**578,277**	566,328
Other assets	29	**641,594**	1,049,398
Total assets		**39,189,931**	39,030,546
LIABILITIES			
Deposits and balances of banks and other financial institutions		**1,072,082**	1,085,595
Financial liabilities designated at fair value through profit or loss	30	**768,509**	2,485,192
Derivative financial instruments	22	**208,845**	51,124
Deposits from customers	31	**31,483,825**	29,360,833
Amount due to subsidiaries	26	**30,888**	28,306
Other accounts and provisions	32	**1,896,335**	1,658,260
Current tax liabilities		**22,067**	78,481
Deferred tax liabilities	33	**52,998**	65,861
Total liabilities		**35,535,549**	34,813,652
EQUITY			
Share capital	34	**300,000**	300,000
Reserves	35	**3,354,382**	3,916,894
Total equity		**3,654,382**	4,216,894
Total liabilities and equity		**39,189,931**	39,030,546

The notes on pages 26 to 150 are an integral part of these financial statements.

Approved by the Board of Directors on 11 March 2009 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 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 of deferred tax	-	(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

	Attributable to equity holders of the Group						
	Share capital	**Premises revaluation reserve**	**Reserve for fair value changes of available-for-sale securities**	**Regulatory reserve***	**Translation reserve**	**Retained earnings**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
At 1 January 2008	**300,000**	**317,579**	**8,157**	**172,274**	**-**	**3,487,131**	**4,285,141**
Net profit for the year	**-**	**-**	**-**	**-**	**-**	**591,183**	**591,183**
Currency translation difference	**-**	**-**	**-**	**-**	**1,888**	**-**	**1,888**
2008 first interim dividend paid	**-**	**-**	**-**	**-**	**-**	**(678,000)**	**(678,000)**
2008 second interim dividend declared	**-**	**-**	**-**	**-**	**-**	**(501,000)**	**(501,000)**
Revaluation of premises	**-**	**30,741**	**-**	**-**	**-**	**-**	**30,741**
Change in fair value of available-for-sale securities taken to equity	**-**	**-**	**12,187**	**-**	**-**	**-**	**12,187**
Release of deferred tax	**-**	**(3,861)**	**1,278**	**-**	**-**	**-**	**(2,583)**
Transfer from retained earnings	**-**	**-**	**-**	**19,221**	**-**	**(19,221)**	**-**
At 31 December 2008	**300,000**	**344,459**	**21,622**	**191,495**	**1,888**	**2,880,093**	**3,739,557**

* 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 26 to 150 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 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 of deferred tax	-	(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

	Attributable to equity holders of the Bank						
	Share capital	**Premises revaluation reserve**	**Reserve for fair value changes of available-for-sale securities**	**Regulatory reserve***	**Translation reserve**	**Retained earnings**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
At 1 January 2008	**300,000**	**315,828**	**1,030**	**172,274**	**-**	**3,427,762**	**4,216,894**
Net profit for the year	**-**	**-**	**-**	**-**	**-**	**587,198**	**587,198**
Currency translation difference	**-**	**-**	**-**	**-**	**1,888**	**-**	**1,888**
2008 first interim dividend paid	**-**	**-**	**-**	**-**	**-**	**(678,000)**	**(678,000)**
2008 second interim dividend declared	**-**	**-**	**-**	**-**	**-**	**(501,000)**	**(501,000)**
Revaluation of premises	**-**	**29,391**	**-**	**-**	**-**	**-**	**29,391**
Change in fair value of available-for-sale securities taken to equity	**-**	**-**	**1,679**	**-**	**-**	**-**	**1,679**
Release of deferred tax	**-**	**(3,659)**	**(9)**	**-**	**-**	**-**	**(3,668)**
Transfer from retained earnings	**-**	**-**	**-**	**19,221**	**-**	**(19,221)**	**-**
At 31 December 2008	**300,000**	**341,560**	**2,700**	**191,495**	**1,888**	**2,816,739**	**3,654,382**

* 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 26 to 150 are an integral part of these financial statements.

Consolidated Cash Flow Statement

For the year ended 31 December	Notes	**2008**	2007
		HK$'000	HK$'000
Cash flows from operating activities			
Operating cash inflow before taxation	36(a)	**3,349,114**	5,635,433
Hong Kong profits tax paid		**(170,458)**	(121,970)
Overseas profits tax paid		**(25,576)**	(12,121)
Net cash inflow from operating activities		**3,153,080**	5,501,342
Cash flows from investing activities			
Purchase of properties, plant and equipment		**(9,600)**	(11,433)
Proceeds from disposal of investment properties		**-**	14,891
Net cash (outflow)/inflow from investing activities		**(9,600)**	3,458
Cash flows from financing activities			
Dividends paid to equity holders of the Bank		**(948,000)**	(432,000)
Net cash outflow from financing activities		**(948,000)**	(432,000)
Increase in cash and cash equivalents		**2,195,480**	5,072,800
Cash and cash equivalents at 1 January		**12,649,557**	7,576,757
Cash and cash equivalents at 31 December	36(b)	**14,845,037**	12,649,557

The notes on pages 26 to 150 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 (HKFRSs is a collective term which includes all applicable individual Hong Kong Financial Reporting Standards, HKASs and Interpretations) issued by the HKICPA, HK GAAP 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.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

Newly adopted HKFRSs

The HKAS 39, 'Financial instruments: Recognition and measurement', amendment on reclassification of financial assets permits reclassification of certain financial assets out of the held-for-trading and available-for-sale categories if specified conditions are met. The related amendment to HKFRS 7, 'Financial instruments: Disclosures', introduces disclosure requirements with respect to financial assets reclassified out of the held-for-trading and available-for-sale categories. The amendment is effective prospectively from 1 July 2008. This amendment does not have any impact on the Group's financial statements as the Group has not reclassified any financial assets.

Interpretations to existing standards already effective in 2008 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 2008 but are not relevant to the Group's operations:

- 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 12, 'Service Concession Arrangements' (effective for annual periods beginning on or after 1 January 2008).
- 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).

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

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 2008:

- HKAS 1 (Revised), 'Presentation of financial statements' (effective from 1 January 2009). The revised standard will prohibit the presentation of items of income and expenses (that is, 'non-owner changes in equity') in the statement of changes in equity, requiring 'non-owner changes in equity' to be presented separately from owner changes in equity. All non-owner changes in equity will be required to be shown in a performance statement. Where entities restate or reclassify comparative information, they will be required to present a restated balance sheet as at the beginning comparative period in addition to the current requirement to present balance sheets at the end of the current period and comparative period. The adoption of this revised standard will affect the presentation of the Group's financial statements.

- HKAS 27 (Revised), 'Consolidated and separate financial statements' (effective from 1 July 2009).The revised standard requires changes in a parent's ownership interest in a subsidiary that do not result in the loss of control are accounted for within equity. The standard also specifies the accounting when control is lost. Any remaining interest in the entity is re-measured to fair value and a gain or loss is recognised in income statement. The Group will apply HKAS 27 (Revised) prospectively from 1 January 2010.

- HKFRS 3 (Revised), 'Business combinations' (effective from 1 July 2009). The revised standard continues to apply the acquisition method to business combinations, with some significant changes. For example, all payments to purchase a business are to be recorded at fair value at the acquisition date, with contingent payments classified as debt subsequently re-measured through the consolidated income statement. All acquisition-related costs should be expensed. The Group will apply HKFRS 3 (Revised) to all business combinations (other than common control combination) acquired on or after 1 January 2010.

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 from 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 will adopt HKFRS 8 with effect from 1 January 2009 and will accordingly present segmental information which reflects the operating segments used to make operating decisions at that time.

- HK(IFRIC)-Int 13 'Customer Loyalty Programmes' (effective from 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 will apply the interpretation from 1 January 2009. It is not expected to have significant impact on the Group's results of operations and financial position.

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)

- There are a number of improvements and amendments to HKFRS published in October 2008 by HKICPA which are not addressed above. The following amendments are unlikely to have an significant impact on the Group's financial statements and have therefore not been analysed in details.
    - HKAS 1 (Amendment), 'Presentation of financial statements' (effective from 1 January 2009)
    - HKAS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors' (effective from 1 January 2009)
    - HKAS 10, 'Events after the Balance Sheet Date' (effective from 1 July 2009)
    - HKAS 18, 'Revenue' (effective from 1 January 2009)
    - HKAS 34, 'Interim Financial Reporting' (effective from 1 January 2009)
    - HKAS 39 (Amendment), 'Financial instruments: Recognition and measurement' (effective from 1 July 2009)
    - HKFRS 5 (Amendment), 'Non-current assets held for sale and discontinued operations' (effective from 1 July 2009)
    - HKFRS 7, 'Financial instruments: Disclosures' (effective from 1 January 2009)

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 16 (Amendment), Property, plant and equipment (and consequential amendment to HKAS 7, Statement of cash flows) (effective from 1 January 2009)
- HKAS 19 (Amendment), Employee benefits (effective from 1 January 2009)
- HKAS 20 (Amendment), 'Accounting for government grants and disclosure of government assistance' (effective from 1 January 2009)
- HKAS 23 (Amendment), 'Borrowing costs' (effective from 1 January 2009)
- HKAS 27 (Amendment), 'Consolidated and separate financial statements' (effective from 1 January 2009)
- HKAS 28 (Amendment), 'Investment in associates' (and consequential amendments to HKAS 32, 'Financial Instruments: Presentation' and HKFRS 7, 'Financial instruments: Disclosures') (effective from 1 January 2009)
- HKAS 29 (Amendment), 'Financial reporting in hyperinflationary economies' (effective from 1 January 2009)
- HKAS 31 (Amendment), 'Interests in joint ventures (and consequential amendments to HKAS 32 and HKFRS 7) (effective from 1 January 2009)
- HKAS 32 (Amendment), 'Financial instruments: Presentation', and HKAS 1 (Amendment), 'Presentation of financial statements', 'Puttable financial instruments and obligations arising on liquidation' (effective from 1 January 2009)
- HKAS 38 (Amendment), 'Intangible assets' (effective from 1 January 2009)
- HKAS 40 (Amendment), 'Investment property' (and consequential amendments to HKAS 16) (effective from 1 January 2009)
- HKAS 41 (Amendment), 'Agriculture' (effective from 1 January 2009)
- HKFRS 1 (Amendment), 'First time adoption of HKFRS' and HKAS 27 'Consolidated and separate financial statements' (effective from 1 January 2009)
- HKFRS 2 (Amendment), 'Share-based payment' (effective from 1 January 2009)
- HK(IFRIC) - Int 15, 'Agreements for construction of real estates' (effective from 1 January 2009 and supercedes HK Int-3, 'Revenue – Pre-completion contracts for the sale of development properties)
- HK(IFRIC) – Int 16, 'Hedges of a net investment in a foreign operation' (effective from 1 October 2008)

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.2 Consolidation

The consolidated financial statements include the financial statements of the Company 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.

