



中國銀行(香港)

BANK OF CHINA (HONG KONG)

## Bank of China (Hong Kong) Limited

(incorporated with limited liability in Hong Kong)

**US\$1,600,000,000 5.55% Subordinated Notes due 2020**

**Issue Price: 99.591%**

Bank of China (Hong Kong) Limited (the “**Issuer**”) is issuing US\$1,600,000,000 5.55% subordinated notes due 2020 (the “**Notes**”). The Notes will constitute direct and unsecured obligations of the Issuer and will rank *pari passu* among themselves and upon a winding-up (as described herein) will be subordinated in right of payment to the claims of depositors and all other unsubordinated creditors of the Issuer. Interest will be payable on the outstanding principal amount of the Notes semi-annually in arrears on August 11 and February 11 in each year. See “Description of the Notes – Payments of Principal and Interest.” Subject to satisfaction of certain regulatory approval requirements, the Issuer may redeem the Notes in whole, but not in part, at their principal amount together with accrued but unpaid interest to the date fixed for redemption upon the occurrence of certain changes in taxation in the Hong Kong Special Administrative Region of the People’s Republic of China (“**Hong Kong**”) requiring the payment of additional amounts. See “Description of the Notes – Redemption – Early Redemption for Tax Reasons.”

Application has been made to The Stock Exchange of Hong Kong Limited (the “**Hong Kong Stock Exchange**” or the “**HKSE**”) for the listing of, and permission to deal in, the Notes by way of selectively marketed securities (as defined in the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “**Listing Rules**”).

**Investing in the Notes involves risks. See “Risk Factors” beginning on page 7 for a discussion of risks relating to an investment in the Notes.**

The Notes have been assigned a rating of “A–” by Fitch Ratings (“**Fitch**”), a rating of “A1” by Moody’s Investors Service, Inc., (“**Moody’s**”) and a rating of “BBB+” by Standard & Poor’s Rating Services, a division of The McGraw-Hill Companies, Inc., (“**S&P**”). The ratings address the Issuer’s ability to perform its obligations under the terms of the Notes. A rating is not a recommendation to buy, sell or hold the Notes and may be subject to suspension, reduction or withdrawal at any time by Fitch, Moody’s or S&P. A suspension, reduction or withdrawal of the rating assigned to the Notes may adversely affect the market price of the Notes.

The Notes have not been and will not be registered under the United States Securities Act of 1933, as amended (the “**Securities Act**”), or the securities laws of any other jurisdiction, and may not be offered or sold within the United States (as defined in Regulation S under the Securities Act (“**Regulation S**”)) or to, or for the account or benefit of, U.S. persons (as defined in Regulation S) except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Accordingly, the Notes are being offered and sold (i) in the United States only to qualified institutional buyers in reliance on the exemption from the registration requirements of the Securities Act provided by Rule 144A thereunder and (ii) outside the United States to non-U.S. persons in compliance with Regulation S. For a description of certain restrictions on resales and transfers, see “Transfer Restrictions.”

Notes offered in the United States to qualified institutional buyers in reliance on Rule 144A will be represented by one or more Global Notes in fully registered form without interest coupons attached and deposited with Citibank, N.A., London Branch, as custodian for The Depository Trust Company (“**DTC**”), and registered in the name of Cede & Co., as the nominee of DTC. Notes offered to non-U.S. persons outside the United States in reliance on Regulation S will be represented by one or more Global Notes in fully registered form without interest coupons attached and deposited with Citibank, N.A., London Branch, as custodian for DTC, and registered in the name of Cede & Co., as nominee of DTC, for the respective beneficial owner accounts of Euroclear Bank S.A./N.V. (“**Euroclear**”), and Clearstream Banking, *société anonyme* (“**Clearstream**”). See “Form, Denomination and Transfer.” Except as described herein, definitive certificates (“**Definitive Notes**”) evidencing holdings of Notes will not be issued in exchange for beneficial interests in the Global Notes. See “Form, Denomination and Transfer.”

*Joint Lead Managers and Bookrunners*



This Offering Memorandum includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Issuer and the Notes.

In this Offering Memorandum, unless the context otherwise requires, (i) references to “**BOCHK**,” the “**Issuer**” or the “**Bank**” mean Bank of China (Hong Kong) Limited and, as the context may require, its subsidiaries; (ii) references to “**we**,” “**us**,” “**our**” or the “**Group**” mean Bank of China (Hong Kong) Limited and its subsidiaries, (iii) references to “**BOCHK (Holdings)**” mean BOC Hong Kong (Holdings) Limited; (iv) references to “**BOCHK (Holdings) Group**” mean BOC Hong Kong (Holdings) Limited and its subsidiaries (including BOCHK); (v) references to “**BOC**” mean Bank of China Limited, a joint stock commercial bank with limited liability established under the laws of the People’s Republic of China (the “**PRC**”); and (vi) references to “**BOC Group**” mean Bank of China Limited and its subsidiaries.

In this Offering Memorandum, unless otherwise specified or the context otherwise requires, references to “**US\$**,” “**USD**” and “**U.S. dollars**” are to the currency of the United States of America and references to “**HK\$**,” “**HKD**” and “**Hong Kong dollars**” are to the currency of the Hong Kong Special Administrative Region of the PRC. References to “**Renminbi**” and “**RMB**” are to the currency of the PRC (for the purpose of this Offering Memorandum, excluding Hong Kong and Macau) (“**Mainland China**”). References to “**Euro**” and “**€**” are to the official currency of the European Union. References to the “**HKMA**” are to the Hong Kong Monetary Authority. References to the “**PBOC**” are to the People’s Bank of China. References to the “**Hong Kong Government**” are to the government of Hong Kong.

This Offering Memorandum has been prepared by us solely for use in connection with the proposed placement of the Notes. BOCI Asia Limited, Deutsche Bank Securities Inc. and UBS AG (the “**Initial Purchasers**”), and we, reserve the right to withdraw the offering of the Notes at any time or to reject any offer to purchase, in whole or in part, for any reason, or to sell less than all of the Notes offered hereby. This Offering Memorandum is personal to the prospective investor to whom it has been delivered by the Initial Purchasers and does not constitute an offer to any other person or to the public in general to subscribe for or otherwise acquire the Notes. Except as set forth in the paragraph below, distribution of this Offering Memorandum to any person other than the prospective investor and those persons, if any, retained to advise that prospective investor with respect thereto is unauthorized, and any disclosure of its contents without our prior written consent is prohibited. Except as set forth in the paragraph below, the prospective investor, by accepting delivery of this Offering Memorandum, agrees to the foregoing and agrees not to make any copies of or redistribute this Offering Memorandum.

This Offering Memorandum is intended solely for the purpose of soliciting indications of interest in the Notes from qualified investors and does not purport to summarize all of the terms, conditions, covenants and other provisions contained in the indenture and other transaction documents described herein. The information provided is not all-inclusive. The market information in this Offering Memorandum has been obtained by us from publicly available sources deemed by us to be reliable. The Initial Purchasers do not accept any liability in relation to the information contained in this Offering Memorandum or its distribution or with regard to any other information supplied by or on our behalf.

We confirm that, after having made all reasonable inquiries, this Offering Memorandum contains all information with regard to us and the Notes which is material to the offering and sale of the Notes, that the information contained in this Offering Memorandum is true and accurate in all material respects and is not misleading in any material respect and that there are no omissions of any other facts from this Offering Memorandum which, by their absence herefrom, make this Offering Memorandum misleading in any material respect. We accept responsibility accordingly. The information presented in the section entitled “Overview of the Hong Kong Banking Industry” has been extracted from publicly available documents from various sources, including officially prepared materials from the HKMA, and has not been independently verified by us.

This Offering Memorandum contains summaries intended to be accurate with respect to certain terms of certain documents, but reference is made to the actual documents, all of which will be made available to prospective investors upon request to us or Citicorp International Limited (the “Trustee”) for complete information with respect thereto, and all such summaries are qualified in their entirety by such reference.

The Hong Kong Exchanges and Clearing Limited and the HKSE take no responsibility for the contents of this Offering Memorandum, make no representation as to its accuracy or completeness and expressly disclaim any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this Offering Memorandum.

Prospective investors in the Notes should rely only on the information contained in this Offering Memorandum. Neither we nor the Initial Purchasers have authorized the provision of information different from that contained in this Offering Memorandum. The information contained in this Offering Memorandum is accurate in all material respects only as of the date of this Offering Memorandum, regardless of the time of delivery of this Offering Memorandum or of any sale of the Notes. Neither the delivery of this Offering Memorandum nor any sale made hereunder shall under any circumstances imply that there has been no change in our affairs and those of each of our respective subsidiaries or that the information set forth herein is correct in all material respects as of any date subsequent to the date hereof.

By receipt hereof, prospective investors are hereby deemed to acknowledge that (i) they have been afforded an opportunity to request from us and to review, and have received, all additional information considered by them to be necessary to verify the accuracy of, or to supplement, the information contained herein, (ii) they have had the opportunity to review all of the documents described herein, (iii) they have not relied on the Initial Purchasers or any person affiliated with the Initial Purchasers in connection with any investigation of the accuracy of such information or their investment decision, and (iv) no person has been authorized to give any information or to make any representation concerning us or the Notes (other than as contained herein and information given by our duly authorized officers and employees, as applicable, in connection with investors’ examination of us and the terms of this offering) and, if given or made, any such other information or representation should not be relied upon as having been authorized by us or the Initial Purchasers.

**Listing of the Notes on the Hong Kong Stock Exchange is not to be taken as an indication of the merits of the Issuer, the Group or the Notes. In making an investment decision, prospective investors must rely on their examination of us and the terms of this offering, including the merits and risks involved. The Notes have not been approved or recommended by any United States federal or state securities commission or any other United States, Hong Kong or other regulatory authority. Furthermore, the foregoing authorities have not passed upon or endorsed the merits of the offering or confirmed the accuracy or determined the adequacy of this Offering Memorandum. Any representation to the contrary is a criminal offense in the United States.**

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## **NOTICE TO NEW HAMPSHIRE RESIDENTS**

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES, OR RSA 421-B, WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A NOTE IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A NOTE OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL

TO, ANY PERSON, NOTE OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT, ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

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This Offering Memorandum does not constitute an offer to sell, or a solicitation of an offer to buy, any Notes offered hereby by any person in any jurisdiction in which it is unlawful for such person to make an offer or solicitation.

IN CONNECTION WITH THE ISSUE OF THE NOTES, DEUTSCHE BANK SECURITIES INC., AS THE STABILIZING MANAGER (THE “**STABILIZING MANAGER**”), OR ANY PERSON DULY APPOINTED AS ACTING FOR IT MAY, TO THE EXTENT PERMITTED BY APPLICABLE LAWS AND RULES, OVER-ALLOT THE NOTES OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF THE NOTES AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL. HOWEVER, THERE IS NO ASSURANCE THAT THE STABILIZING MANAGER (OR ANY PERSON ACTING ON ITS BEHALF) WILL UNDERTAKE STABILIZATION ACTION. ANY STABILIZATION ACTION MAY BEGIN ON OR AFTER THE DATE ON WHICH ADEQUATE PUBLIC DISCLOSURE OF THE TERMS OF THE OFFER OF THE NOTES IS MADE AND, IF BEGUN, MAY BE ENDED AT ANY TIME, BUT IT MUST END NO LATER THAN THE EARLIER OF 30 DAYS AFTER THE ISSUE DATE OF THE NOTES AND 60 DAYS AFTER THE DATE OF THE ALLOTMENT OF THE NOTES.