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.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

__2.2 Consolidation (continued)__

(1) Subsidiaries (continued)

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.

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 Company'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.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.4 Foreign currency translation (continued)

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.

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

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.

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

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

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.

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)

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.

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 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.

(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:

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 (continued)

- 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 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 and 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.

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 and debt securities in issue 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.

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.10 Recognition and de-recognition of financial instruments (continued)

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 or securities lending 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 or securities borrowing 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.

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:

Notes to the Financial Statements (continued)

2. Summary of significant accounting policies (continued)

2.12 Impairment of financial assets (continued)

(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

(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.

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)

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.

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.

2.16 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 straightline 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.

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 Current and deferred income taxes

Tax expenses for the period comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised directly in equity. In this case, the tax is also recognised in equity.

Income tax payable on profits, based on the applicable tax law enacted or substantially enacted at the balance sheet date in each jurisdiction where the Bank and the subsidiaries operate and generate taxable income, is recognised as a current income tax expense in the period in which profits arise.

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.

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 and 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 and 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 amount 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 Impairment of held-to-maturity and available-for-sale investments

The Group reviews its held-to-maturity and available-for-sale investment portfolios to assess impairment at least on a quarterly basis. In determining whether any of these investments is impaired, risk characteristics and performance such as external credit rating, market price etc will be assessed. The Group makes estimates on the default rate and loss severity of each investment with reference to market performance of the portfolios, current payment status of the issuers or performance of the underlying assets, or economic conditions that correlate with defaults on the collateralised assets. The methodology and assumptions used for the assessments are reviewed regularly.

Notes to the Financial Statements (continued)

3. Critical accounting estimates and judgements in applying accounting policies (continued)

3.3 Fair values of derivatives financial instruments

The fair values of derivatives financial instruments that are not quoted in active markets are determined by using valuation techniques. Valuation techniques used include discounted cash flows analysis and models with built-in functions available in externally acquired financial analysis or risk management systems widely used by the industry. To the extent practical, the models use only observable data.

3.4 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.

3.5 Provision

The Group uses judgment to assess whether the Group has a present legal or constructive obligation as a result of past events at each balance sheet date, and judgment is used to determine if it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and to determine a reliable estimate of the amount of the obligation.

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 and interest rate 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, 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 its obligation under a contract. It arises principally from lending, trade finance, treasury business including inter-bank transactions, investments in bonds and securities.

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 units, which are 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

In view of the rapidly changing market conditions since the outbreak of the Subprime crisis, the Bank has been continuously revisiting its lending strategies and conducting rigorous reviews on the concerned portfolios.

<u>Loans and advances</u>

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, objectively assessed and monitored by risk management units. A small business credit scorecard as a supplemental tool is used to assist the credit assessment of small enterprise credit facilities. A credit scoring system is used to process retail credit transactions, including residential mortgage loans and personal loans while a bank scorecard is used to assist the risk assessment of financial institutions' credit risk.

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.

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 of 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)

The Group's internal loan grading system divides loans into 5 categories with reference to HKMA's guidelines.

"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 mainly from foreign exchange transactions with counterparty and also 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. The Group has established a mechanism to update the value of its main type of collateral, real properties, with the use of public indices on a portfolio basis. Collateral is 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 2008 and 2007, the Group did not hold any collateral permitted to sell or re-pledge in the absence of default by the borrower.

Credit exposures

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

	2008	2007
	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	**8,585,754**	9,751,518
Placements with banks and other financial institutions maturing between 1 and 12 months	**8,721,608**	7,242,392
Financial assets designated at fair value through profit or loss		
- debt securities	**369,757**	1,036,422
Derivative financial instruments	**385,945**	176,682
Advances and other accounts	**15,908,861**	13,354,058
Investment in securities		
- debt securities - available-for-sale	**287,385**	89,771
- debt securities - held-to-maturity	**3,526,676**	4,666,248
- debt securities - loans and receivables	**77,645**	1,007,472
Other assets	**641,594**	1,049,398
Credit risk exposures relating to off-balance sheet items are as follows:		
Letters of guarantee issued	**925,729**	1,238,246
Loan commitment and other credit related liabilities	**3,763,460**	4,476,934
	43,194,414	44,089,141

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 are summarised by product type as follows:

	2008	2007
	HK$'000	HK$'000
Advances to customers		
Personal		
- Mortgages	**2,763,231**	2,603,353
- Others	**1,487,617**	1,575,490
Corporate		
- Commercial loans	**10,702,963**	7,974,075
- Trade finance	**823,293**	989,419
	15,777,104	13,142,337
Trade bills	**203,238**	266,260
Total	**15,980,342**	13,408,597

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 are analysed by internal credit grades as follows:

	2008			
	Pass	**Special mention**	**Sub-Standard or below**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**
Advances to customers				
Personal				
- Mortgages	**2,715,581**	**14,170**	**2,809**	**2,732,560**
- Others	**1,424,976**	**37,651**	**12**	**1,462,639**
Corporate				
- Commercial loans	**10,044,260**	**571,424**	**-**	**10,615,684**
- Trade finance	**755,058**	**48,600**	**-**	**803,658**
	14,939,875	**671,845**	**2,821**	**15,614,541**
Trade bills	**137,793**	**65,445**	**-**	**203,238**
Total	**15,077,668**	**737,290**	**2,821**	**15,817,779**

	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

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)

The occurrence of loss event(s) may not necessarily result in impairment loss where the loans are fully collateralised. While such 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 is analysed as follows:

	2008					
	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**	**Market value of collateral**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
Advances to customers						
Personal						
- Mortgages	**28,591**	**369**	**-**	**249**	**29,209**	**58,507**
- Others	**24,495**	**-**	**-**	**88**	**24,583**	**46,378**
Corporate						
- Commercial loans	**57,281**	**-**	**-**	**1,254**	**58,535**	**69,047**
- Trade finance	**3,941**	**-**	**-**	**-**	**3,941**	**5,028**
Total	**114,308**	**369**	**-**	**1,591**	**116,268**	**178,960**

	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	Market value of collateral
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Advances to customers						
Personal						
- Mortgages	34,961	897	-	483	36,341	93,485
- Others	43,315	-	-	167	43,482	72,894
Corporate						
- Commercial loans	100,076	-	-	3,197	103,273	306,484
- Trade finance	11,774	-	-	-	11,774	9,922
Total	190,126	897	-	3,847	194,870	482,785

	2008	2007
	HK$'000	HK$'000
Current market value of collateral held against the covered portion of advances to customers	**178,960**	482,785
Covered portion of advances to customers	**92,074**	167,088
Uncovered portion of advances to customers	**24,194**	27,782

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Gross loans and advances (continued)

(c) Impaired advances

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

	2008		2007	
	Gross advances	**Market value of collateral**	Gross advances	Market value of collateral
	HK$'000	**HK$'000**	HK$'000	HK$'000
Advances to customers				
Personal				
- Mortgages	**1,462**	**1,500**	-	-
- Others	**395**	**503**	394	477
Corporate				
- Commercial loans	**28,744**	**21,337**	27,401	25,117
- Trade finance	**15,694**	**10,386**	3,089	1,016
Total	**46,295**	**33,726**	30,884	26,610
Loan impairment allowances made in respect of such advances	**20,059**		10,984	

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

	2008	2007
	HK$'000	HK$'000
Current market value of collateral held against the covered portion of advances to customers	**33,726**	26,610
Covered portion of advances to customers	**28,561**	21,806
Uncovered portion of advances to customers	**17,734**	9,078

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

	2008	2007
	HK$'000	HK$'000
Gross classified or impaired advances to customers	**54,608**	**40,550**
Gross classified or impaired advances to customers as a percentage of gross advances to customers	**0.35%**	**0.31%**
Individually assessed loan impairment allowances made in respect of such advances	**20,059**	**10,984**

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.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Gross loans and advances (continued)

(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:

	2008		2007	
	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	**743**	**0.00%**	897	0.01%
- one year or less but over six months	**2,402**	**0.02%**	10,322	0.08%
- over one year	**14,817**	**0.09%**	22,948	0.17%
Advances overdue for over three months	**17,962**	**0.11%**	34,167	0.26%
Individually assessed loan impairment allowances made in respect of such advances	**7,742**		10,244	

	2008	2007
	HK$'000	HK$'000
Current market value of collateral held against the covered portion of advances to customers	**27,472**	39,943
Covered portion of advances to customers	**9,791**	22,501
Uncovered portion of advances to customers	**8,171**	11,666

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 2008 and 2007, there were no advances to banks and other financial institutions overdue for more than three months.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Gross loans and advances (continued)

(e) Rescheduled advances

	2008		2007	
	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	**4,280**	**0.03%**	1,121	0.01%

As at 31 December 2008, the total rescheduled advances to customers during the year amounted to HK$ 5,488,000 (2007: HK$3,576,000).