**None of us, the Initial Purchasers or any of our or their respective affiliates or representatives is making any representation to any offeree or purchaser of the Notes offered hereby regarding the legality of any investment by such offeree or purchaser under applicable legal investment or similar laws. Each prospective investor should consult with its own advisors as to legal, tax, business, financial and related aspects of a purchase of the Notes.**

For this offering, we and the Initial Purchasers are relying upon exemptions from registration under the Securities Act for offers and sales of securities which do not involve a public offering, including Rule 144A under the Securities Act. Prospective investors are hereby notified that sellers of the Notes may be relying on the exemption from the provision of Section 5 of the Securities Act provided by Rule 144A. The Notes are subject to restrictions on transferability and resale. Purchasers of the Notes may not transfer or resell the Notes except as permitted under the Securities Act and applicable state securities laws. See “Transfer Restrictions.” Prospective investors should thus be aware that they may be required to bear the financial risks of this investment for an indefinite period of time.

The distribution of this Offering Memorandum and the offer and sale of the Notes may, in certain jurisdictions, be restricted by law. Each purchaser of the Notes must comply with all applicable laws and regulations in force in each jurisdiction in which it purchases, offers or sells the Notes or possesses or distributes this Offering Memorandum, and must obtain any consent, approval or permission required for the purchase, offer or sale by it of the Notes under the laws and regulations in force in any jurisdiction to which it is subject or in which it makes purchases, offers or sales. There are restrictions on the offer and sale of the Notes, and the circulation of documents relating thereto, in certain jurisdictions, including the United States, the United Kingdom, Hong Kong and Singapore, and to persons connected therewith. See “Plan of Distribution – Selling Restrictions.”

Investors should contact the Initial Purchasers with any questions about this offering or if they require additional information to verify the information contained in this Offering Memorandum.

NEITHER THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION (THE “SEC”) NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE NOTES OR DETERMINED IF THIS OFFERING MEMORANDUM IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

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## FORWARD-LOOKING STATEMENTS

We have included statements in this Offering Memorandum which contain words and phrases such as “aim,” “anticipate,” “assume,” “believe,” “contemplate,” “continue,” “estimate,” “expect,” “future,” “goal,” “intend,” “may,” “objective,” “plan,” “predict,” “positioned,” “project,” “risk,” “seek to,” “shall,” “should,” “will likely result,” “will pursue,” “plan” and words and terms of similar substance used in connection with any discussion of future operating or financial performance or our expectations, plans, projections or business prospects identify forward-looking statements. In particular, the statements under the headings “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Business” regarding our financial condition and other future events or prospects are forward-looking statements. All forward-looking statements are management’s present expectations of future events and are subject to a number of factors and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements.

In addition to the risks related to our business discussed under “Risk Factors,” other factors could cause actual results to differ materially from those described in the forward-looking statements. These factors include, but are not limited to:

- our various initiatives to implement our business strategy;
- future levels of non-performing loans;
- the adequacy of allowance for credit and investment losses;
- our ability to identify, measure, monitor and control risk in our business, including our ability to improve our overall risk profile and risk management practices;
- our growth and expansion in Mainland China and overseas markets;
- the anticipated support from, and cooperation with, BOC;
- our ability to market new products;
- technological changes;
- investment income changes;
- availability of funding and liquidity;
- our exposure to credit, market and liquidity risks;
- the outcome of any legal, tax or regulatory proceedings we are or become a party to; and
- our ability to implement our dividend policy and dividend distribution plans.

By their nature, certain disclosures relating to these and other risks are only estimates and could be materially different from what actually occurs in the future. As a result, actual future gains, losses or impact on our income or results of operations could materially differ from those that have been estimated. For example, revenues could decrease, costs could increase, capital costs could increase, capital investment could be delayed and anticipated improvements in performance might not be fully realized.

In addition, other factors that could cause actual results to differ materially from those estimated by the forward-looking statements contained in this Offering Memorandum could include, but are not limited to:

- changes in the general operating environment of the Hong Kong banking industry;
- changes in general economic, market and business conditions in Hong Kong, Mainland China, the United States and other countries;
- changes in the monetary and credit policies of the United States, Hong Kong and Mainland China;
- changes or volatility in interest rates, foreign exchange rates, equity prices or other rates or prices;
- changes in Hong Kong governmental policies, laws or regulations, in particular those affecting the banking industry in Hong Kong;
- the effects of intensifying competition in the banking industry in Hong Kong and Mainland China; and
- the performance of the real property and financial markets in Hong Kong.

We caution you not to place undue reliance on the forward-looking statements, which speak only as of the date of this Offering Memorandum. Except as required by law, we are not under any obligation, and expressly disclaim any obligation, to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise.

All subsequent forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this Offering Memorandum.

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## PRESENTATION OF FINANCIAL INFORMATION

Our financial statements are prepared in accordance with Hong Kong Financial Reporting Standards (“**HKFRS**”), which differ in certain respects from generally accepted accounting principles in other countries, including accounting principles generally accepted in the United States (“**U.S. GAAP**”), which differences might be material to the financial information presented herein. We have made no attempt to quantify the impact of those differences. In particular, we have not attempted to reconcile our Consolidated Financial Statements and Information (as defined below) to U.S. GAAP, but had we done so it may have had a material impact on the financial information contained herein. Potential investors should consult their own professional advisors for an understanding of the difference between HKFRS, U.S. GAAP and certain other jurisdictions, and how those differences might affect the financial information presented herein. In making an investment decision, investors must rely upon their own independent examination of us, the terms of this offering and our recent financial information, including the risks involved. Unless specified or the context otherwise requires, all financial information in this Offering Memorandum is presented on a consolidated basis.

Unless otherwise indicated, the historical financial information included in this Offering Memorandum has been derived from our audited financial statements as of and for the years ended December 31, 2006, 2007 and 2008 (the “**Audited Consolidated Financial Statements**”) and our unaudited condensed consolidated



financial information as of and for the nine months ended September 30, 2009 (the “**Unaudited Condensed Consolidated Financial Information**”). With respect to the Unaudited Condensed Consolidated Financial Information included in this Offering Memorandum, PricewaterhouseCoopers Hong Kong (“**PwC**”) reported that they had reviewed the Unaudited Condensed Consolidated Financial Information in accordance with the Hong Kong Standard on Review Engagements 2410, “Review of interim financial information performed by the independent auditor of the entity,” issued by the Hong Kong Institute of Certified Public Accountants. The review report from PwC dated January 29, 2010 included in this Offering Memorandum states that they have not audited and that they do not express an audit opinion on the Unaudited Condensed Consolidated Financial Information of the Group. Accordingly, the degree of reliance on their report relating to the Unaudited Condensed Consolidated Financial Information should be restricted in light of the limited scope of the review procedures applied.

This Offering Memorandum contains a translation of certain Hong Kong dollar amounts into U.S. dollars at specified rates solely for the convenience of the reader. Except as otherwise stated, all translations from Hong Kong dollars to U.S. dollars are based on the noon buying rate in the City of New York on September 30, 2009, for cable transfers in Hong Kong dollars as certified for customs purposes by the Federal Reserve Bank of New York which was HK\$7.7500 per US\$1.00, as set forth in the weekly H.10 statistical release of the Federal Reserve Board. No representation is made that the Hong Kong dollar amounts referred to herein could have been or could be converted into U.S. dollars at such a rate or any other rate. Any discrepancies in any table between totals and sums of the amounts listed are due to rounding.

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## **INCORPORATION BY REFERENCE**

We hereby incorporate by reference the consolidated financial statements of the Issuer with respect to the year ended December 31, 2006, together with the independent auditor’s report thereon issued by PwC dated March 22, 2007, as contained in the 2006 Annual Report of the Issuer. Such documents are deemed to form part of this Offering Memorandum.

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## **AVAILABLE INFORMATION**

For so long as any of the notes are “restricted securities” within the meaning of Rule 144(a)(3) under the Securities Act, we will, during any period in which we are neither subject to the reporting requirements of Section 13 or 15(d) of the United States Securities Exchange Act of 1934, as amended (the “**Exchange Act**”) nor exempt from the reporting requirements of the Exchange Act under Rule 12g3-2(b) thereunder, provide to the holder or beneficial owner of such restricted securities or to any prospective purchaser of such restricted securities designated by such holder or beneficial owner, in each case upon the written request of such holder, beneficial owner or prospective purchaser, the information required to be provided by Rule 144A(d)(4) under the Securities Act.

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## **ENFORCEABILITY OF CIVIL LIABILITIES**

We are incorporated under the laws of Hong Kong. Most of our directors and officers and the experts named herein reside outside the United States (principally in Hong Kong). A substantial portion of our assets and the assets of such persons are or may be located outside the United States. As a result, it may not be possible for investors to effect service of process within the United States upon us or such persons, or to enforce against us or such persons judgments obtained in United States courts, including judgments predicated upon the civil liability provisions of the federal securities laws of the United States. We have been advised by our Hong Kong counsel, Clifford Chance, that there is doubt as to the enforceability in Hong Kong, in original actions or in actions for enforcement of judgments of United States courts, of civil liabilities predicated solely upon the federal securities laws of the United States.



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## SUMMARY

*The summary below is only intended to provide a very limited overview of information described in more detail elsewhere in this Offering Memorandum. As it is a summary, it does not contain all of the information that may be important to investors. Terms defined elsewhere in this Offering Memorandum shall have the same meanings when used in this summary. Prospective investors should therefore read this entire Offering Memorandum, including the section entitled “Risk Factors” and the Audited Consolidated Financial Statements and Unaudited Condensed Consolidated Financial Information, before making an investment decision.*

### Overview

We are a major commercial banking group in Hong Kong with a leading market share in our core commercial banking business such as deposits, residential mortgages, corporate loans and syndicated loans. We are one of the three Hong Kong dollar note-issuing banks. We were appointed by the PBOC as the sole clearing bank for Renminbi business in Hong Kong in 2003. With over 270 branches and more than 470 ATMs, as well as other delivery channels in Hong Kong as of September 30, 2009, we offer a comprehensive range of financial products and services to individual and corporate customers. At the same date, we had 23 branches and sub-branches in Mainland China that provide local and cross-border banking services to customers in Hong Kong and Mainland China.

In Hong Kong, we are the second largest banking group in terms of asset size, customer deposits and loans. As of December 31, 2008, we had HK\$1,118 billion in total assets, HK\$806 billion in total deposits and HK\$461 billion in gross advances to customers. Our net operating income before impairment allowances in 2008 was HK\$26 billion. As of September 30, 2009, we had HK\$1,197 billion in total assets, HK\$889 billion in total deposits and HK\$507 billion in gross advances to customers. Our net operating income before impairment allowances for the nine months ended September 30, 2009 was HK\$19 billion.

We have three principal lines of business, consisting of personal banking, corporate banking and treasury operations. We provide a comprehensive range of banking products and services to our individual and corporate customers. We also provide Renminbi banking products and services in Hong Kong, such as deposit, exchange, remittance, credit cards and bonds distribution to our individual customers, as well as trade settlement and finance to our corporate customers.

We have made, and will continue to make, substantial investments in our technology platform and distribution capabilities. In addition to our extensive network of branches, self-service banking centers and ATMs, we also offer 24-hour automated telephone banking and online banking services. These resources enable us to deliver a broad range of banking products and services through multiple delivery channels that are convenient to our customers.

**Strategy**

Our objective is to become a premier financial services group with an extensive base in Hong Kong, a solid presence in Mainland China and a strategic foothold in Asia. The principal components of our strategy are as follows:

- strengthen our overall leading position in Hong Kong's banking sector
- diversify our sources of revenue to achieve a sustainable growth
- extend our leadership in offshore Renminbi business
- leverage our relationship with BOC to increase our presence in Greater China and Asia Pacific region

## THE OFFERING

*The following is a brief summary of certain terms of this offering. For a more detailed description of the terms of the Notes, see “Description of the Notes.” Capitalized terms used herein and not defined have the meanings given to them in the “Description of the Notes.”*

**Issuer** . . . . . Bank of China (Hong Kong) Limited, a company incorporated with limited liability in Hong Kong

**The Notes** . . . . . US\$1,600,000,000 5.55% Subordinated Notes due 2020

*It is intended that the Notes should be eligible for inclusion as Category II Supplementary Capital of the Issuer.*

**Form.** . . . . . The Notes will be represented by one or more global notes in registered form without interest coupons deposited with a custodian for DTC and registered in the name of Cede & Co as DTC’s nominee.

**Currency.** . . . . . U.S. dollars

**Denominations** . . . . . US\$100,000 per Note and integral multiples of US\$1,000 in excess thereof

**Subordination** . . . . . The Notes constitute direct, unsecured and subordinated obligations of the Issuer, ranking *pari passu* without any preference among themselves.

Upon the occurrence of a Subordination Event (defined below), the claims of the holders of the Notes will be subordinated in right of payment in the manner provided in the Indenture constituting the Notes to the claims of depositors and all other unsubordinated creditors of the Issuer and will rank at least *pari passu* in right of payment with all other Subordinated Indebtedness (defined below), present and future, of the Issuer. Claims in respect of the Notes will rank in priority to the rights and claims of holders of subordinated liabilities which by their terms rank in right of payment junior to the Notes and all classes of equity securities of the Issuer, including holders of preference shares, if any.

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

**Issue Date** . . . . . February 11, 2010

**Maturity Date** . . . . . Unless previously redeemed or purchased and cancelled with the prior written approval of the HKMA, the Notes will mature and become payable at their principal amount, together with accrued but unpaid interest at the date of redemption on February 11, 2020.

**Issue Price** . . . . . 99.591%

**Redemption** . . . . . 100%

**Interest** . . . . . 5.55%

**Interest Payment Dates** . . . . . Interest is payable semi-annually in arrear commencing August 11, 2010.

If any Interest Payment Date falls on a day which is not a Business Day in New York City, that Interest Payment Date will be the next succeeding Business Day in New York City, unless that day falls in the next calendar month, in which case the Interest Payment Date will be the immediately preceding Business Day in New York City.

**Tax Redemption** . . . . . Subject to the prior written approval of the HKMA, the Issuer may at its option redeem the Notes, in whole but not in part, at any time at their principal amount together with accrued but unpaid interest in the event of certain changes affecting taxes of Hong Kong as further described in the Indenture constituting the Notes.

**Clearing** . . . . . DTC

**Security Codes**

	<u>Rule 144A</u>	<u>Regulation S</u>
CUSIP . . . . .	061199 AA3	Y1391C AJ0
ISIN . . . . .	US061199AA35	USY1391CAJ00

**Governing Law** . . . . . New York law (other than the provisions of the Indenture relating to subordination, which shall be governed by Hong Kong law)

**Use of Proceeds** . . . . . It is intended that the proceeds will be used for the partial repayment of the outstanding amount of an existing subordinated loan with BOC.

**Listing** . . . . . The Hong Kong Stock Exchange Application has been made to list the Notes as selectively marketed securities on the Hong Kong Stock Exchange.

**Transfer Restrictions** . . . . . The Notes will not be registered under the Securities Act. The Notes are subject to certain transfer restrictions and may only be offered and sold in transactions that are exempt from or not subject to the registration requirements of the Securities Act. See “Plan of Distribution.”

**Trustee** . . . . . Citicorp International Limited

**Paying Agent and**

**Note Register** . . . . . Citibank, N.A., London Branch

**Indenture** . . . . . The Notes will be constituted by an Indenture to be dated February 11, 2010 between the Issuer, the Trustee, the note registrar and the paying agent.

**Events of Default; Limited**

**Right of Acceleration.** . . . . If default is made in the payment of principal or interest due in respect of the Notes or any of them and the default continues for a period of five business days in Hong Kong (in the case of principal) or 10 business days in Hong Kong (in the case of interest) (each such event, an “**Event of Default**”), then the Trustee at its sole and absolute discretion may and with the consent of the Noteholders holding at least one-quarter in aggregate principal amount of the Notes then outstanding shall, subject in each case to being indemnified to its satisfaction, after giving the Issuer five days’ notice, institute proceedings for the winding-up of the Issuer in Hong Kong, but may take no further action in respect of such default (but without prejudice to the limited right of acceleration described below).

If any Subordination Event (as defined below) shall occur and be continuing (also an “Event of Default”), then the Trustee, at its sole and absolute discretion may and with the consent of the Noteholders holding at least one-quarter in aggregate principal amount of the Notes then outstanding shall, subject in each case to being indemnified to its satisfaction, by written notice to the Issuer, declare the Notes to be forthwith due and repayable whereupon the same shall become forthwith due and repayable at their principal amount, together with accrued interest (if any), as provided in the Indenture. Immediately upon delivery of such notice, the principal of and all interest accrued on the Notes shall become due and payable, subject to the subordination conditions described in “Subordination” above.

A “**Subordination Event**” shall occur if an order is made or an effective resolution is passed for the winding-up, liquidation or dissolution or similar proceeding of the Issuer in Hong Kong (except for the purposes of a reconstruction, amalgamation or reorganization the terms of which have previously been approved by a resolution of the Noteholders passed at a meeting duly convened and held in accordance with the Indenture by a majority of at least 66 $\frac{2}{3}$ % of the votes cast).

**Additional Amounts . . . . .** All payments of principal and interest on the Notes will be made without withholding or deducting any present or future taxes, penalties, fines, duties, assessments or other governmental charges of any nature imposed by Hong Kong or any political subdivision or governmental authority thereof or therein having power to tax. If the Issuer is required by law to withhold or deduct any such taxes, the Issuer shall pay the Noteholders such additional amounts necessary to ensure that the Noteholders receive the same amount as they would have received without such withholding or deduction, subject to certain exceptions. See “Description of the Notes – Additional Amounts.”

**ERISA Considerations . . . . .** Each purchaser and each transferee of a Note will be deemed to have represented and agreed either that (a) it is not and for so long as it holds Notes will not be and is not acquiring the Notes directly or indirectly with the assets of a person who is or while the Notes are held will be an employee benefit plan as described in section 3(3) of ERISA and subject to Title I of ERISA, or a “plan” subject to Section 4975 of the Code, or a governmental plan or church plan which is subject to any federal, state or local or non U.S. law that is substantially similar to the provisions of section 406 of ERISA or Section 4975 of the Code, or an entity whose assets are treated as assets of any such plan or (b) its purchase and holding of the Notes will not result in a prohibited transaction under Section 406 of ERISA or Section 4975 of the Code (or, in the case of such a governmental or other employee benefit plan, any such substantially similar U.S. federal, state or local law) for which an exemption is not available. See “ERISA and Certain Other U.S. Considerations.”



## RISK FACTORS

*Prospective investors should carefully consider the risks described below, together with the risks described in the other sections of this Offering Memorandum, before making any investment decision relating to our Notes. The occurrence of any of the following events could have a material adverse effect on our business, including our ability to grow our asset portfolio, the quality of our assets, our liquidity, our financial performance, our ability to implement our strategy and our ability to repay the interest or principal on the Notes in a timely fashion or at all.*

*Before making an investment decision, prospective investors should carefully consider all of the information contained in this Offering Memorandum, including the financial statements included in this Offering Memorandum.*

### **Risks Relating to Our Business**

***If we are unable to effectively maintain the quality of our loan portfolio, investment securities or other assets, our business could be materially and adversely affected.***

Our results of operations could be materially and adversely affected by any deterioration in the quality of our loan portfolio, investment securities or other assets. Risks from changes in credit quality and the recoverability of loans and amounts due from counterparties as well as risks from our investment activities are inherent in a wide range of our businesses. Our classified or impaired loans represented 0.57%, 0.44%, 0.46% and 0.29% of our total loans to customers as of December 31, 2006, 2007 and 2008 and September 30, 2009, respectively. We may not be able to effectively control the level of impaired loans in our current loan portfolio or effectively control the level of new loans that may become impaired in the future. In particular, the amount of our impaired loans may increase in the future due to a deterioration in the quality of our loan portfolio and/or a substantial increase in the amount of our new loans. Our gross loans to customers have increased from HK\$347 billion as of December 31, 2006 to HK\$461 billion as of December 31, 2008 and have further increased to HK\$507 billion as of September 30, 2009.

Deterioration in the quality of our loan portfolio, investment securities or other assets may occur for a variety of reasons, including factors which are beyond our control, such as a slowdown in growth of the Hong Kong or global economies, a relapse of a global credit crisis, volatility in interest rates and market liquidity, and other adverse macroeconomic trends and financial conditions in Hong Kong and other parts of the world. As a result, these factors may cause operational, financial and liquidity problems for our borrowers and the issuers of our investment securities which may materially and adversely affect their ability to service their outstanding debt and fulfill their payment obligations associated with the securities issued. Other factors may also cause the asset quality of our loan portfolio to deteriorate and the market value of our securities investment to decrease, including actual or perceived failure or worsening credit of counterparties (in particular those counterparties to which we have substantial exposure), declines in residential and commercial property prices, higher unemployment rates and reduced profitability of corporate borrowers. Moreover, to the extent that if a material portion of our loans have been extended to a relatively small number of counterparties, the overall quality of our loan portfolio could be adversely affected by a decline in the credit quality of such borrowers. In addition, our expansion in Mainland China and overseas markets may potentially impact the quality of our loan portfolio, where we are less able to control our loan portfolio quality and where uncertainties in economic and monetary policies are likely to affect our borrowers severely. Moreover, in connection with its periodic examinations of our operations, the HKMA may in the future require us to change the classification of some of our loans, which may increase our level of impaired loans. If the level of our impaired loans or write-offs in our investment securities and other assets increases, our business, financial condition and results of operations may be materially and adversely affected.

***We have a relatively high concentration of loans to certain sectors, in particular property-related sectors, and if these sectors experience volatility or an extended downturn in the future, our business and financial condition could be adversely affected.***

As of September 30, 2009, we had a relatively high concentration of loans to property-related sectors, including 24.6% of our total loans to customers in residential mortgages, 14.2% in the property investment sector and 5.3% in the property development sector; approximately 5.5% of our total loans were to customers in the transport and transport equipment sector. As of the same date, approximately 9.2%, 15.5%, 0.2% and 6.4% of our classified or impaired loans to customers were in these sectors, respectively.

The Hong Kong property market is cyclical and property prices in general have been volatile in the past decade. The property-related sectors in Hong Kong have experienced significant fluctuations in property prices and transaction volumes. The transport and transport equipment sector has in recent years been adversely affected by the general slowdown of economic activity in Hong Kong. Any future volatility or extended downturn in these sectors may reduce the borrowing activities in these sectors, increase the levels of our classified loans and allowances for impaired loans, reduce our net profit and adversely affect our financial condition and results of operations.

***Any significant decline in the value of the collateral securing our loans may adversely affect our financial condition and results of operations.***

We may not be able to realize the full value of our collateral as a result of downturn in the real estate markets, delays in bankruptcy and foreclosure proceedings, fraudulent transfers by borrowers and other factors beyond our control. Any decline in the value of the collateral securing our loans may result in an increase in our impairment allowances and a reduction in the recovery from collateral realization, which may reduce our net profit and may adversely affect our financial condition and results of operations.