As at 31 December 2008 and 2007, 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:

	2008					
	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	815,035	20.70%	-	-	-	2,268
- Property investment	3,162,324	97.69%	-	11,542	-	13,399
- Financial concerns	376,451	22.91%	-	-	-	710
- Stockbrokers	-	-	-	-	-	-
- Wholesale and retail trade	640,119	74.82%	-	20,810	-	3,228
- Manufacturing	922,329	43.73%	10,674	8,147	6,173	3,848
- Transport and transport equipment	320,212	78.06%	-	2,007	-	2,077
- Recreational activities	793	100.00%	-	-	-	3
- Information technology	202,238	4.04%	-	1,300	-	356
- Others	587,963	58.95%	1,208	4,982	-	2,256
Individuals						
- Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	113,231	99.88%	710	2,130	169	85
- Loans for purchase of other residential properties	2,467,290	99.92%	3,584	27,607	24	1,552
- Others	1,282,300	92.94%	496	24,264	11	957
Total loans for use in Hong Kong	10,890,285	78.99%	16,672	102,789	6,377	30,739
Trade finance	823,292	58.33%	15,694	11,425	6,168	3,712
Loans for use outside Hong Kong	4,063,527	66.30%	22,242	34,825	7,514	16,971
Gross advances to customers	15,777,104	74.64%	54,608	149,039	20,059	51,422

*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)

	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

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:

	2008		2007	
	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	**408**	**-**	589	-
- Property investment	**2,410**	**-**	1,529	567
- Financial concerns	**128**	**-**	84	-
- Stockbrokers	**-**	**-**	1	-
- Wholesale and retail trade	**625**	**1,027**	2,047	568
- Manufacturing	**6,582**	**1,770**	2,836	1,702
- Transport and transport equipment	**374**	**-**	14	-
- Recreational activities	**1**	**-**	-	-
- Information technology	**64**	**-**	-	-
- Others	**405**	**-**	532	-
Individuals				
- Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	**185**	**-**	10	-
- Loans for purchase of other residential properties	**312**	**-**	168	-
- Others	**172**	**-**	63	-
Total loans for use in Hong Kong	**11,666**	**2,797**	7,873	2,837
Trade finance	**6,067**	**-**	1,730	-
Loans for use outside Hong Kong	**6,407**	**628**	6,627	894
Gross advances to customers	**24,140**	**3,425**	16,230	3,731

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 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

	2008	2007
	HK$'000	HK$'000
Hong Kong	**13,098,916**	11,765,150
Mainland China	**2,678,188**	1,377,187
	15,777,104	13,142,337
Collectively assessed loan impairment allowances in respect of the gross advances to customers		
Hong Kong	**(42,122)**	(35,695)
Mainland China	**(9,300)**	(7,860)
	(51,422)	(43,555)

Overdue advances

	2008	2007
	HK$'000	HK$'000
Hong Kong	**140,424**	220,004
Mainland China	**8,615**	5,356
	149,039	225,360
Individually assessed loan impairment allowances in respect of the overdue advances		
Hong Kong	**(8,892)**	(9,171)
Mainland China	**(2,837)**	(1,813)
	(11,729)	(10,984)
Collectively assessed loan impairment allowances in respect of the overdue advances		
Hong Kong	**(796)**	(2,441)
Mainland China	**(6)**	-
	(802)	(2,441)

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

	2008	2007
	HK$'000	HK$'000
Hong Kong	**46,651**	35,194
Mainland China	**7,957**	5,356
	54,608	40,550
Individually assessed loan impairment allowances in respect of the classified or impaired advances		
Hong Kong	**(17,222)**	(9,171)
Mainland China	**(2,837)**	(1,813)
	(20,059)	(10,984)
Collectively assessed loan impairment allowances in respect of the classified or impaired advances		
Hong Kong	**(58)**	(42)
Mainland China	**-**	-
	(58)	(42)

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	
	2008	2007
	HK$'000	HK$'000
Commercial properties	**7,190**	3,130
Residential properties	**-**	683
	7,190	3,813

The estimated market value of repossessed assets held by the Group as at 31 December 2008 amounted to HK$8,000,000 (2007: HK$16,100,000). 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)

Balances and placements with banks and other financial institutions

The following table presents an analysis of balances and placements with banks and other financial institutions that are neither overdue nor impaired as at 31 December by rating agency designation, based on Moody's ratings or their equivalent.

	2008			
	Aaa to A3	**Lower than A3**	**Unrated**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**
Central banks	**258,957**	**-**	**-**	**258,957**
Banks and other financial institutions	**16,115,993**	**1,494**	**780,257**	**16,897,744**
	16,374,950	**1,494**	**780,257**	**17,156,701**

	2007			
	Aaa to A3	Lower than A3	Unrated	Total
	HK$'000	HK$'000	HK$'000	HK$'000
Central banks	274,055	-	-	274,055
Banks and other financial institutions	15,852,842	175,656	540,667	16,569,165
	16,126,897	175,656	540,667	16,843,220

As at 31 December 2008 and 2007, there were no overdue or impaired balances and placements with banks and other financial institutions.

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 debt securities neither overdue 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.

	2008				
	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	**133,021**	**-**	**234,365**	**-**	**367,386**
Aa1 to Aa3	**194,452**	**-**	**2,421,248**	**-**	**2,615,700**
A1 to A3	**42,284**	**239,988**	**771,066**	**-**	**1,053,338**
Lower than A3	**-**	**27,785**	**-**	**-**	**27,785**
Unrated	**-**	**19,612**	**99,997**	**77,645**	**197,254**
	369,757	**287,385**	**3,526,676**	**77,645**	**4,261,463**

	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

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

	2008				
	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	**-**	**-**	**-**	**-**	**-**
Aa1 to Aa3	**-**	**-**	**99,997**	**77,645**	**177,642**
A1 to A3	**-**	**19,612**	**-**	**-**	**19,612**
Unrated	**-**	**-**	**-**	**-**	**-**
	-	**19,612**	**99,997**	**77,645**	**197,254**

	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

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.1 Credit Risk (continued)

Debt securities (continued)

As at 31 December 2008 and 2007, there were no impaired, overdue, mortgage-backed nor asset-backed debt securities.

4.2 Market Risk

Market risk is the risk of loss that results form movements in market rates and prices. The Group's market risk arises from customer-related business. The Group's market risk in the trading book arises from customer-related business. The risk includes potential losses arising from changes in foreign exchange and interest rates as well as equities and commodities prices. On the other hand, the major market risk in banking book arises from the group's investment portfolio. These positions are subject to monthly mark-to-market valuation. The risk includes potential losses arising from changing in foreign exchange, credit, liquidity, and interest rate risk.

Market risk management framework

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 its 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.

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.

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.

	2008							
	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	724,397	771,847	6,093,011	177,712	26,771	114,867	677,149	8,585,754
Placements with banks and other financial institutions maturing between one and twelve months	68,916	1,549,436	6,002,192	120,351	-	112,191	868,522	8,721,608
Financial assets designated at fair value through profit or loss	-	267,248	102,509	-	-	-	-	369,757
Derivative financial instruments	-	779	385,166	-	-	-	-	385,945
Advances and other accounts	1,167,194	3,004,555	11,694,881	12,534	27,362	2,335	-	15,908,861
Investment in securities								
-Available-for-sale securities	287,385	-	41,077	220	-	-	-	328,682
- Held-to-maturity securities	-	749,094	2,777,582	-	-	-	-	3,526,676
- Loans and receivables	-	-	77,645	-	-	-	-	77,645
Investment properties	-	-	80,050	-	-	-	-	80,050
Properties, plant and equipment	-	-	584,477	-	-	-	-	584,477
Other assets (including deferred tax assets)	1,071	3,350	636,122	-	1,051	-	-	641,594
Total assets	2,248,963	6,346,309	28,474,712	310,817	55,184	229,393	1,545,671	39,211,049

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

Currency risk (continued)

	2008							
	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	**(91,067)**	**(123,475)**	**(315,421)**	**(1,076)**	**(442,458)**	**-**	**(98,585)**	**(1,072,082)**
Financial liabilities designated at fair value through profit or loss	**-**	**(377,788)**	**(390,721)**	**-**	**-**	**-**	**-**	**(768,509)**
Derivative financial instruments	**-**	**(7,865)**	**(200,980)**	**-**	**-**	**-**	**-**	**(208,845)**
Deposits from customers	**(1,631,627)**	**(5,515,191)**	**(22,314,131)**	**(305,163)**	**(23,130)**	**(205,201)**	**(1,455,354)**	**(31,449,797)**
Other accounts and provisions (including current and deferred tax liabilities)	**(234,269)**	**(209,683)**	**(1,471,077)**	**(6,841)**	**-**	**(2,921)**	**(47,468)**	**(1,972,259)**
Total liabilities	**(1,956,963)**	**(6,234,002)**	**(24,692,330)**	**(313,080)**	**(465,588)**	**(208,122)**	**(1,601,407)**	**(35,471,492)**
Net on-balance sheet position	**292,000**	**112,307**	**3,782,382**	**(2,263)**	**(410,404)**	**21,271**	**(55,736)**	**3,739,557**
Off-balance sheet net notional position*	**13,406**	**(134,623)**	**(124,567)**	**6,353**	**410,082**	**(28,999)**	**55,747**	**197,399**
Contingent liabilities and commitments	**89,962**	**1,023,825**	**3,506,167**	**36,856**	**31,159**	**1,220**	**-**	**4,689,189**

* 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)

	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

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 according to approved limits 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 gap analysis 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.

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.2 Market Risk (continued)

Interest rate risk (continued)

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.

	2008						
	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	8,178,523	-	-	-	-	407,231	8,585,754
Placements with banks and other financial institutions maturing between one and twelve months	-	8,660,344	61,264	-	-	-	8,721,608
Financial assets designated at fair value through profit or loss	224,964	-	102,509	42,284	-	-	369,757
Derivative financial instruments	-	-	-	-	-	385,945	385,945
Advances and other accounts	13,715,466	1,904,819	257,250	16,286	15,040	-	15,908,861
Investment in securities							
- Available-for-sale securities	-	-	69,686	217,699	-	41,297	328,682
- Held-to-maturity securities	328,308	1,922,598	423,262	852,508	-	-	3,526,676
- Loans and receivables	-	77,645	-	-	-	-	77,645
Investment properties	-	-	-	-	-	80,050	80,050
Properties, plant and equipment	-	-	-	-	-	584,477	584,477
Other assets (including deferred tax assets)	-	-	-	-	-	641,594	641,594
Total assets	22,447,261	12,565,406	913,971	1,128,777	15,040	2,140,594	39,211,049
Liabilities							
Deposits and balances of banks and other financial institutions	(631,106)	(35,028)	-	-	-	(405,948)	(1,072,082)
Financial liabilities designated at fair value through profit or loss	(215,925)	(409,496)	(143,088)	-	-	-	(768,509)
Derivative financial instruments	-	-	-	-	-	(208,845)	(208,845)
Deposits from customers	(21,669,699)	(7,250,469)	(1,411,314)	(33,223)	-	(1,085,092)	(31,449,797)
Other accounts and provisions (including current and deferred tax liabilities)	(542,539)	-	-	-	-	(1,429,720)	(1,972,259)
Total liabilities	(23,059,269)	(7,694,993)	(1,554,402)	(33,223)		(3,129,605)	(35,471,492)
Interest sensitivity gap	(612,008)	4,870,413	(640,431)	1,095,554	15,040	(989,011)	(3,739,557)

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
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)

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 2008, 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$16,000,000 (2007: HK$15,500,000) lower by HKD and USD assets liabilities structure. The impact on reserves would be insignificant. The sensitivity analysis set out above is illustrative only.

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 for major currencies in its banking book. Subsidiaries are excluded from the analysis below:

	Impact on positions at 31 December	
Earnings perspective	**2008**	2007
Scenarios	**HK$'000**	HK$'000
Down 100 basis points parallel shift in HK dollar yield curves	**(22,000)**	(20,000)
Up 100 basis points parallel shift in US dollar yield curves	**(6,000)**	(4,500)

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. Other 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. The stress tests set out above are illustrative only.

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 2008, 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$1,468,000 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$217,000 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 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.

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.

	2008					
	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	**(1,037,271)**	**(35,292)**	**-**	**-**	**-**	**(1,072,563)**
Financial liabilities designated at fair value through profit or loss	**(2,725)**	**(4,910)**	**(361,332)**	**(242,895)**	**(293,904)**	**(905,766)**
Deposits from customers	**(22,719,988)**	**(7,207,984)**	**(1,424,432)**	**(139,828)**	**-**	**(31,492,232)**
Other financial liabilities	**(1,247,168)**	**(507,134)**	**(4,932)**	**(3,798)**	**-**	**(1,763,032)**
	(25,007,152)	**(7,755,320)**	**(1,790,696)**	**(386,521)**	**(293,904)**	**(35,233,593)**

	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)

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; and

- Bullion derivatives: bullion margin contracts.

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.

	2008					
	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	**(168,635)**	**(2,115)**	**(13,323)**	**-**	**-**	**(184,073)**
- Interest rate derivatives	**261**	**(110)**	**(514)**	**10,271**	**1,994**	**11,902**
- Bullion derivatives	**(6,031)**	**-**	**-**	**-**	**-**	**(6,031)**
	(174,405)	**(2,225)**	**(13,837)**	**10,271**	**1,994**	**(178,202)**

	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)
- Bullion derivatives	-	-	-	-	-	-
	(25,477)	(1,001)	(11,334)	(2,022)	-	(39,834)

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

	2008					
	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	(30,987)	(1,671)	-	-	-	(32,658)
- Inflow	30,981	1,673	-	-	-	32,654
- Equity derivatives:						
- Outflow	(633)	(276)	-	-	-	(909)
- Inflow	633	276	-	-	-	909
Total outflow	(31,620)	(1,947)	-	-	-	(33,567)
Total inflow	31,614	1,949	-	-	-	33,563

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)

	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
- 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

Off-balance sheet items

Loan commitments

The contractual amounts of the Group's off-balance sheet financial instruments as at 31 December 2008 that commit it to extend credit to customers and other facilities amounting to HK$ 3,763,460,000 (2007: HK$4,476,934,000) are maturing no later than 1 year.

Financial guarantees and other financial facilities

Financial guarantees as at 31 December 2008 amounting to HK$ 925,729,000 (2007: HK$1,238,246,000) 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.

	2008							
	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	1,080,477	7,505,277	-	-	-	-	-	8,585,754
Placements with banks and other financial institutions maturing between one and twelve months	-	-	8,660,344	61,264	-	-	-	8,721,608
Financial assets designated at fair value through profit or loss								
– debt securities designated at fair value through profit or loss								
- certificates of deposit held	-	-	-	-	-	-	-	-
- others	-	-	-	102,508	42,284	224,965	-	369,757
Derivative financial instruments	358,443	463	3,034	22,061	1,944	-	-	385,945
Advances and other accounts								
– advances to customers	1,207,415	955,869	1,138,648	2,442,009	5,348,420	4,575,315	37,947	15,705,623
– trade bills	90	91,584	105,763	5,801	-	-	-	203,238
Investment in securities								
– debt securities held for available-for-sales								
- others	-	-	-	69,686	217,699	-	-	287,385
– debt securities held for held-to-maturity								
- certificates of deposit held	-	-	100,085	-	-	-	-	100,085
- others	-	99,997	153,542	423,262	2,749,790	-	-	3,426,591
– debt securities held for loans and receivables	-	-	77,645	-	-	-	-	77,645
– equity securities	-	-	-	-	-	-	41,297	41,297
Investment properties	-	-	-	-	-	-	80,050	80,050
Properties, plant and equipment	-	-	-	-	-	-	584,477	584,477
Other assets (including deferred tax assets)	4,084	634,724	-	2,270	-	-	516	641,594
Total assets	2,650,509	9,287,914	10,239,061	3,128,861	8,360,137	4,800,280	744,287	39,211,049

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.3 Liquidity Risk (continued)

(b) Maturity analysis (continued)

	2008							
	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	(405,948)	(631,106)	(35,028)	-	-	-	-	(1,072,082)
Financial liabilities designated at fair value through profit or loss								
– certificates of deposit issued	-	-	-	-	-	-	-	-
– others	-	-	-	(340,325)	(158,289)	(269,895)	-	(768,509)
Derivative financial instruments	(174,452)	(314)	(3,083)	(23,131)	(6,829)	(1,036)	-	(208,845)
Deposits from customers	(14,834,911)	(7,879,881)	(7,188,468)	(1,411,314)	(135,223)	-	-	(31,449,797)
Other accounts and provisions (including current and deferred tax liabilities)	(624,669)	(659,761)	(513,822)	(98,324)	(75,683)	-	-	(1,972,259)
Total liabilities	(16,039,980)	(9,171,062)	(7,740,401)	(1,873,094)	(376,024)	(270,931)	-	(35,471,492)
Net liquidity gap	(13,389,471)	116,852	2,498,660	1,255,767	7,984,113	4,529,349	744,287	3,739,557

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
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
– 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
– equity securities	-	-	-	-	-	-	30,225	30,225
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

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 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 derived 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 it 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 its business development need sand risk profile.

(a) Capital adequacy ratio

	2008	2007
Capital adequacy ratio	**15.37%**	19.97%
Core capital ratio	**14.29%**	18.92%

Notes to the Financial Statements (continued)

4. Financial risk management (continued)

4.4 Capital management (continued)

(a) Capital adequacy ratio (continued)

The capital ratios 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.

The differences between the basis of consolidation for accounting and regulatory purposes are described in Note 26.

(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:

	2008	2007
	HK$'000	HK$'000
Core capital:		
Paid up ordinary share capital	**300,000**	300,000
Reserves	**3,374,891**	3,064,743
Profit and loss account	**(601,103)**	327,277
	3,073,788	3,692,020
Deductions from core capital	**(12,251)**	(13,181)
Core capital	**3,061,537**	3,678,839
Supplementary capital:		
Reserves on revaluation of premises and investment properties	**224**	224
Fair Value gain arising from holdings of available-for-sale securities	**1,317**	562
Collective loan impairment allowances	**51,422**	43,555
Regulatory reserve	**191,495**	172,274
	244,458	216,615
Deductions from supplementary capital	**(12,252)**	(13,181)
Supplementary capital	**232,206**	203,434
Total capital base after deductions	**3,293,743**	3,882,273

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.

	2008	2007
	HK$'000	HK$'000
Credit risk	**1,580,347**	1,440,138
Market risk	**13,837**	11,118
Operational risk	**155,062**	135,823
	1,749,246	1,587,079

(i) Capital requirements for credit risk

	2008					
		Exposures after CRM*		**Risk-weighted amount**		
	Total exposures	**Rated**	**Unrated**	**Rated**	**Unrated**	**Capital requirement****
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**	**HK$'000**
On-balance sheet exposures						
Sovereign	**401,224**	**404,779**	**-**	**17,184**	**-**	**1,375**
Public sector entity	**-**	**114,666**	**-**	**22,933**	**-**	**1,835**
Bank	**21,286,836**	**20,396,014**	**891,603**	**5,117,979**	**236,471**	**428,356**
Corporate	**9,269,441**	**63,333**	**8,837,904**	**63,333**	**8,837,904**	**712,099**
Cash items	**150,661**	**-**	**150,661**	**-**	**-**	**-**
Regulatory retail	**1,812,793**	**-**	**1,685,374**	**-**	**1,264,031**	**101,122**
Residential mortgage loans	**3,946,912**	**-**	**3,823,029**	**-**	**1,995,853**	**159,668**
Other exposures which are not past due	**1,331,615**	**-**	**1,252,259**	**-**	**1,252,259**	**100,181**
Past due exposures	**10,426**	**-**	**10,426**	**-**	**13,934**	**1,115**
Total for on-balance sheet exposures	**38,209,908**	**20,978,792**	**16,651,256**	**5,221,429**	**13,600,452**	**1,505,751**
Off-balance sheet exposures						
Off-balance sheet exposures other than OTC derivative transactions or credit derivative contracts	**976,367**	**8,530**	**967,837**	**2,244**	**912,510**	**73,180**
OTC derivative transactions	**34,344**	**30,308**	**4,036**	**13,661**	**4,036**	**1,416**
Total for off-balance sheet exposures	**1,010,711**	**38,838**	**971,873**	**15,905**	**916,546**	**74,596**
	39,220,619	**21,017,630**	**17,623,129**	**5,237,334**	**14,516,998**	**1,580,347**

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)

	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.

As at 31 December 2008, credit exposures deducted from the capital base amounted to HK$ 20,590,000 (2007: HK$ 22,449,000).

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

The Group's counterparty credit risk arising from over-the-counter ("OTC") derivative transactions, repo-style transactions both in trading and banking book is subject to the same risk management framework as above mentioned. 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 exposure due to fluctuations in the market value by determining the current exposure value of the transactions. Exceptions or excesses are timely and closely identified and monitored by credit risk management units.

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.

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 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.

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

	2008	2007
	HK$'000	HK$'000
Gross total positive fair value	**25,155**	16,229
Credit equivalent amount	**34,344**	24,131
Less: recognised collateral	**-**	-
Net credit equivalent amount	**34,344**	24,131
Net credit equivalent amounts analysed by type of issuer:		
Bank	**30,308**	15,088
Corporate	**3,001**	8,749
Others	**1,035**	294
	34.344	24,131
Risk weighted amounts analysed by type of issuer:		
Bank	**13,661**	4,087
Corporate	**3,001**	8,749
Others	**1,035**	294
	17,697	13,130
Notional amount of recognised credit derivative contracts which provide credit protection	**-**	-

There is no effect of valid bilateral netting agreement on the credit equivalent amounts of the derivative transactions as at 31 December 2008 (2007: Nil).