***The loan classification and provisioning system for Hong Kong banks is different in certain respects from that in certain other countries.***

The banking industry in Hong Kong is primarily regulated by the HKMA. In 2007, the HKMA promulgated the implementation of the Revised Framework of International Convergence of Capital Measurement and Capital Standards (“**Basel II**”). In accordance with guidelines set by the HKMA, we are in the process of seeking approval from the HKMA to adopt the Internal Ratings-based Approach which divides obligor ratings into more refined credit grades.

However, under the existing regulatory reporting requirements of the HKMA, loans and advances are classified into one of the following categories corresponding to the levels of risk: “Pass,” “Special Mention,” “Sub-standard,” “Doubtful” and “Loss.” See “Assets and Liabilities.” The classification of impaired loans and advances into one of the categories under “Sub-standard,” “Doubtful” and “Loss” depends on various quantitative and qualitative factors, including the number of months payment in arrears, the type, the tenor and the expected recovery status of the loans and advances.

The laws, regulations and guidelines governing the banking industry in Hong Kong differ from those applicable in certain other countries in certain respects and may result in particular advances being classified as impaired loans at a different time or being classified in a category reflecting a different degree of risk than would be required in certain other countries. The manner of writing off impaired loans of banks in Hong Kong may result in a higher level of impaired loans and associated loan provisions than that of banks in certain other countries. For a description of the banking regulations that apply to banks in Hong Kong, see “Regulation and Supervision – Regulation and Supervision in Hong Kong.”

***The increasing competition in the Hong Kong and Mainland China banking industries could adversely affect our profitability.***

We focus principally on the Hong Kong market for individual and corporate customers. The banking industry in Hong Kong is a mature market, and we are subject to increasing competition from many other Hong Kong-incorporated banks and Hong Kong branches of international banks, including competitors that have significantly greater financial and other resources. According to statistics published by the HKMA, there were 146 international and local licensed banks as of September 30, 2009, competing for a population of approximately seven million people. There is a limited market, especially for personal banking products such as residential mortgage loans, credit cards and personal loans. We expect that further consolidation in the industry, in particular among mid-cap Hong Kong banks, will continue to intensify competition. There can be no assurance that we will be able to compete effectively in the face of such increased competition. Increased competition may make it difficult for us to increase the size of our loan portfolio and deposit base and may cause intense pricing competition, which could have an adverse effect on our growth plans, margins, ability to pass on increased costs of funding, results of operations and financial condition.

In particular, since 2000, banks in Hong Kong, including us, have lowered interest rates charged on non-Hong Kong government-guaranteed new residential mortgage loans (“**Mortgage Interest Rates**”). As future movements in Mortgage Interest Rates are uncertain, there can be no assurance that competition among banks in Hong Kong for residential mortgage loans will not result in further reductions in Mortgage Interest Rates. Further reductions in Mortgage Interest Rates could have an adverse effect on our interest margin, business, financial condition or results of operations.

Due to the maturity of the Hong Kong banking industry and new business opportunities in Mainland China, we intend to continue to expand our personal and corporate lending portfolio by growing our Mainland China-related business. However, we are likely to face increased competition in the Mainland China market from existing local Chinese banks and other foreign banks entering the market. We expect competition from foreign commercial banks to increase significantly, as previous restrictions on their geographical presence, customer base and operating licenses in Mainland China were removed in December 2006 pursuant to the PRC’s World Trade Organization (“**WTO**”) commitments. A number of foreign banks have established locally incorporated banks in Mainland China. In addition, the PRC’s Closer Economic Partnership Arrangement (“**CEPA**”) with Hong Kong and Macau allows smaller banks from these jurisdictions to operate in Mainland China, a development which may also increase the competition in the banking industry in Mainland China.

The increased competition in the Hong Kong and Mainland China banking industries may adversely affect our business and prospects, results of operations and financial condition by potentially:

- reducing our market share in the principal products and services that we offer;
- reducing the growth of our loan and deposit portfolios and other products and services;
- reducing our net interest income;
- reducing our fee and commission income; and
- increasing our non-interest expenses.

***Our exposure to the Mainland China market is subject to economic, political, social or legal uncertainties or changes in Mainland China.***

We are exposed to all of the risks inherent in cross-border transactions with Mainland China, such as counterparty risk and market risk, as well as fluctuations in exchange rates for the Renminbi. Although we have adopted policies to limit and manage such risks, there can be no assurance that the political, economic or other circumstances in Mainland China or any future exchange rate volatility relating to the Renminbi will not adversely affect our business, financial condition and results of operations.

As of September 30, 2009, we had HK\$71,332 million of Mainland China-related loans to customers based on the location of the counterparties, after taking into account the transfer of risk in respect of such loans where appropriate. These amounts represented approximately 14.1% of our gross loans and advances at that date.

The value of our loans to entities with exposure to Mainland China may be influenced by the general state of the PRC economy and may be affected by significant political, social or legal uncertainties or changes in Mainland China, including changes in economic and monetary policies, the rate of inflation, exchange controls and the exchange rate and the regulations governing banking businesses. In particular, any change to the current PRC tax regulations affecting our business in Mainland China and Hong Kong may increase our effective income tax rate. In addition, as we plan to expand our Mainland China business, the operations of our branches or sub-branches located in Mainland China depend on the economic conditions in Mainland China and are also subject to the above uncertainties and changes. There can be no assurance that our continued exposure to Mainland China or our strategy to grow our business in Mainland China will not have an adverse effect on our business, financial condition or results of operations, or that the economic, monetary and political environment in Mainland China will remain favorable to our business in Mainland China in the future.

***We are controlled by BOC, whose interests may not always coincide with the interests of the holders of the Notes.***

As of December 31, 2009, BOC indirectly controlled 66.06% of our equity interests through BOCHK (Holdings). Accordingly, BOC may be able to exercise significant influence over our business and will be able to control matters requiring shareholders' approval, including:

- the election of directors;
- our merger or consolidation with other entities;
- the timing and amount of our dividend payments; and
- other actions that require the approval of our shareholders.

There can be no assurance that the interests of BOC, as our controlling shareholder, could not conflict with the interests of the holders of the Notes. In addition, we may compete with BOC as we pursue further business opportunities. Any such competition may have an adverse effect on our business, financial condition and results of operations by reducing our revenues or raising our operating costs, or both, and by inhibiting our ability to cooperate effectively with BOC in the development of our potential business.

***Our ability to extend credit may be affected by BOC's credit exposure limits, which may adversely affect our business and results of operations.***

As a subsidiary of BOC, our ability to extend credit to a customer or counterparty of BOC may be constrained by BOC's overall credit exposure limits and specific credit exposure limits to such customer or counterparty. Any constraint on our ability to conduct operations in our best economic interest may make our business less competitive, as well as adversely affect our business and results of operations.

***Discontinuation of the link of the Hong Kong dollar to the U.S. dollar or revaluation of the Hong Kong dollar could adversely affect our liquidity position as well as our financial condition and results of operations.***

The majority of our revenue is generated in Hong Kong dollars. Nonetheless, as of December 31, 2006, 2007 and 2008 and September 30, 2009, we held a substantial part of our assets in U.S. dollars, amounting to HK\$258,844 million, HK\$300,844 million, HK\$293,855 million and HK\$334,922 million, respectively. The Hong Kong dollar has been linked to the U.S. dollar at the rate of HK\$7.80 to US\$1.00 since October 17, 1983 (the “**Linked Exchange Rate System**”). In May 2005, the HKMA broadened the 22-year old trading band from the original rate of HK\$7.80 per U.S. dollar to a rate range of HK\$7.75 to HK\$7.85 per U.S. dollar. The Hong Kong government has in the past indicated its intention to maintain the Linked Exchange Rate System. In addition, to ensure continued liquidity of the Hong Kong dollar, the HKMA has entered into bilateral repurchase agreements with the central banks of Australia, Mainland China, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand. However, there can be no assurance that the Hong Kong dollar will continue to be linked to the U.S. dollar or its trading band will be maintained at HK\$7.75 to HK\$7.85 per U.S. dollar, or that, in the event of a liquidity problem affecting the Hong Kong dollar, such bilateral repurchase agreements will help to maintain adequate liquidity for the Hong Kong dollar. Our business, financial condition and results of operations could be adversely affected by the impact on the Hong Kong economy of the discontinuation of the link of the Hong Kong dollar to the U.S. dollar or any revaluation of the Hong Kong dollar.

***Volatility in interest rates could have an adverse effect on our business, financial condition, liquidity and results of operations.***

As with most banks, our net interest income is a significant factor in determining our overall financial performance. For the years ended December 31, 2006, 2007 and 2008 and for the nine months ended September 30, 2009, our net interest income represented approximately 72.8%, 69.1%, 71.7% and 63.8%, respectively, of our net operating income before impairment allowances.

Interest rates in Hong Kong have remained relatively low and have been falling steadily in recent years, a situation which has had a negative impact on our net interest income. However, there can be no assurance that interest rates will not become volatile or that changes in interest rates will not be frequent. Fluctuations in interest rates could affect our financial condition and results of operations and profitability in different ways. For example, a decrease in interest rates may reduce our interest income and yields from interest-earning investments. A substantial increase in interest rates may decrease the value of our debt securities portfolio and raise our funding costs. In addition, an extended rise in interest rate levels may adversely affect the economy in Hong Kong and the financial condition and repayment ability of our corporate and retail borrowers, including credit card holders, which in turn may lead to a deterioration in our credit portfolio. As some of our assets and liabilities are subject to the risk of funding mismatch, we are vulnerable to fluctuations in market interest rates. As a result, volatility in interest rates could have an adverse effect on our business, financial condition, liquidity and results of operations.

***Our funding is primarily short-term, and if depositors do not roll over their deposits upon maturity, our liquidity could be adversely affected.***

Most of our funding requirements are met through short-term funding sources, primarily in the form of customer deposits. As of December 31, 2006, 2007 and 2008 and September 30, 2009, approximately 96.7%, 95.5%, 95.8% and 95.4%, respectively, of our customer deposits had a remaining maturity of three months or less. Historically, a substantial portion of such customer deposits have been rolled over upon maturity and these deposits have been, in essence, a stable source of long-term funding. However, there is no assurance that this pattern will continue or that our customer deposits will remain stable. If a substantial number of depositors fail to roll over their deposits upon maturity, our liquidity position would be adversely affected and we may need to seek alternative sources of short-term or long-term funding to finance our operations, which may be more expensive than existing deposits.

To minimize the impact of the financial crisis on the banks in Hong Kong and to restore depositor confidence, the Hong Kong government on October 14, 2008 announced the use of the Exchange Fund to guarantee repayment of all customer deposits held with all authorized institutions in Hong Kong subject to the rules set forth in the Deposit Protection Scheme. The guarantee took immediate effect and is scheduled to remain in force until the end of 2010, whereupon the previous protection limit of HK\$100,000 for each eligible customer deposit held with a licensed bank (as opposed to with any authorized institution) will apply. There can be no assurance that the level of our customer deposits and our liquidity will not be adversely affected by the withdrawal of, or any changes to, the Deposit Protection Scheme if the financial crisis recurs in the future.

The HKMA acts as the lender of last resort to all authorized institutions in Hong Kong to provide support for liquidity needs in the banking system generally as well as to specific institutions. In this regard, certain portions of our interest-earning assets are acceptable to the HKMA for emergency funding support, and such asset figures are subject to the HKMA's monthly review. Although the Hong Kong government has in the past taken measures on a case-by-case basis to maintain or restore public confidence in individual banks with an isolated liquidity crisis, there can be no assurance that the HKMA will provide such assistance in the future in the event of a liquidity crisis.

***We are subject to a number of risks, such as credit risk, market risk and liquidity risk, and cannot assure you that our risk management and internal control policies, procedures and systems will be sufficient to protect us against such risks.***

In recent years, the HKMA, in connection with its regular on-site examinations, and certain of our external advisors, including our independent auditors, in connection with their audits of our financial statements, have provided us with various observations and recommendations with respect to our internal controls over financial reporting. These observations and recommendations have been related to issues with, among others, our risk management systems, management of loans, management of branches, transactions between related parties, including identification of group borrowers, determination of fair-value of certain financial instruments, management of our IT security system, and our design, sales and distribution of wealth management products. We will continue to seek to enhance our existing risk management and internal control policies, procedures and systems to improve our risk management capabilities and internal controls. However, any deficiencies in our systems and practices could adversely affect our ability to timely and accurately record, process, summarize and report financials and other data, as well as adversely impact our efficiency, undermine the effectiveness of our risk management process and increase the potential for financial reporting errors and non-compliance with regulations.

In addition, many of our methods of managing risks and exposures are based upon observed market behavior and statistics based on historical models. Consequently, the systems and tools we use to manage credit, market and liquidity risks have not been fully tested under all circumstances.

If we are unable to properly address any internal control or other deficiencies as they arise, such deficiencies may result in losses and inaccuracies in our financial statements and may also impair our ability to comply with applicable financial reporting requirements and related regulatory filings on a timely basis. As a result, our asset quality, business, financial condition and result of operations may be materially and adversely affected.



***There are operational risks associated with our industry which, if realized, may have an adverse impact on our business.***

Like all other financial institutions, we are exposed to many types of operational risks, including the risk of fraud, unauthorized transactions or other misconduct by employees (including the violation of regulations for the prevention of corrupt practices, and other regulations governing our business activities), or operational errors, including clerical or record keeping errors or errors resulting from faulty computer or telecommunications systems. We are further exposed to the risk that external vendors may be unable to fulfill their contractual obligations to us (or will be subject to the same risk of fraud or operational errors by their employees). For example, we use direct marketing associates to market our retail credit products, and we also outsource some functions to other agencies. Moreover, we are exposed to the risk that our (or our vendors') business continuity and data security systems prove not to be sufficient in case of a system failure or natural disaster.

Given our high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. In addition, our dependence upon automated systems to record and process transactions may further increase the risk of technical system flaws or employee tampering or manipulation of those systems that will result in losses that may be difficult to detect. We may also be subject to disruptions of our operating systems, arising from events that are wholly or partially beyond our control (including, for example, computer viruses or electrical or telecommunication outages), which may give rise to a deterioration in customer service and to loss or liability to us. We also face the risk that the design of our controls and procedures may prove inadequate or are circumvented, thereby causing delays in detection of errors in information. Although, like all banks, we maintain a system of controls designed to keep operational risks at appropriate levels, we have suffered losses from operational risks and there can be no assurance that we will not suffer material losses from operational risks in the future. Our reputation could be adversely affected by the occurrence of any such events involving our employees, customers or third parties. In addition to internal factors that may affect our operations, the rapid growth and expansion of our business in recent years as compared to other banks may have also resulted in increasing complexity in our internal and external control systems and risk management measures, which may add to our operational risks.

***Our online banking business is subject to security risks and the proper functioning of our information technology system.***

To the extent that our online banking activities involve the storage and transmission of confidential information, security breaches could expose us to possible liability and reputation damage. Our information technology systems may be vulnerable to unauthorized access, computer viruses or other disruptive problems. Costs incurred in rectifying any such disruptive problems may be high and may adversely affect our business, financial condition and results of operations. Concerns regarding security risks may deter our existing and potential customers from using our online banking products and services. Eliminating computer viruses and alleviating other security problems may result in interruptions, delays or termination of service to users accessing our online banking services. In the past, we have experienced temporary disruptions and delays in our online banking system due to limited capacities. There can be no assurance that our online banking services will not experience any further disruptions or delays, or our online banking service will not have further security problems. If we cannot detect security risks in advance, sustain a high volume of network traffic and protect against software leaks or computer viruses, our online banking business may be materially and adversely affected.



***We will be exposed to various risks as we expand our range of products and services.***

In order to meet the needs of our customers and to diversify our business portfolio, we have been expanding the range of products and services we provide to our customers. Expansion of our business is subject to certain risks and challenges, including:

- new products and services may not be accepted by customers or meet our expectations for profitability;
- the requirement to hire additional qualified personnel who may not be available;
- failure to obtain regulatory approval for new products or services; and
- inability to enhance risk management capabilities and information technology systems to support a broader range of products and services.

If we are not able to achieve the intended results with respect to the new products and services to be offered to our customers, we could experience an adverse effect on our business, financial condition and results of operations.

***We face potential risks in relation to the sales of certain investment products such as the Lehman Brothers Minibonds.***

On July 22, 2009, we, without admission of any liability, reached an agreement among the Securities and Futures Commission (“SFC”), the HKMA, and 13 other distributing banks pursuant to which we offered to repurchase all the outstanding retail structured notes issued under the “Secured Continuously Offered Note Program” by Pacific International Finance Limited and arranged by Lehman Brothers group companies, commonly known as Lehman Brothers Minibonds (the “**Minibonds**”), from eligible customers who had subscribed or purchased the Minibonds through us (the “**Repurchase Scheme**”). The acceptance of our offer under the Repurchase Scheme by such eligible customers will result in the release of claims such eligible customers may have against us in relation to the sales and purchase of the Minibonds. There can be no assurance, however, that we will not be subject to further claims by customers who have not accepted the terms of the Repurchase Scheme and/or who are not eligible for the Repurchase Scheme. Therefore, we cannot assure you that our maximum exposure associated with the Minibonds will not exceed the amount of our provisions made. In addition, there can be no assurance that we will not face any further claims by our customers who have purchased other investment products offered by us. Expenses associated with Lehman Brothers-related products for the nine months ended September 30, 2009 were HK\$3,242 million, primarily including those in relation to the Minibonds by taking into account the uncertainties in the amount recoverable from such Minibonds.

In addition, investors’ interest in structured financial products and their confidence in other related products offered by us may be adversely affected by the Minibonds incident and the Repurchase Scheme. Such a loss of confidence by our existing or future customers may adversely affect our ability to market and promote the structured financial products we offer and, in turn, our business operations and income may suffer.

***We may need additional capital in the future, and we cannot assure you that we would be able to obtain such capital on acceptable terms, or at all.***

The uncertainties in the economic and business environment in Hong Kong, Mainland China, the United States and certain other developed countries may result in a deterioration of our capital adequacy position. In particular, we may experience a deterioration in our asset quality. Any increase in our allowances for impaired assets will decrease our operating profit after such allowances. To the extent that our future operating income is not sufficient to meet provisioning requirements, our capital will be eroded, and we may be required to obtain new capital. A requirement to significantly increase the level of our provisions

would adversely affect our financial condition, results of operations and capital position. Moreover, the HKMA may increase our required capital adequacy ratio levels in the future in response to, among other things, an adverse economic or credit environment or regulatory changes. In addition, in order for us to grow, remain competitive, enter new businesses or expand our base of operations, we may require new capital in the future. We may raise additional capital in the future through equity issuances or other capital instruments that are eligible for capital adequacy purposes under the Banking (Capital) Rules (Cap. 155L). There can be no assurance that we will be able to obtain additional capital in a timely manner, on acceptable terms or at all.

***Any inability to attract and retain talented professionals may adversely impact our business.***

Our ability to sustain our growth and meet future business demands depends on our ability to attract and recruit suitably skilled and qualified staff. Given our continued expansion and increasing market competition, there can be no assurance that we will be able to recruit staff in sufficient numbers or with sufficient experience. In addition, we also face strong competition to retain skilled and qualified staff. Any inability to attract and retain talented professionals may have an adverse effect on our business and ability to grow.

***We may not be able to detect money laundering and other illegal or improper activities fully or on a timely basis, which could expose us to additional liability and harm our business or reputation.***

We are required to comply with applicable anti-money laundering, anti-terrorism and sanctions laws and other regulations in Hong Kong and Mainland China and other jurisdictions where we have operations. Financial institutions in Hong Kong and Mainland China are required to establish sound internal control policies and procedures with respect to anti-money laundering monitoring and reporting activities. Such policies and procedures require us to, among other activities, designate an independent anti-money laundering officer, establish a customer identification system in accordance with relevant rules, record the details of customer activities and report suspicious transactions to relevant authorities.

While we have adopted policies and procedures aimed at detecting and preventing the use of our banking network for money laundering activities and by terrorists and terrorist-related organizations and individuals generally, such policies and procedures have in some cases only been adopted recently and may not completely eliminate instances where we may be used by other parties to engage in money laundering and other illegal or improper activities. To the extent we fail to fully comply with applicable laws and regulations, the relevant government agencies to which we report have the power and authority to impose fines, freeze our assets and impose other penalties on us. We cannot assure you that there will not be future failures in detecting money laundering or other illegal or improper activities which may adversely affect our business reputation and operations.

***Any future outbreaks of contagious diseases in Hong Kong may have a material adverse effect on our business operations, financial condition and results of operations.***

During the first half of 2003, Hong Kong, along with many other countries in Asia, encountered an outbreak of Severe Acute Respiratory Syndrome (“SARS”), a highly contagious and potentially deadly disease. The SARS outbreak caused an adverse effect on the economies of the affected regions, including Hong Kong and Mainland China. Like other financial institutions, our operations in those affected regions were influenced by a number of SARS-related factors, including, but not limited to, a decline in demand for residential mortgage advances, a reduction in the number of customers visiting our branches and an adverse impact on asset quality due to a weakened economy as well as higher unemployment rate. In the last few years, there have also been outbreaks of avian influenza in parts of Asia, including Hong Kong. There have also been recent outbreaks among humans of the Human Swine Influenza A (“H1N1”) virus globally. On June 11, 2009, the World Health Organization (“WHO”) raised its pandemic alert level to Phase 6, its highest level, after considering data confirming the H1N1 outbreak. To date, there has been a significant number of confirmed cases of H1N1 in the Asia Pacific region and a number of deaths worldwide.

No assurance can be given that there will not be a recurrence of the outbreak of SARS or other epidemics, or that incidents of avian influenza or H1N1 will not increase. There can be no assurance that our business, financial condition and results of operations would not be adversely affected if another outbreak of SARS, H1N1 virus or another highly contagious disease occurs.

### **Risks Relating to Hong Kong and Mainland China**

*An economic downturn in Hong Kong and Mainland China may materially and adversely affect our business, financial condition or results of operations.*

We conduct most of our operations and generate most of our revenue in Hong Kong. Our performance and the quality and growth of our assets are necessarily dependent on the overall economy in Hong Kong. As a result, any downturn in the Hong Kong economy may adversely affect our business, financial condition or results of operations.

In 2003, the Hong Kong economy was severely affected by SARS, which resulted in, among other things, increased provisions which negatively affected our profitability. Although the Hong Kong economy had, to a great extent, recovered from the impact of SARS in the subsequent years after 2003, it has been adversely affected by the worsening of the global economy resulting from the subprime mortgage crisis in the United States and the global credit crunch in 2007 and the collapse of Lehman Brothers Inc. in September 2008, which adversely affected global financial markets and the liquidity in global credit markets. These developments resulted in an economic slowdown in the United States and most economies around the world, substantial volatility in equity securities markets globally, fluctuations in foreign currency exchange rates and volatility and tightening of liquidity in global credit markets. Although Hong Kong's gross domestic product in real terms (after adjustment for inflation) rose by 6.4% in 2007 and 2.5% in 2008, it is forecast by the Hong Kong Government to contract by 3.3% in 2009. We expect the recovery of, and the continued growth in, the Hong Kong economy to depend in part upon the economic performance of the United States and Mainland China, as well as certain other developed countries. If the economic downturn continues, there can be no assurance that the Hong Kong economy or our business and financial condition will not continue to be adversely affected.