There are no outstanding repo-style transactions or credit derivative contracts as at 31 December 2008 and 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. In addition, real property collateral is also recognised for 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 the Banking (Capital) Rules.

According to the 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. To cope with the requirement under Pillar two, we have adopted a scorecard methodology to assess our credit concentration risk and consider whether add-on capital charge is needed to cover this risk.

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)

Credit risk mitigation (continued)

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

	2008		2007	
	Covered by recognised collateral	**Covered by recognised guarantees**	Covered by recognised collateral	Covered by recognised guarantees
	HK$'000	**HK$'000**	HK$'000	HK$'000
On-balance sheet exposures				
Corporate	**367,825**	**1,470**	529,424	-
Regulatory retail	**122,946**	**3,382**	171,607	5,197
Residential mortgage loans	**9,733**	**114,150**	56,750	110,760
Other exposures which are not past due	**79,356**	**-**	91,040	-
Past due exposures	**3,409**	**-**	2,999	-
Off-balance sheet exposures	**97,322**	**6,735**	532,207	-
	680,591	**125,737**	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

	2008	2007
	HK$'000	HK$'000
Interest rate exposures	**297**	350
Foreign exchange exposures	**13,540**	10,768
	13,837	11,118

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

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

	2008		2007	
	Long	**Short**	Long	Short
	HK$'000	**HK$'000**	HK$'000	HK$'000
Interest rate exposures	**750,220**	**750,747**	583,591	584,921
Foreign exchange exposures (Net)	**169,256**	**-**	134,600	-
	919,476	**750,747**	718,191	584,921

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)

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:

	2008	2007
	HK$'000	HK$'000
Realised gains from sales or liquidations	**-**	-
Unrealised gains on revaluation recognized in reserves but not through profit or loss	**1,546**	971
Unrealised gains included in supplementary capital	**696**	437

(iii) Capital charge for operational risk

	2008	2007
	HK$'000	HK$'000
Capital charge for operational risk	**155,062**	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 and fair value as at 31 December 2008 amounted to HK$3,526,676,000 (2007: HK$4,666,248,000) and HK$3,428,705,000 (2007: HK$4,586,413,000).

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

	2008	2007
	HK$'000	HK$'000
Interest income		
Cash and due from banks and other financial institutions	**469,709**	657,942
Advances to customers	**636,414**	748,169
Listed investments	**3,796**	3,634
Unlisted investments	**190,220**	347,031
Others	**16,351**	17,788
	1,316,490	1,774,564
Interest expense		
Due to banks, customers and other financial institutions	**(476,761)**	(945,687)
Debt securities in issue	**(4,742)**	(9,544)
Others	**(7,716)**	(27,566)
	(489,219)	(982,797)
Net interest income	**827,271**	791,767

Included within interest income is HK$464,000 (2007: HK$3,778,000) of interest with respect to income recognised on advances classified as impaired for the year ended 31 December 2008.

Included within interest income and interest expense are HK$1,287,318,000 (2007: HK$1,725,639,000) and HK$468,804,000 (2007: HK$835,044,000) 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

	2008	2007
	HK$'000	HK$'000
Fees and commission income		
Securities brokerage		
- Stockbroking	125,251	206,366
- Bonds	31,591	24,863
Credit cards	125	120
Bills commissions	45,876	39,757
Loan commissions	17,800	14,233
Payment services	20,592	19,803
Insurance	15,463	13,255
Asset management	4,497	25,173
Guarantees	1,906	584
Others		
- safe deposit box	9,866	9,971
- currency exchange	278	267
- information search	2,370	1,944
- correspondent banking	1,364	2,016
- low deposit balance accounts	1,020	1,270
- BOC cards	1,055	1,065
- postage and telegrams	856	2,087
- agency services	1,706	314
- dormant accounts	775	868
- sundries	10,926	16,722
	293,317	380,678
Fees and commission expenses	(47,692)	(64,553)
Net fees and commission income	245,625	316,125
Of which arise from		
- financial assets or financial liabilities not at fair value through profit or loss		
- Fees and commission income	26,544	16,581
- Fees and commission expenses	(401)	(894)
	26,143	15,687
- trust and other fiduciary activities		
- Fees and commission income	5,820	5,169
- Fees and commission expenses	(2,828)	(4,147)
	2,992	1,022

7. Net trading income

	2008	2007
	HK$'000	HK$'000
Net gain from:		
- foreign exchange and foreign exchange products	63,855	63,615
- interest rate instruments	(9,503)	16,398
- equity instruments	-	(1)
- commodities	806	(5)
	55,158	80,007

Notes to the Financial Statements (continued)

8. Net gain on investments in securities

	2008 HK$'000	2007 HK$'000
Net gain from redemption of held-to-maturity securities	**131**	-

9. Other operating income

	2008 HK$'000	2007 HK$'000
Dividend income from investments in securities		
- unlisted investments	**4,197**	3,042
Gross rental income from investment properties	**2,966**	2,563
Less: Outgoings in respect of investment properties	**(60)**	(50)
Others	**725**	176
	7,828	5,731

Included in the "Outgoings in respect of investment properties" is HK$26,000 (2007: HK$ Nil) of direct operating expenses related to investment properties that were not let during the year.

10. Net (charge)/reversal of impairment allowances

	2008 HK$'000	2007 HK$'000
Advances to customers		
Individually assessed		
- new allowances	**(14,891)**	(10,005)
- releases	**1,919**	1,856
- recoveries	**9,500**	37,648
Net (charge)/ reversal of individually assessed loan impairment allowances (Note 24)	**(3,472)**	29,499
Collectively assessed		
- new allowances	**(9,249)**	(6,225)
- releases	**1,389**	-
Net charge of collectively assessed loan impairment allowances (Note 24)	**(7,860)**	(6,225)
Net (charge) /reversal of loan impairment allowances	**(11,332)**	23,274
Others	**(1,756)**	-
Net (charge)/ reversal of impairment allowances	**(13,088)**	23,274

Notes to the Financial Statements (continued)

11. Operating expenses

	2008	2007
	HK$'000	HK$'000
Staff costs (including directors' emoluments)		
- salaries and other costs	160,096	155,257
- pension cost	14,828	11,356
	174,924	166,613
Premises and equipment expenses (excluding depreciation)		
- rental of premises	19,422	17,002
- information technology	29,548	30,194
- others	4,345	4,437
	53,315	51,633
Depreciation (Note 28)	13,706	13,154
Auditors' remuneration		
- audit services	2,933	3,104
- non-audit services	97	97
Other operating expenses	174,805	35,524
	419,780	270,125

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

	2008	2007
	HK$'000	HK$'000
Net gain on disposal of investment properties	-	1,391
Net gain on fair value adjustments on investment properties (Note 27)	2,100	9,910
	2,100	11,301

13. Net loss from disposal of properties, plant and equipment

	2008	2007
	HK$'000	HK$'000
Net loss on disposal of other fixed assets	(9)	(11)

Notes to the Financial Statements (continued)

14. Taxation

Taxation in the income statement represents:

	2008	2007
	HK$'000	HK$'000
Hong Kong profits tax		
- current year taxation	117,070	149,500
- over-provision in prior years	(2,500)	-
Deferred tax charge (Note 33)	(16,536)	991
Hong Kong profits tax	98,034	150,491
Overseas taxation	25,050	16,892
	123,084	167,383

Hong Kong profits tax has been provided at the rate of 16.5 % (2007: 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:

	2008	2007
	HK$'000	HK$'000
Profit before taxation	714,267	942,273
Calculated at a taxation rate of 16.5% (2007: 17.5%)	117,854	164,898
Effect of different taxation rates in other countries	4,864	1,346
Income not subject to taxation	(1,380)	(3,517)
Expenses not deductible for taxation purposes	4,246	4,656
Over-provision in prior years	(2,500)	-
Taxation charge	123,084	167,383
Effective tax rate	17.23%	17.76%

15. Profit attributable to equity holders of the Bank

The profit of the Bank for the year ended 31 December 2008 attributable to equity holders of the Bank and dealt with in the financial statements of the Bank amounted to HK$587,198,000 (2007: HK$771,939,000).

Notes to the Financial Statements (continued)

16. Dividends

	2008		2007	
	Per share HK$	**Total HK$'000**	Per share HK$	Total HK$'000
First interim dividend paid	**226**	**678,000**	74	222,000
Second interim dividend declared	**167**	**501,000**	90	270,000
	393	**1,179,000**	164	492,000

At a meeting held on 11 June 2008, the Board declared a first interim dividend of HK$226 per ordinary share for the first half of 2008 amounting to HK$678,000,000.

At a meeting held on 28 November 2008, the Board declared a second interim dividend of HK$167 per ordinary share for second half of 2008 amounting to HK$501,000,000.

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 2008 amounted to approximately HK$11,715,000 (2007: approximately HK$9,954,000), after a deduction of forfeited contributions of approximately HK$618,000 (2007: approximately HK$770,000). For the MPF Scheme, the Group contributed approximately HK$1,457,000 (2007: approximately HK$1,083,000) for the year ended 31 December 2008.

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 2008 (2007: 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 2008 are disclosed as follows:

	Total number of share options to Directors of the Group	**Average Exercise price (HK$ per share)**
At 1 January 2008	**934,300**	
Less: Share options exercised during the year	**(155,400)**	**8.5**
At 31 December 2008	**778,900**	
Exercisable at 31 December 2008	**778,900**	

	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	

Share options were exercised on a regular basis throughout the year, the weighted average share price during the year was HK$15.81 (2007: HK$18.89).