Due to our relationship with BOC and our strategy to expand our Mainland China business, our performance is also influenced by Mainland China's economic conditions and the economic measures undertaken by the PRC government. Mainland China has experienced rapid economic growth over the past three decades in part as a result of the PRC government's extensive economic reforms. However, recent adverse economic conditions have adversely impacted Mainland China's growth in 2008, and the PRC government has taken several steps to support economic growth. From the last quarter of 2008 to the end of 2009, the PBOC loosened monetary policies, increasing liquidity and lowering the required reserve ratio, thereby increasing lending. The PRC government implemented a four trillion Renminbi fiscal stimulus package centered on infrastructure projects. Large liquidity injections in the last quarter of 2008 contributed to a significant increase in bank lending in 2009. Because of the Chinese government's growing concerns that rapidly rising bank lending could fuel asset bubbles and increase the risk of inflation, in January 2010, the PBOC raised the Renminbi deposit reserve requirement ratio for banks by 50 basis points. If Mainland China's economic growth experiences slowdowns in the future, or the Chinese government continues to tighten its monetary policies, our Mainland China business and our ability to implement our growth strategies in Mainland China could be materially and adversely affected.

*We are subject to different regulatory requirements in the Hong Kong banking industry.*

The issued shares of our direct holding company, BOCHK (Holdings), are listed on the HKSE. Both BOCHK (Holdings) and BOCHK are required to publish annual audited and semi-annual unaudited financial information. The amount of information publicly available for issuers in Hong Kong is less than that publicly available for comparable banks in certain other countries.

Under the Hong Kong Banking Ordinance (Cap. 155 of the Laws of Hong Kong) (the “**Banking Ordinance**”), the HKMA regulates the business activities and operations of commercial banks and has the ability to influence banking and financial markets generally. Potential investors should be aware that regulatory requirements in Hong Kong may differ from those that prevail in other countries. Since we operate in the highly regulated banking and securities industries in Hong Kong, potential investors should also be aware that the regulatory authorities have been consistently imposing higher standards and developing new guidelines and regulatory requirements. For example, the Basel II capital adequacy standards have been adopted by the HKMA in Hong Kong since the beginning of 2007. The new standards require banks to disclose key pieces of information on capital, risk exposures, risk assessment processes and hence capital adequacy. The aim of the new standards is to encourage banks to demonstrate to the market participants that their risk management systems are robust and that all relevant risks have been identified and controlled. In addition, since 2007, the regulators in Hong Kong have introduced recommendations which are intended to provide tighter control and more transparency in the Hong Kong banking sector, in particular, in relation to the marketing and sale of investment products.

We have taken steps to implement the recommendations by relevant regulators and to comply with any new or modified regulations. Increased regulation and the requirement for more stringent investor protections have increased our operational and compliance expenses. Any changes in regulation, governmental policies, income tax laws or rules and accounting principles, as well as international conventions and standards relating to commercial banking operations in Hong Kong, could affect our operations. There can be no assurance that the relevant regulatory authorities will not implement further regulations and that such change will not materially increase our operational and compliance cost or adversely affect our business or operations. There can also be no assurance that breaches of legislation or regulations by us will not occur and, to the extent that such a breach does occur, that significant liability or penalties will not be incurred.

### **Risks relating to the Notes**

*The Notes are unsecured and subordinated and have only limited rights of acceleration.*

The Notes will be unsecured and subordinated. The Notes are not deposits and are not insured by any regulatory agency and they may not be used as collateral for any loan made by us. In the event of a winding-up of our operations, your claims will be subordinated in right of payment to the prior payment in full of all of our other liabilities (whether actual or contingent, present or future), including all deposit liabilities and other liabilities and all of our offices and branches, except those liabilities which by their terms rank equally with or junior to the Notes. As a consequence of these subordination provisions, if any such events should occur, the holders of the Notes may recover proportionately less than the holders of our deposit liabilities or the holders of our other unsubordinated liabilities.

If the Issuer defaults on the payment of principal or interest on the Notes, the only action the Trustee may take against it is to institute a proceeding in Hong Kong for the winding-up of the Issuer. The Trustee will have no right to accelerate payment of the Notes in the case of default in payment other than in the event of a winding-up of the Issuer.

***Limited liquidity of the Notes may affect the market price of the Notes.***

The Notes are a new issue of securities with no established trading market. Application has been made to the HKSE for the listing of, and permission to deal in, the Notes by way of selectively marketed securities; however, if for any reason no listing is obtained, the liquidity of the Notes may be negatively impacted.

We have been advised by the Initial Purchasers that they currently intend to make markets for the Notes as permitted by applicable law, but they are not required to do so, and any such market making may be discontinued at any time at their sole discretion. A liquid or active trading market for the Notes may not develop. If an active trading market for the Notes does not develop or does develop and is not maintained, the market price of the Notes may be adversely affected. If the Notes are traded, they may trade at a discount from their initial issue price, depending on prevailing interest rates, the market for similar securities, our performance and other factors. See “Plan of Distribution.”

The Notes will not be registered under the Securities Act or the securities or blue sky laws of any state of the United States. The Notes are being offered, and may be resold, outside of the United States within the meaning of and in compliance with Regulation S. The Notes are also being offered, and may be resold, within the United States to qualified institutional buyers within the meaning of and in compliance with Rule 144A under the Securities Act, or pursuant to another exemption from the registration requirements of the Securities Act. Consequently, the Notes are subject to restrictions on transfer and resale.

***A downgrade in ratings may affect the market price of the Notes.***

The Notes have been rated “A–” by Fitch, “A1” by Moody’s and “BBB+” by S&P. The ratings may not reflect the potential impact of all risks related to the structure, market, additional factors discussed above, and other factors that may affect the value of the Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time. Rating agencies may also revise or replace entirely the methodology applied to derive credit ratings.

There is a risk that the credit rating of the Issuer and of the Notes may change as a result of changes in the Issuer’s operating performance or capital structure, or for some other reason. Moreover, no assurance can be given that a credit rating will remain for any given period of time or that a credit rating will not be lowered or withdrawn by the relevant rating agency if, in its judgment, circumstances in the future so warrant or if a different methodology is applied to derive such credit ratings. This could affect the market price and the liquidity of the Notes.

## USE OF PROCEEDS

The proceeds from the issue of the Notes will be approximately US\$1.59 billion, which we intend to use for the partial repayment of the outstanding amount of our existing US\$2.5 billion subordinated loan from BOC in December 2008 (the “**BOC Loan**”). The BOC Loan, which was qualified as “Category II Supplementary Capital” of BOCHK, has a term of 10 years and bears interest payable on a semi-annual basis at the rate of (i) 2.00% per annum over LIBOR for the initial five years and (ii) 2.50% per annum over LIBOR for the remaining years. The Notes are intended to qualify as “Category II Supplementary Capital” of BOCHK and are freely available to absorb the losses of BOCHK, if any, in accordance with the requirements of the Banking (Capital) Rules (Cap. 155L).

## CAPITALIZATION

The following table sets forth our capitalization as of September 30, 2009 as derived from our Unaudited Condensed Consolidated Financial Information prepared in accordance HKFRS and as adjusted to give effect to the issue of the Notes but before the application of the proceeds therefrom to repay the BOC Loan as described in “Use of Proceeds.” This table should be read in conjunction with (i) our Unaudited Condensed Consolidated Financial Information and (ii) “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

	As of September 30, 2009			
	Actual	As Adjusted	Actual	As Adjusted
	(HK\$ in millions)		(US\$ in millions)	
Subordinated liabilities . . . . .	27,076	27,076	3,494	3,494
Subordinated Notes offered hereby . . . . .	–	12,349	–	1,593
Total subordinated liabilities . . . . .	27,076	39,425	3,494	5,087
<b>Equity</b>				
Share capital . . . . .	43,043	43,043	5,554	5,554
Reserves . . . . .	51,055	51,055	6,588	6,588
Minority interests . . . . .	1,406	1,406	181	181
Total equity . . . . .	<u>95,504</u>	<u>95,504</u>	<u>12,323</u>	<u>12,323</u>
<b>Total capitalization<sup>(1)</sup> . . . . .</b>	<u>122,580</u>	<u>134,929</u>	<u>15,817</u>	<u>17,410</u>

Notes:

- (1) Total capitalization refers to total subordinated liabilities plus total equity.
- (2) Convenience translation of Hong Kong dollar amounts to U.S. dollar amounts were made at a rate of HK\$7.7500 to US\$1.00.



## EXCHANGE RATE INFORMATION

The Hong Kong dollar is freely convertible into other currencies, including the U.S. dollar. Since October 17, 1983, the Hong Kong dollar has been linked to the U.S. dollar at the rate of HK\$7.80 to US\$1.00. The Basic Law of the Hong Kong (the “**Basic Law**”), which came into effect on July 1, 1997, provides that no foreign exchange control policies shall be applied in Hong Kong. The market exchange rate of the Hong Kong dollar against the U.S. dollar continues to be determined by the forces of supply and demand in the foreign exchange market within a boundary. However, against the background of the fixed rate which applies to the issue of the Hong Kong currency in the form of banknotes, as described above, the market exchange rate has not deviated materially from the level of HK\$7.80 to US\$1.00 since the peg was first established. In May 2005, the HKMA broadened the 22-year old trading band from the original rate of HK\$7.80 per U.S. dollar to a rate range of HK\$7.75 to HK\$7.85 per U.S. dollar. The Hong Kong government has indicated its intention to maintain the link within that rate range. The Hong Kong government has also stated that it has no intention of imposing exchange controls in Hong Kong and that the HK dollar will remain freely convertible into other currencies, including the U.S. dollar. However no assurance can be given that the Hong Kong dollar will continue to be linked to U.S. dollar or at all.

The following table sets forth information concerning exchange rates between the Hong Kong dollar and U.S. dollar for the periods indicated:

Period	Exchange Rate			
	Period end	Average <sup>(1)</sup>	High	Low
		(HK\$ per US\$1.00)		
2005 . . . . .	7.7533	7.7755	7.7999	7.7514
2006 . . . . .	7.7771	7.7685	7.7928	7.7506
2007 . . . . .	7.7984	7.8008	7.8289	7.7497
2008 . . . . .	7.7499	7.7814	7.8159	7.7497
2009 . . . . .	7.7536	7.7513	7.7618	7.7495
July . . . . .	7.7500	7.7500	7.7505	7.7495
August . . . . .	7.7505	7.7506	7.7516	7.7500
September . . . . .	7.7500	7.7503	7.7514	7.7498
October . . . . .	7.7497	7.7497	7.7502	7.7495
November . . . . .	7.7500	7.7497	7.7501	7.7495
December . . . . .	7.7536	7.7526	7.7572	7.7495
2010				
January (through January 25th) . . . . .	7.7679	7.7600	7.7713	7.7539

*Source:* Federal Reserve Bank of New York for period ends indicated through December 2008 and the weekly H.10 statistical release of the Federal Reserve Board for period ends indicated from and after January 2009.

*Note:*

- (1) Annual averages are calculated by averaging the rates on the last business day of each month during the relevant year. Period averages are calculated by averaging the daily rates during the relevant period.