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:

	2008	2007
	HK$'000	HK$'000
Fees	**2,780**	980
Other emoluments		
- basic salaries and allowances	**3,047**	2,794
- discretionary bonuses	**1,781**	1,270
- others (including pension contributions)	**475**	497
	8,083	5,541

Fees of HK$660,000 (2007: HK$210,000) 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	
	2008	2007
	HK$'000	HK$'000
Cash	**150,661**	150,690
Balances with central banks	**258,957**	274,055
Balances with banks and other financial institutions	**670,859**	395,840
Placements with banks and other financial institutions maturing within one month	**7,505,277**	8,930,933
	8,585,754	9,751,518

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

	The Group and the Bank	
	2008	2007
	HK$'000	HK$'000
At fair value		
Debt securities		
- Unlisted	**369,757**	1,036,422

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

	The Group and the Bank	
	2008	2007
	HK$'000	HK$'000
Sovereigns	**42,284**	43,430
Banks and other financial institutions	**327,473**	992,992
	369,757	1,036,422

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

	The Group and the Bank	
	2008	2007
	HK$'000	HK$'000
Certificates of deposit held	**-**	324,945
Other financial assets designated at fair value through profit or loss	**369,757**	711,477
	369,757	1,036,422

Notes to the Financial Statements (continued)

22. Derivative financial instruments

The Group enters into the following equity, foreign exchange and 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		
	2008		
	Trading	Not qualified for hedge accounting*	Total
	HK$'000	HK$'000	HK$'000
Exchange rate contracts			
Spot and forwards	3,327,746	-	3,327,746
Foreign currency option contracts			
- Options purchased	5,917	-	5,917
- Options written	5,917	-	5,917
	3,339,580	-	3,339,580
Interest rate contracts			
Swaps	-	677,815	677,815
Bullion contracts	144,325	-	144,325
Equity contracts			
Equity option contracts			
- Options purchased	2,829	-	2,829
- Options written	2,829	-	2,829
	5,658	-	5,658
Total	3,489,563	677,815	4,167,378

* 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		
	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

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 2008					
	Fair value assets			Fair value liabilities		
	Trading HK$'000	Not qualified for hedge accounting HK$'000	Total HK$'000	Trading HK$'000	Not qualified for hedge accounting HK$'000	Total HK$'000
Exchange rate contracts						
Spot and forwards	368,496	-	368,496	190,367	-	190,367
Foreign currency option contracts						
- Options purchased	78	-	78	-	-	-
- Options written	-	-	-	78	-	78
	368,574	-	368,574	190,445	-	190,445
Interest rate contracts						
Swaps	-	5,396	5,396	-	12,164	12,164
Bullion contract	11,770	-	11,770	6,031	-	6,031
Equity contracts						
Equity option contracts						
- Options purchased	205	-	205	-	-	-
- Options written	-	-	-	205	-	205
	205	-	205	205	-	205
Total	380,549	5,396	385,945	196,681	12,164	208,845

	The Group and the Bank 2007					
	Fair value assets			Fair value liabilities		
	Trading HK$'000	Not qualified for hedge accounting HK$'000	Total HK$'000	Trading HK$'000	Not qualified for hedge accounting HK$'000	Total HK$'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

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	
	2008	2007
	HK$'000	HK$'000
Exchange rate contracts		
Forwards	**16,605**	10,654
Foreign currency option contracts		
- Options purchased	**-**	8
Interest rate contracts		
Swaps	**1,093**	2,468
	17,698	13,130

The credit risk weighted amounts are the amounts that have been calculated in accordance with the Banking (Capital) Rules. 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 28% (2007: 44%) 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	
	2008	2007
	HK$'000	HK$'000
Personal loans and advances	**4,250,849**	4,178,843
Corporate loans and advances	**11,526,255**	8,963,494
Advances to customers	**15,777,104**	13,142,337
Loan impairment allowances		
- Individually assessed	**(20,059)**	(10,984)
- Collectively assessed	**(51,422)**	(43,555)
	(71,481)	(54,539)
Trade bills	**203,238**	266,260
Total	**15,908,861**	13,354,058

As at 31 December 2008, advances to customers include accrued interest on gross advances of HK$40,881,000 (2007: HK$34,339,000).

As at 31 December 2008 and 2007, no impairment allowance was made in respect of trade bills.

24. Loan impairment allowances

	The Group and the Bank		
	2008		
	Individual assessment		
	Personal	**Corporate**	**Total**
	HK$'000	**HK$'000**	**HK$'000**
At 1 January 2008	**36**	**10,948**	**10,984**
(Credited)/Charged to income statement (Note 10)	**(141)**	**3,613**	**3,472**
Loans written off during the year as uncollectible	**-**	**(3,425)**	**(3,425)**
Recoveries	**319**	**9,181**	**9,500**
Unwind of discount on allowance	**(10)**	**(454)**	**(464)**
Translation difference	**-**	**(8)**	**(8)**
At 31 December 2008	**204**	**19,855**	**20,059**

	The Group and the Bank		
	2008		
	Collective assessment		
	Personal	**Corporate**	**Total**
	HK$'000	**HK$'000**	**HK$'000**
At 1 January 2008	**2,436**	**41,119**	**43,555**
Charged to income statement (Note 10)	**474**	**7,386**	**7,860**
Translation difference	**-**	**7**	**7**
At 31 December 2008	**2,910**	**48,512**	**51,422**

Notes to the Financial Statements (continued)

24. Loan impairment allowances (continued)

	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)

25. Investment in securities

	The Group 2008 HK$'000	The Group 2007 HK$'000
(a) Available-for-sale securities		
Debt securities, at fair value - Unlisted	**287,385**	89,771
Equity securities, at fair value - Unlisted	**41,297**	30,225
	328,682	119,996
(b) Held-to-maturity securities		
Listed, at amortised cost - outside Hong Kong	**157,190**	78,306
Unlisted, at amortised cost	**3,369,486**	4,587,942
	3,526,676	4,666,248
(c) Loans and receivables		
Unlisted, at amortised cost	**77,645**	1,007,472
Total	**3,933,003**	5,793,716
Market value of listed held-to-maturity securities	**155,823**	77,953

	The Bank 2008 HK$'000	The Bank 2007 HK$'000
(a) Available-for-sale securities		
Debt securities, at fair value - Unlisted	**287,385**	89,771
Equity securities, at fair value - Unlisted	**2,126**	1,562
	289,511	91,333
(b) Held-to-maturity securities		
Listed, at amortised cost - outside Hong Kong	**157,190**	78,306
Unlisted, at amortised cost	**3,369,486**	4,587,942
	3,526,676	4,666,248
(c) Loans and receivables		
Unlisted, at amortised cost	**77,645**	1,007,472
Total	**3,893,832**	5,765,053
Market value of listed held-to-maturity securities	**155,823**	77,953

Notes to the Financial Statements (continued)

25. Investment in securities (continued)

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

	The Group			
	2008			
	Available-for-sale securities	**Held-to-maturity securities**	**Loans and receivables**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**
Sovereigns	**-**	**99,997**	**-**	**99,997**
Public sector entities	**-**	**-**	**-**	**-**
Banks and other financial institutions	**287,385**	**3,426,679**	**77,645**	**3,791,709**
Corporate entities	**41,297**	**-**	**-**	**41,297**
	328,682	**3,526,676**	**77,645**	**3,933,003**

	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 Bank			
	2008			
	Available-for-sale Securities	**Held-to-maturity securities**	**Loans and receivables**	**Total**
	HK$'000	**HK$'000**	**HK$'000**	**HK$'000**
Sovereigns	**-**	**99,997**	**-**	**99,997**
Public sector entities	**-**	**-**	**-**	**-**
Banks and other financial institutions	**287,385**	**3,426,679**	**77,645**	**3,791,709**
Corporate entities	**2,126**	**-**	**-**	**2,126**
	289,511	**3,526,676**	**77,645**	**3,893,832**

	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

Notes to the Financial Statements (continued)

25. Investment in securities (continued)

The movements in investment in securities are summarised as follows:

	The Group		
	2008		
	Available-for-sale securities	**Held-to-maturity securities**	**Loans and receivables**
	HK$'000	**HK$'000**	**HK$'000**
At 1 January 2008	**119,996**	**4,666,248**	**1,007,472**
Additions	**188,692**	**4,112,483**	**989,695**
Disposals, redemptions and maturity	**-**	**(5,176,096)**	**(1,955,903)**
Amortisation	**2,035**	**13,578**	**75,403**
Change in fair value	**12,187**	**-**	**-**
Exchange differences	**5,772**	**(89,537)**	**(39,022)**
At 31 December 2008	**328,682**	**3,526,676**	**77,645**

	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

Notes to the Financial Statements (continued)

25. Investment in securities (continued)

	The Bank 2008 Available-for-sale securities HK$'000	The Bank 2008 Held-to-maturity securities HK$'000	The Bank 2008 Loans and receivables HK$'000
At 1 January 2008	**91,333**	**4,666,248**	**1,007,472**
Additions	**188,692**	**4,112,483**	**989,695**
Disposals, redemptions and maturity	**-**	**(5,176,096)**	**(1,955,903)**
Amortisation	**2,035**	**13,578**	**75,403**
Change in fair value	**1,679**	**-**	**-**
Exchange differences	**5,772**	**(89,537)**	**(39,022)**
At 31 December 2008	**289,511**	**3,526,676**	**77,645**

	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

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

	The Group			
	2008	2007	**2008**	2007
	Available-for-sale securities		**Held-to-maturity securities**	
	HK$'000	HK$'000	**HK$'000**	HK$'000
Treasury bills	**-**	-	**99,997**	199,852
Certificates of deposit held	**-**	-	**100,085**	21,045
Others	**328,682**	119,996	**3,326,594**	4,445,351
	328,682	119,996	**3,526,676**	4,666,248

	The Bank			
	2008	2007	**2008**	2007
	Available-for-sale securities		**Held-to-maturity securities**	
	HK$'000	HK$'000	**HK$'000**	HK$'000
Treasury bills	**-**	-	**99,997**	199,852
Certificates of deposit held	**-**	-	**100,085**	21,045
Others	**289,511**	91,333	**3,326,594**	4,445,351
	289,511	91,333	**3,526,676**	4,666,248

Notes to the Financial Statements (continued)

26. Investment in subsidiaries

	The Bank	
	2008	2007
	HK$'000	HK$'000
Unlisted shares, at cost	**3,913**	3,913
Amount due from subsidiaries (Note)	**20,340**	20,332
Amount due to subsidiaries (Note)	**(30,888)**	(28,306)
	(6,635)	(4,061)

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 2008:

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 pursuant to section 18A of the Professional Accountants Ordinance.

Notes to the Financial Statements (continued)

27. Investment properties

	The Group and the Bank	
	2008	2007
	HK$'000	HK$'000
At 1 January	**64,450**	54,540
Disposals	**-**	(13,500)
Fair value gains (Note 12)	**2,100**	9,910
Reclassification from properties, plant and equipment (Note 28)	**13,500**	13,500
At 31 December	**80,050**	64,450

As at 31 December 2008, investment properties are included in the consolidated balance sheet at valuation carried out at 31 December 2008 on the basis of their fair value by an independent firm of chartered surveyors, Knight Frank Petty Limited.

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

	The Group and the Bank	
	2008	2007
	HK$'000	HK$'000
Held in Hong Kong		
On long-term lease (over 50 years)	**74,570**	60,630
Held outside Hong Kong		
On medium-term lease (10 – 50 years)	**5,480**	3,820
	80,050	64,450

Notes to the Financial Statements (continued)

28. Properties, plant and equipment

	The Group		
	Premises	Equipment, fixtures and fittings	Total
	HK$'000	HK$'000	HK$'000
Net book value at 1 January 2008	**541,130**	**30,198**	**571,328**
Additions	**-**	**9,600**	**9,600**
Disposals	**-**	**(9)**	**(9)**
Revaluation	**30,741**	**-**	**30,741**
Depreciation for the year (Note 11)	**(6,581)**	**(7,125)**	**(13,706)**
Reclassification to investment properties (Note 27)	**(13,500)**	**-**	**(13,500)**
Exchange adjustments	**-**	**23**	**23**
Net book value at 31 December 2008	**551,790**	**32,687**	**584,477**
At 31 December 2008			
Cost or valuation	**551,790**	**107,706**	**659,496**
Accumulated depreciation and impairment	**-**	**(75,019)**	**(75,019)**
Net book value at 31 December 2008	**551,790**	**32,687**	**584,477**
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

The analysis of cost or valuation of the above assets is as follows:			
At 31 December 2008			
At cost	**-**	**107,706**	**107,706**
At valuation	**551,790**	**-**	**551,790**
	551,790	**107,706**	**659,496**
At 31 December 2007			
At cost	-	104,697	104,697
At valuation	541,130	-	541,130
	541,130	104,697	645,827

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 2008	**536,130**	**30,198**	**566,328**
Additions	**-**	**9,600**	**9,600**
Disposals	**-**	**(9)**	**(9)**
Revaluation	**29,391**	**-**	**29,391**
Depreciation for the year	**(6,431)**	**(7,125)**	**(13,556)**
Reclassification to investment properties (Note 27)	**(13,500)**	**-**	**(13,500)**
Exchange adjustments	**-**	**23**	**23**
Net book value at 31 December 2008	**545,590**	**32,687**	**578,277**
At 31 December 2008			
Cost or valuation	**545,590**	**107,706**	**653,296**
Accumulated depreciation and impairment	**-**	**(75,019)**	**(75,019)**
Net book value at 31 December 2008	**545,590**	**32,687**	**578,277**
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

The analysis of cost or valuation of the above assets is as follows:			
At 31 December 2008			
At cost	**-**	**107,706**	**107,706**
At valuation	**545,590**	**-**	**545,590**
	545,590	**107,706**	**653,296**
At 31 December 2007			
At cost	-	104,697	104,697
At valuation	536,130	-	536,130
	536,130	104,697	640,827

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	
	2008	2007
	HK$'000	HK$'000
Held in Hong Kong		
On long-term lease (over 50 years)	**360,790**	362,270
On medium-term lease (10 – 50 years)	**167,340**	168,050
Held outside Hong Kong		
On long-term lease (over 50 years)	**21,570**	9,330
On medium-term lease (10 – 50 years)	**2,090**	1,480
	551,790	541,130

	The Bank	
	2008	2007
	HK$'000	HK$'000
Held in Hong Kong		
On long-term lease (over 50 years)	**360,790**	362,270
On medium-term lease (10 – 50 years)	**161,140**	163,050
Held outside Hong Kong		
On long-term lease (over 50 years)	**21,570**	9,330
On medium-term lease (10 – 50 years)	**2,090**	1,480
	545,590	536,130

As at 31 December 2008, premises are included in the consolidated balance sheet at valuation carried out at 31 December 2008 on the basis of their fair value by an independent firm of chartered surveyors, Knight Frank Petty 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	
	2008	2007
	HK$'000	HK$'000
Increase in valuation credited to premises revaluation reserve	**30,741**	57,715

	The Bank	
	2008	2007
	HK$'000	HK$'000
Increase in valuation credited to premises revaluation reserve	**29,391**	55,827

As at 31 December 2008, 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$ 155,607,000 (2007: HK$162,415,000).

Notes to the Financial Statements (continued)

29. Other assets

	The Group and the Bank	
	2008	2007
	HK$'000	HK$'000
Repossessed assets	**7,190**	7,543
Accounts receivable and prepayments	**634,404**	1,041,855
	641,594	1,049,398

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

	The Group and the Bank	
	2008	2007
	HK$'000	HK$'000
Structured deposits (Note 31)	**768,509**	2,189,452
Certificates of deposit issued	**-**	295,740
	768,509	2,485,192

The carrying amount of financial liabilities designated at fair value through profit or loss as at 31 December 2008 is less than the amount that the Group and the Bank would be contractually required to pay at maturity to the holder by HK$14,979,000 (2007: HK$7,982,000). The amount of change in their fair values, during the year and cumulatively, attributable to changes in credit risk is insignificant.

Notes to the Financial Statements (continued)

31. Deposits from customers

	The Group	
	2008	2007
	HK$'000	HK$'000
Current, savings and other deposit accounts (per consolidated balance sheet)	**31,449,797**	29,328,028
Structured deposits reported as financial liabilities designated at fair value through profit or loss (Note 30)	**768,509**	2,189,452
	32,218,306	31,517,480
Analysed by :		
Demand deposits and current accounts		
- corporate customers	**1,602,658**	1,270,123
- individual customers	**332,705**	306,926
	1,935,363	1,577,049
Savings deposits		
- corporate customers	**2,521,612**	3,117,766
- individual customers	**10,116,034**	9,169,330
	12,637,646	12,287,096
Time, call and notice deposits		
- corporate customers	**4,733,983**	3,663,655
- individual customers	**12,142,805**	11,800,228
	16,876,788	15,463,883
	31,449,797	29,328,028

Notes to the Financial Statements (continued)

31. Deposits from customers (continued)

	The Bank	
	2008	2007
	HK$'000	HK$'000
Current, savings and other deposit accounts (per consolidated balance sheet)	**31,483,825**	29,360,833
Structured deposits reported as financial liabilities designated at fair value through profit or loss (Note 30)	**768,509**	2,189,452
	32,252,334	31,550,285
Analysed by :		
Demand deposits and current accounts		
- corporate customers	**1,620,725**	1,286,984
- individual customers	**332,705**	306,926
	1,953,430	1,593,910
Savings deposits		
- corporate customers	**2,537,573**	3,133,710
- individual customers	**10,116,034**	9,169,330
	12,653,607	12,303,040
Time, call and notice deposits		
- corporate customers	**4,733,983**	3,663,655
- individual customers	**12,142,805**	11,800,228
	16,876,788	15,463,883
	31,483,825	29,360,833

32. Other accounts and provisions

	The Group		The Bank	
	2008	2007	**2008**	2007
	HK$'000	HK$'000	**HK$'000**	HK$'000
Dividend payable	**501,404**	270,404	**501,404**	270,404
Accruals and other payables	**1,276,838**	1,388,663	**1,276,364**	1,387,856
Provisions	**118,567**	-	**118,567**	-
	1,896,809	1,659,067	**1,896,335**	1,658,260

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					
	2008					
	Accelerated tax depreciation	**Asset revaluation**	**Losses**	**Impairment allowance**	**Other temporary difference**	**Total**
	HK$’000	**HK$’000**	**HK$’000**	**HK$’000**	**HK$’000**	**HK$’000**
At 1 January 2008	**6,211**	**69,615**	**(375)**	**(8,115)**	**-**	**67,336**
Charged/(credited) to income statement (Note 14)	**24**	**1,234**	**9**	**926**	**(18,729)**	**(16,536)**
Charged to equity	**-**	**2,583**	**-**	**-**	**-**	**2,583**
At 31 December 2008	**6,235**	**73,432**	**(366)**	**(7,189)**	**(18,729)**	**53,383**

	The Group					
	2007					
	Accelerated tax depreciation	Asset revaluation	Losses	Impairment allowance	Other temporary difference	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 Bank				
	2008				
	Accelerated tax depreciation	**Asset revaluation**	**Impairment allowance**	**Other temporary difference**	**Total**
	HK$’000	**HK$’000**	**HK$’000**	**HK$’000**	**HK$’000**
At 1 January 2008	**6,020**	**67,956**	**(8,115)**	**-**	**65,861**
Charged/(credited) to income statement	**37**	**1,235**	**926**	**(18,729)**	**(16,531)**
Charged to equity	**-**	**3,668**	**-**	**-**	**3,668**
At 31 December 2008	**6,057**	**72,859**	**(7,189)**	**(18,729)**	**52,998**

	The Bank				
	2007				
	Accelerated tax depreciation	Asset revaluation	Impairment allowance	Other temporary difference	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

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	
	2008	2007	**2008**	2007
	HK$'000	HK$'000	**HK$'000**	HK$'000
Deferred tax assets	**-**	-	**-**	-
Deferred tax liabilities	**(53,383)**	(67,336)	**(52,998)**	(65,861)
	(53,383)	(67,336)	**(52,998)**	(65,861)

	The Group	
	2008	2007
	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	**(71,885)**	(65,831)
	(71,885)	(65,831)

	The Bank	
	2008	2007
	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	**(71,499)**	(65,643)
	(71,499)	(65,643)

The deferred tax charged to equity during the year is as follows:

	The Group	
	2008	2007
	HK$'000	HK$'000
Fair value reserves in shareholders' equity:		
- premises	**3,861**	8,005
- available-for-sale securities	**(1,278)**	1,505
	2,583	9,510

	The Bank	
	2008	2007
	HK$'000	HK$'000
Fair value reserves in shareholders' equity:		
- premises	**3,659**	7,675
- available-for-sale securities	**9**	218
	3,668	7,893

Notes to the Financial Statements (continued)

34. Share capital

	2008 HK$'000	2007 HK$'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 23 to 24 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:

	2008	2007
	HK$'000	HK$'000
Operating profit	712,176	930,983
Depreciation	13,706	13,154
Net charge/(reversal) of loan impairment allowances	11,332	(23,274)
Unwind of discount on impairment	(464)	(3,778)
Advances written off net of recoveries	6,075	33,917
Change in cash and balances with banks and other financial institutions with original maturity over three months	205,163	310,534
Change in placements with banks and other financial institutions with original maturity over three months	1,776,722	352,803
Change in financial assets designated at fair value through profit or loss	666,665	184,555
Change in derivative financial instruments	(51,542)	(46,726)
Change in advances and other accounts	(2,571,746)	(2,259,699)
Change in investment in securities	1,773,045	1,584,495
Change in other assets	407,804	(48,136)
Change in deposits and balances of banks and other financial institutions	(13,513)	459,727
Change in financial liabilities designated at fair value through profit or loss	(1,716,683)	(834,013)
Change in deposits from customers	2,121,769	4,785,333
Change in other accounts and provisions	6,742	194,629
Exchange difference	1,863	929
Operating cash inflow before taxation	3,349,114	5,635,433
Cash flows from operating activities included:		
- Interest received	1,421,719	1,716,843
- Interest paid	(526,297)	(968,526)
- Dividend received	4,197	3,042

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

	2008	2007
	HK$'000	HK$'000
Cash and balances with banks and other financial institutions with original maturity within three months	8,444,292	9,404,893
Placements with banks and other financial institutions with original maturity within three months	6,300,748	3,044,811
Treasury bills with original maturity within three months	99,997	199,853
	14,845,037	12,649,557

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:

	2008	2007
	HK$'000	HK$'000
Direct credit substitutes	**17,829**	20,100
Transaction-related contingencies	**155,096**	120,791
Trade-related contingencies	**752,804**	1,097,355
Commitments that are unconditionally cancellable without prior notice	**267,529**	-
Other commitments with an original maturity of		
- up to one year	**3,147,320**	3,809,005
- over one year	**348,611**	667,929
	4,689,189	5,715,180
Credit risk weighted amount	**914,754**	1,195,157

The calculation basis of credit risk weighted amount has been set out in Note 22 to the financial statements.