## SELECTED FINANCIAL INFORMATION

*The following tables present our consolidated financial information as of and for the years ended December 31, 2006, 2007 and 2008, and as of and for the nine months ended September 30, 2008 and 2009, which have been extracted from our Audited Consolidated Financial Statements and Unaudited Condensed Consolidated Financial Information. Such information should be read in conjunction with (i) our Audited Consolidated Financial Statements and Unaudited Condensed Consolidated Financial Information, and (ii) “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”*

### RESULTS OF OPERATIONS

	Years ended December 31,			Nine months ended September 30,		
	2006	2007	2008	2008	2009	2009
	(audited)	(audited)	(audited)	(unaudited)	(unaudited)	(unaudited)
	(HK\$ in millions)					(US\$ in millions) <sup>(1)</sup>
Interest income . . . . .	39,856	45,309	34,185	25,890	16,553	2,136
Interest expense . . . . .	(24,571)	(26,769)	(15,186)	(11,980)	(4,174)	(538)
<b>Net interest income</b> . . . . .	<b>15,285</b>	<b>18,540</b>	<b>18,999</b>	<b>13,910</b>	<b>12,379</b>	<b>1,598</b>
Fees and commission income . . . . .	5,186	8,480	7,475	5,688	6,474	835
Fees and commission expenses . . . . .	(1,259)	(1,897)	(2,011)	(1,433)	(1,431)	(185)
<b>Net fees and commission income</b> . . . . .	<b>3,927</b>	<b>6,583</b>	<b>5,464</b>	<b>4,255</b>	<b>5,043</b>	<b>650</b>
Net trading income . . . . .	1,567	1,013	1,914	1,661	1,313	169
Net (loss)/gain on financial instruments designated at fair value through profit or loss . . . . .	(100)	(25)	(316)	(117)	255	33
Net (loss)/gain on investment in securities . . . . .	(5)	(53)	(15)	40	73	10
Other operating income . . . . .	326	756	434	317	339	44
<b>Net operating income before impairment allowances</b> . . . . .	<b>21,000</b>	<b>26,814</b>	<b>26,480</b>	<b>20,066</b>	<b>19,402</b>	<b>2,504</b>
Net reversal/(charge) of impairment allowances . . . . .	1,794	(1,448)	(9,843)	(5,870)	(21)	(3)
<b>Net operating income</b> . . . . .	<b>22,794</b>	<b>25,366</b>	<b>16,637</b>	<b>14,196</b>	<b>19,381</b>	<b>2,501</b>
Operating expenses . . . . .	(6,495)	(7,659)	(8,636)	(6,166)	(9,165)	(1,183)
<b>Operating profit</b> . . . . .	<b>16,299</b>	<b>17,707</b>	<b>8,001</b>	<b>8,030</b>	<b>10,216</b>	<b>1,318</b>
Net gain/(loss) from disposal of/fair value adjustments on investment properties . . . . .	605	1,064	(118)	475	1,266	163
Net (loss)/gain from disposal/ revaluation of properties, plant and equipment . . . . .	(16)	28	18	5	24	3
Share of profits less losses of associates . . . . .	5	3	7	9	4	1
<b>Profit before taxation</b> . . . . .	<b>16,893</b>	<b>18,802</b>	<b>7,908</b>	<b>8,519</b>	<b>11,510</b>	<b>1,485</b>
Taxation . . . . .	(2,858)	(3,255)	(1,170)	(1,331)	(1,912)	(247)
<b>Profit for the year/period</b> . . . . .	<b>14,035</b>	<b>15,547</b>	<b>6,738</b>	<b>7,188</b>	<b>9,598</b>	<b>1,238</b>
<b>Profit attributable to:</b>						
Equity holders of the Bank . . . . .	13,844	15,277	6,517	6,989	9,474	1,222
Minority interests . . . . .	191	270	221	199	124	16
	<u>14,035</u>	<u>15,547</u>	<u>6,738</u>	<u>7,188</u>	<u>9,598</u>	<u>1,238</u>
<b>Dividends</b> . . . . .	<u>9,298</u>	<u>14,376</u>	<u>3,960</u>	<u>3,960</u>	<u>3,469</u>	<u>448</u>

# BALANCE SHEET DATA

	As of December 31,			As of September 30,	
	2006	2007	2008	2009	2009
	(audited)	(audited)	(audited)	(unaudited)	(unaudited)
		(HK\$ in millions)			(US\$ in millions) <sup>(1)</sup>
<b>ASSETS</b>					
Cash and balances with banks and other financial institutions . . . . .	105,236	159,052	153,268	168,551	21,749
Placements with banks and other financial institutions maturing between one and 12 months . . . . .	56,373	53,154	89,718	98,486	12,708
Financial assets at fair value through profit or loss . . . . .	13,194	10,302	16,404	12,072	1,558
Derivative financial instruments . . . . .	7,393	14,477	19,628	18,722	2,416
Hong Kong SAR Government certificates of indebtedness . . . . .	34,750	32,770	34,200	37,560	4,846
Advances and other accounts . . . . .	352,844	420,212	470,220	517,791	66,812
Investment in securities . . . . .	302,091	297,048	289,353	293,655	37,891
Interests in associates . . . . .	60	83	88	89	11
Investment properties . . . . .	7,481	8,058	7,727	9,024	1,164
Properties, plant and equipment . . . . .	19,735	23,288	22,788	25,301	3,265
Deferred tax assets . . . . .	2	10	47	73	9
Other assets . . . . .	14,630	20,776	14,555	16,001	2,065
Total assets . . . . .	<u>913,789</u>	<u>1,039,230</u>	<u>1,117,996</u>	<u>1,197,325</u>	<u>154,494</u>
<b>LIABILITIES</b>					
Hong Kong SAR currency notes in circulation . . . . .	34,750	32,770	34,200	37,560	4,846
Deposits and balances of banks and other financial institutions . . . . .	49,034	60,599	88,779	81,871	10,564
Financial liabilities at fair value through profit or loss . . . . .	15,127	11,405	21,938	9,988	1,289
Derivative financial instruments . . . . .	4,052	11,082	20,450	15,557	2,007
Deposits from customers . . . . .	695,616	794,247	805,866	888,967	114,705
Debt securities in issue at amortized cost . . . . .	–	2,089	1,042	78	10
Other accounts and provisions . . . . .	30,271	38,569	33,662	34,393	4,438
Current tax liabilities . . . . .	1,128	1,210	441	1,929	249
Deferred tax liabilities . . . . .	3,391	3,967	2,799	4,402	568
Subordinated liabilities . . . . .	–	–	26,604	27,076	3,494
Total liabilities . . . . .	<u>833,369</u>	<u>955,938</u>	<u>1,035,781</u>	<u>1,101,821</u>	<u>142,170</u>
<b>EQUITY</b>					
Share capital . . . . .	43,043	43,043	43,043	43,043	5,554
Reserves . . . . .	<u>35,958</u>	<u>38,700</u>	<u>37,714</u>	<u>51,055</u>	<u>6,588</u>
Capital and reserves attributable to the equity holders of the Bank . . . . .	<u>79,001</u>	<u>81,743</u>	<u>80,757</u>	<u>94,098</u>	<u>12,142</u>
Minority interests . . . . .	<u>1,419</u>	<u>1,549</u>	<u>1,458</u>	<u>1,406</u>	<u>182</u>
Total equity . . . . .	<u>80,420</u>	<u>83,292</u>	<u>82,215</u>	<u>95,504</u>	<u>12,324</u>
Total liabilities and equity . . . . .	<u>913,789</u>	<u>1,039,230</u>	<u>1,117,996</u>	<u>1,197,325</u>	<u>154,494</u>

Note:

(1) Convenience translation of Hong Kong dollar amounts to U.S. dollar amounts were made at a rate of HK\$7.7500 to US\$1.00.

## PROFITABILITY RATIOS AND OTHER DATA

	Year ended December 31,					Nine months ended September 30,
	2004	2005	2006	2007	2008	2009
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Return on average total assets <sup>(1)</sup> . . . . .	1.56%	1.66%	1.55%	1.53%	0.63%	1.14%
Return on average equity <sup>(2)</sup> . . . . .	20.1%	19.7%	18.2%	19.0%	8.0%	14.5%
Dividend payout ratio <sup>(3)</sup> . . . . .	66.4%	61.3%	67.2%	94.1%	60.8%	36.6%
Net interest spread <sup>(4)</sup> . . . . .	1.46%	1.48%	1.47%	1.65%	1.75%	1.58%
Net interest margin <sup>(5)</sup> . . . . .	1.55%	1.71%	1.85%	2.01%	1.93%	1.63%
Cost to income ratio <sup>(6)</sup> . . . . .	34.61%	31.89%	30.93%	28.56%	32.61%	47.24%
Cost to average assets ratio <sup>(7)</sup> . . . . .	0.71%	0.70%	0.72%	0.76%	0.81%	1.09%
Loan to deposit ratio <sup>(8)</sup> . . . . .	49.52%	52.23%	49.25%	51.62%	56.60%	56.87%

(1) Profit for the year divided by daily average balance of total assets.

(2) Profit attributable to shareholders divided by average of the beginning and ending balance of capital and reserves attributable to the equity holders of the bank.

(3) Dividend paid divided by profit attributable to shareholders.

(4) Average interest rate of total interest-earning assets less average interest rate of total interest-bearing liabilities.

(5) Net interest income divided by average interest-earning assets.

(6) Operating expenses divided by net operating income before impairment allowances.

(7) Operating expenses divided by daily average balance of total assets.

(8) Advances to customers divided by customers deposits (including structured deposits).

## SELECTED STATISTICAL DATA

*The following information should be read together with our Audited Consolidated Financial Statements and Unaudited Condensed Consolidated Financial Information as well as the section entitled, “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”*

### AVERAGE BALANCE SHEETS AND AVERAGE RATES

The following table sets forth, for the periods indicated, our average balances and average interest rates. Average balances are based on a daily average, which are considered to be representative of our operations.

	Year ended December 31,						Nine months ended September 30,			
	2006		2007		2008		2008		2009	
	Average balance	Average yield (%)	Average balance	Average yield (%)	Average balance	Average yield (%)	Average balance	Average yield (%)	Average balance	Average yield (%)
(HK\$ in millions, except percentages)										
Loans to banks <sup>(1)</sup> . . . . .	177,070	3.91	207,573	4.00	261,607	2.11	224,182	2.34	239,246	1.32
Interest-earning securities . .	293,414	4.60	315,761	4.92	283,599	4.23	280,983	4.48	301,671	2.22
Loans and advances to customers. . . . .	333,890	5.65	382,023	5.44	424,409	3.83	453,771	3.58	462,462	2.30
Other interest-earning assets .	21,778	2.63	17,462	3.73	13,786	2.92	14,553	2.87	11,974	1.55
<b>Total interest-earning assets . . . . .</b>	<b>826,152</b>	<b>4.82</b>	<b>922,819</b>	<b>4.91</b>	<b>983,401</b>	<b>3.48</b>	<b>973,489</b>	<b>3.54</b>	<b>1,015,353</b>	<b>2.04</b>
Non interest-earning assets. .	78,288		90,861		85,919		91,805		105,994	
<b>Total assets . . . . .</b>	<b>904,440</b>	<b>4.41</b>	<b>1,013,680</b>	<b>4.47</b>	<b>1,069,320</b>	<b>3.20</b>	<b>1,065,294</b>	<b>3.24</b>	<b>1,121,347</b>	<b>1.84</b>

*Note:*

- (1) Including balances and placement with banks and other financial institutions, trade bills and advances to banks and other financial institutions.