38. Capital commitments

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

	2008	2007
	HK$'000	HK$'000
Authorised and contracted for but not provided for	**1,665**	-
Authorised but not contracted for	**960**	-
	2,625	-

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:

	2008	2007
	HK$'000	HK$'000
Land and buildings		
- not later than one year	**19,428**	14,886
- later than one year but not later than five years	**30,900**	24,482
- later than five years	**405**	-
	50,733	39,368

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:

	2008	2007
	HK$'000	HK$'000
Land and buildings		
- not later than one year	**3,375**	1,252
- later than one year but not later than five years	**2,826**	90
	6,201	1,342

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 defenses 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. 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)

	2008							
	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	(215,919)	423,900	619,290	-	-	827,271	-	827,271
- inter-segment	494,564	(114,045)	(367,923)	(12,596)	-	-	-	-
	278,645	309,855	251,367	(12,596)	-	827,271	-	827,271
Net fees and commission income /(expenses)	171,717	74,419	(713)	-	202	245,625	-	245,625
Net trading income	32,342	24,030	(2,272)	1,058	-	55,158	-	55,158
Net gain on financial instruments designated at fair value through profit or loss	-	-	9,031	-	-	9,031	-	9,031
Net gain on investments in securities	-	-	131	-	-	131	-	131
Other operating income	726	424	-	29,957	-	31,107	(23,279)	7,828
Net operating income before impairment allowances	483,430	408,728	257,544	18,419	202	1,168,323	(23,279)	1,145,044
Net charge of impairment allowances	(967)	(12,121)	-	-	-	(13,088)	-	(13,088)
Net operating income	482,463	396,607	257,544	18,419	202	1,155,235	(23,279)	1,131,956
Operating expenses	(342,943)	(67,119)	(6,678)	(8,653)	(17,666)	(443,059)	23,279	(419,780)
Operating profit/(loss)	139,520	329,488	250,866	9,766	(17,464)	712,176	-	712,176
Net gain from disposal of/fair value adjustments on investment properties	-	-	-	2,100	-	2,100	-	2,100
Net loss from disposal of properties, plant and equipment	-	-	-	(9)	-	(9)	-	(9)
Profit/(loss) before taxation	139,520	329,488	250,866	11,857	(17,464)	714,267	-	714,267
Assets								
Segment assets	5,940,481	11,530,931	21,088,656	644,436	6,545	39,211,049	-	39,211,049
Liabilities								
Segment liabilities	28,030,177	5,918,266	810,860	502,985	209,204	35,471,492	-	35,471,492
Other information								
Additions of properties, plant and equipment	-	-	-	9,600	-	9,600	-	9,600
Depreciation	5,568	1,346	157	6,275	360	13,706	-	13,706
Amortisation of securities	-	-	91,016	-	-	91,016	-	91,016

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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)

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:

	2008	2007
	HK$'000	HK$'000
Aggregate amount of relevant loans outstanding at year end	**1,085**	1,306
Maximum aggregate amount of relevant loans outstanding during the year	**1,306**	1,519

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 Bank of China Limited ("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:

		2008	
	Notes	**Immediate and intermediate holding companies**	**Other related parties[1]**
		HK$'000	**HK$'000**
Income statement items:			
Interest income	(i)	**100,629**	**9,555**
Interest expense	(ii)	**(12,284)**	**(14,631)**
Insurance commission received (net)	(iii)	**-**	**10,275**
Administrative services fees paid/ payable	(iv)	**(40,422)**	**(2,482)**
Credit card commission received/ receivable (net)	(v)	**-**	**125**
Securities brokerage commission paid/payable (net)	(v)	**-**	**(15,103)**
Rental, property management and letting agency fees paid/payable	(v)	**(1,436)**	**-**
Funds selling commission received	(vi)	**-**	**1,905**
Net trading gains		**7,199**	**-**

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	2007 Immediate and intermediate holding companies HK$'000	2007 Other related parties[1] HK$'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	**2008** **Immediate and intermediate holding companies** **HK$'000**	**2008** **Other related parties[1]** **HK$'000**
Balance sheet items:			
Cash and balances with banks and other financial institutions	(i)	**2,324,410**	**213,652**
Placements with banks and other financial institutions maturing between one and twelve months	(i)	**2,700,099**	**341,959**
Derivative financial instruments assets	(vii)	**25,135**	**-**
Advances and other accounts	(viii)	**-**	**250,113**
Investment in securities		**66,105**	**-**
Other assets	(viii)	**243,607**	**90,134**
Deposits and balances of banks and other financial institutions	(ii)	**(906,210)**	**(127,767)**
Deposits from customers	(ii)	**-**	**(1,733,168)**
Derivative financial instruments liabilities	(vii)	**(8,269)**	**-**
Other accounts and provisions	(viii)	**(672,768)**	**(105,081)**
Off-balance sheet items:			
Contingent liabilities and commitments	(ix)	**-**	**2,360**

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)

		2007	
	Notes	Immediate and intermediate holding companies	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

[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 2008 the aggregate notional amount of such derivative transactions amounted to HK$ 538,510,000 (2007: HK$ 676,178,000) whilst the corresponding derivative financial instruments assets and liabilities amounted to HK$ 25,135,000 (2007: HK$ 779,000) and HK$ 8,269,000 (2007: HK$10,266,000) 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 2008 and 31 December 2007 is detailed as follows:

	2008	2007
	HK$'000	HK$'000
Salaries and other short-term employee benefits	**8,083**	5,541

(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:

	2008		2007	
	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	**2,647**	**40,688**	2,653	41,824
Due from banks and other financial institutions	**3,054**	**257,244**	1,776	128,225

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 Investments Limited 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 2008 (2007: 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:

(i) Financial assets/financial liabilities

	2008		2007	
	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
Investment in security	**985**	**100,290**	-	-
Due from banks and other financial institutions	**6,477**	**84,897**	10,354	136,383

	2008	2007
	HK$'000	HK$'000
(ii) Contingent liabilities and commitments (including guarantees)	**3,626**	-

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

	2008		2007	
	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)	**16,361**	**871,516**	22,989	272,567
Investment in securities	**2,752**	**118,729**	885	67,072
Due from banks and other financial institutions	**10,319**	**222,083**	33,932	730,404
Due to banks and other financial institutions	**(148)**	**13,843**	(7,085)	15,930
Deposits from customers	**(4,685)**	**419,325**	(13,119)	391,686

	2008	2007
	HK$'000	HK$'000
(ii) Contingent liabilities and commitments (including guarantees)	**328,018**	382,789

Notes to the Financial Statements (continued)

44. Liquidity ratio

	2008	2007
Average liquidity ratio	**42.88%**	44.63%

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.

	2008							
	Equivalent in thousand of HK$							
	US Dollars	**Euro Dollars**	**Pound Sterling**	**Australian Dollars**	**New Zealand Dollars**	**Renminbi Yuan**	**Others**	**Total**
Spot assets	**6,715,039**	**310,763**	**229,389**	**802,527**	**588,802**	**2,185,128**	**208,593**	**11,040,241**
Spot liabilities	**(6,581,930)**	**(312,986)**	**(208,112)**	**(771,893)**	**(585,682)**	**(2,034,826)**	**(708,380)**	**(11,203,809)**
Forward purchases	**506,026**	**15,586**	**8,393**	**6,446**	**1,348**	**382,375**	**519,694**	**1,439,868**
Forward sales	**(652,399)**	**(9,235)**	**(37,391)**	**(38,487)**	**(3,775)**	**(368,969)**	**(19,396)**	**(1,129,652)**
Net long/(short) position	**(13,264)**	**4,128**	**(7,721)**	**(1,407)**	**693**	**163,708**	**511**	**146,648**
Net structural position	**-**	**-**	**-**	**-**	**-**	**68,182**	**-**	**68,182**

	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

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 2008				
Asia, other than Hong Kong				
- Mainland China	**5,735,000**	**297,000**	**752,000**	**6,784,000**
- Others	**4,540,000**	**-**	**426,000**	**4,966,000**
	10,275,000	**297,000**	**1,178,000**	**11,750,000**
Western Europe	**8,418,000**	**-**	**7,000**	**8,425,000**
Total	**18,693,000**	**297,000**	**1,185,000**	**20,175,000**

	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

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:

	2008			
	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	**2,788,073**	**602,618**	**3,390,691**	**-**
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China	**2,018,862**	**361,605**	**2,380,467**	**6,520**
Other non-bank Mainland China exposures	**262,572**	**553**	**263,125**	**-**
	5,069,507	**964,776**	**6,034,283**	**6,520**

	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

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. Approval of financial statements

The financial statements were approved and authorised for issue by the Board of Directors on 11 March 2009.

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.	Shop 3, G/F, Lee Fung Building, 315-349 Queen's Road Central, 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
Aberdeen Br.	G/F, 138-140, Aberdeen Main Road, Aberdeen, Hong Kong	2553 0603
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