	Year ended December 31,						Nine months ended September 30,			
	2006		2007		2008		2008		2009	
	Average balance	Average rate (%)	Average balance	Average rate (%)	Average balance	Average rate (%)	Average balance	Average rate (%)	Average balance	Average rate (%)
(HK\$ in millions, except percentages)										
Deposits and balances of banks and other financial institutions . . . . .	44,859	2.99	45,819	3.38	79,785	1.90	75,024	2.02	96,479	1.55
Current, savings, time and other deposits of customers. . . . .	656,321	3.36	745,174	3.27	771,242	1.65	762,183	1.77	770,665	0.33
Certificate of deposits issued.	3,484	3.22	2,266	3.58	1,474	3.73	1,684	3.66	694	3.96
Other interest-bearing liabilities . . . . .	28,231	3.78	27,189	2.92	27,598	3.08	35,148	2.53	20,706	0.26
<b>Total interest-bearing liabilities. . . . .</b>	<b>732,895</b>	<b>3.35</b>	<b>820,448</b>	<b>3.26</b>	<b>880,099</b>	<b>1.73</b>	<b>874,039</b>	<b>1.83</b>	<b>888,544</b>	<b>0.46</b>
Non interest-bearing deposits . . . . .	32,850		36,925		37,220		45,271		66,463	
Shareholders’ funds and non interest-bearing liabilities .	138,695		156,307		152,001		145,984		166,340	
<b>Total liabilities. . . . .</b>	<b>904,440</b>	<b>2.72</b>	<b>1,013,680</b>	<b>2.64</b>	<b>1,069,320</b>	<b>1.42</b>	<b>1,065,294</b>	<b>1.50</b>	<b>1,121,347</b>	<b>0.37</b>

## Analysis of Net Interest Income

The following table sets forth our net interest income by changes in volume and by changes in rate for 2007 compared to 2006, and 2008 compared to 2007 and the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008. Information is provided with respect to: (1) effects attributable to changes in volume (changes in volume multiplied by prior rate) and (2) effects attributable to changes in rate, and variances caused by changes in both volume and rate have been allocated to rate.

	2007 vs. 2006			2008 vs. 2007			Nine months ended September 30, 2009 vs. nine months ended September 30, 2008 <sup>(3)</sup>		
	Change in average volume <sup>(1)</sup>	Change in average rate <sup>(2)</sup>	Net change	Change in average volume <sup>(1)</sup>	Change in average rate <sup>(2)</sup>	Net change	Change in average volume <sup>(1)</sup>	Change in average rate <sup>(2)</sup>	Net change
	(a)	(b)	(a)+(b)	(a)	(b)	(a)+(b)	(a)	(b)	(a)+(b)
(HK\$ in millions)									
Loans to banks. . . . .	1,191	205	1,396	2,163	(4,951)	(2,788)	265	(1,844)	(1,579)
Interest-earning securities . .	1,028	1,020	2,048	(1,583)	(1,959)	(3,542)	696	(5,151)	(4,455)
Loans and advances to customers . . . . .	2,720	(789)	1,931	2,308	(6,854)	(4,546)	233	(4,455)	(4,222)
Other interest-earning assets .	(114)	192	78	(137)	(111)	(248)	(56)	(119)	(175)
<b>Total interest-earning assets. . . . .</b>	<u>4,825</u>	<u>628</u>	<u>5,453</u>	<u>2,751</u>	<u>(13,875)</u>	<u>(11,124)</u>	<u>1,138</u>	<u>(11,569)</u>	<u>(10,431)</u>
Deposits and balances of banks and other financial institutions. . . . .	29	177	206	1,149	(1,182)	(33)	326	(351)	(25)
Current, savings, time and other deposits of customers . . . . .	2,985	(687)	2,298	852	(12,434)	(11,582)	113	(8,333)	(8,220)
Certificate of deposits issued. . . . .	(39)	8	(31)	(28)	2	(26)	(27)	1	(26)
Other interest-bearing liabilities. . . . .	(39)	(236)	(275)	12	46	58	(274)	(353)	(627)
<b>Total interest-bearing liabilities . . . . .</b>	<u>2,936</u>	<u>(738)</u>	<u>2,198</u>	<u>1,985</u>	<u>(13,568)</u>	<u>(11,583)</u>	<u>138</u>	<u>(9,036)</u>	<u>(8,898)</u>

### Notes:

- (1) Changes in volume multiplied by prior rate.
- (2) Variances caused by changes in both volume and rate have been allocated to rate.
- (3) Swap interest was reallocated to different balance sheet items.

## INVESTMENT PORTFOLIO

The following table sets forth, as of the dates indicated, information as to the carrying value of our investment securities available-for-sale and being held-to-maturity as well as loans and receivables.

	As of December 31,			As of September 30,
	2006	2007	2008	2009
	(HK\$ in millions)			
<b>Available-for-sale securities issued by:</b>				
Sovereigns . . . . .	13,180	13,402	70,274	56,757
Public sector entities . . . . .	6,933	9,673	9,202	21,851
Banks and other financial institutions . . .	34,873	43,854	70,576	111,932
Corporate entities . . . . .	45,403	33,589	21,313	16,303
Total available-for-sale securities . . . . .	<u>100,389</u>	<u>100,518</u>	<u>171,365</u>	<u>206,843</u>
<b>Held-to-maturity securities issued by:</b>				
Sovereigns . . . . .	1,768	1,814	1,079	1,304
Public sector entities . . . . .	21,166	20,530	12,481	3,481
Banks and other financial institutions . . .	102,823	108,547	71,426	56,770
Corporate entities . . . . .	39,831	34,537	20,407	10,990
Total held-to-maturity securities . . . . .	<u>165,588</u>	<u>165,428</u>	<u>105,393</u>	<u>72,545</u>
<b>Loans and receivables issued by:</b>				
Banks and other financial institutions . . .	<u>36,114</u>	<u>31,102</u>	<u>12,595</u>	<u>14,267</u>
Total loans and receivables . . . . .	<u>36,114</u>	<u>31,102</u>	<u>12,595</u>	<u>14,267</u>
<b>Total securities . . . . .</b>	<u><u>302,091</u></u>	<u><u>297,048</u></u>	<u><u>289,353</u></u>	<u><u>293,655</u></u>



The following table sets forth the carrying values and maturities of our investment securities available-for-sale and being held-to-maturity as well as loans and receivables, excluding equity securities, as of September 30, 2009.

	As of September 30, 2009							
	On demand	Up to one month	One – three months	Three – 12 months	One – five years	Over five years	Indefinite	Total
	(HK\$ in millions)							
Assets								
Investment in securities								
Debt securities held for available-for-sale								
– Certificates of deposit held . . . . .	–	1,000	4,814	5,107	6,675	–	–	17,596
– Others. . . . .	–	10,798	25,700	14,837	107,496	24,286	5,611	188,728
Debt securities held for held-to-maturity								
– Certificates of deposit held . . . . .	–	784	876	2,681	4,224	–	–	8,565
– Others. . . . .	–	1,819	2,708	17,873	31,369	6,853	3,358	63,980
Debt securities held for loans and receivables . . . . .								
	–	3,718	7,914	2,635	–	–	–	14,267
Total . . . . .	–	18,119	42,012	43,133	149,764	31,139	8,969	293,136

## LOAN PORTFOLIO

The following table sets forth, as of the date indicated, our gross advances to customers by loans used inside or outside Hong Kong and industry sectors of the borrowers as of December 31, 2004 to 2008 and September 30, 2009.

	As of December 31,					As of September 30,
	2004	2005	2006	2007	2008	2009
	(HK\$ in millions)					
<b>Loans for use in Hong Kong</b>						
Industrial, commercial and financial						
Property development . . . . .	20,239	18,536	19,290	17,979	19,856	26,667
Property investment . . . . .	46,979	52,490	55,943	65,963	71,374	72,009
Financial concerns . . . . .	10,345	11,624	10,721	12,346	12,312	11,524
Stockbrokers . . . . .	124	167	65	242	124	5,314
Wholesale and retail trade . . . . .	15,016	12,796	13,019	13,572	18,156	20,066
Manufacturing . . . . .	11,837	11,723	12,417	14,468	16,410	23,223
Transport and transport equipment . . . . .	11,780	11,911	15,548	21,001	21,590	27,879
Recreational activities <sup>(1)</sup> . . . . .	—	—	33	30	139	309
Information technology <sup>(1)</sup> . . . . .	—	—	1,586	2,009	6,049	4,978
Others . . . . .	<u>29,659</u>	<u>26,853</u>	<u>20,158</u>	<u>21,046</u>	<u>23,529</u>	<u>34,859</u>
<b>Individuals</b>						
Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme . . . . .	17,430	15,983	14,236	13,969	13,477	12,332
Loans for purchase of other residential properties . . . . .	95,615	99,171	96,953	106,583	116,303	124,902
Credit card advances . . . . .	4,256	4,668	4,806	5,761	6,553	6,703
Others . . . . .	<u>7,386</u>	<u>8,071</u>	<u>9,501</u>	<u>10,686</u>	<u>11,452</u>	<u>10,333</u>
<b>Total loans for use in Hong Kong . . . . .</b>	<b>270,666</b>	<b>273,993</b>	<b>274,276</b>	<b>305,655</b>	<b>337,324</b>	<b>381,098</b>
<b>Trade finance . . . . .</b>	<b>13,279</b>	<b>16,079</b>	<b>16,865</b>	<b>24,275</b>	<b>24,555</b>	<b>27,514</b>
<b>Loans for use outside Hong Kong . . . . .</b>	<b><u>29,281</u></b>	<b><u>43,942</u></b>	<b><u>55,935</u></b>	<b><u>83,110</u></b>	<b><u>99,295</u></b>	<b><u>98,346</u></b>
<b>Gross advances to customers . . . . .</b>	<b><u>313,226</u></b>	<b><u>334,014</u></b>	<b><u>347,076</u></b>	<b><u>413,040</u></b>	<b><u>461,174</u></b>	<b><u>506,958</u></b>

Note:

(1) For 2004 and 2005, the industry sectors “Recreational activities” and “Informational technology” are grouped in “Others.”

## Maturity Analysis of Loan Portfolio

The following table sets forth the maturity analysis of our loan portfolio as of September 30, 2009.

As of September 30, 2009							
On demand	Up to one month	One – three months	Three – 12 months	One – five years	Over five years	Indefinite	Total
(HK\$ in millions)							
<b>Assets</b>							
Advances and other accounts							
– advances to customers . . . . .	31,737	12,607	30,015	65,346	221,420	142,988	852 504,965
– trade bills . . . . .	46	4,074	4,669	222	–	–	– 9,011
– advances to banks and other financial institutions . . . . .	15	77	500	396	2,827	–	– 3,815
<b>Total . . . . .</b>	<b>31,798</b>	<b>16,758</b>	<b>35,184</b>	<b>65,964</b>	<b>224,247</b>	<b>142,988</b>	<b>852 517,791</b>

## Classified or impaired and overdue loans

The following table shows the distribution of our (a) classified or impaired and (b) overdue loans to customers as of December 31, 2006 to 2008 and September 30, 2009, by the loans used inside or outside Hong Kong and industry sectors of the borrowers.

	As of December 31,						As of September 30,	
	2006		2007		2008		2009	
	Classified or impaired <sup>(1)</sup>	Overdue <sup>(2)</sup>	Classified or impaired <sup>(1)</sup>	Overdue <sup>(2)</sup>	Classified or impaired <sup>(1)</sup>	Overdue <sup>(2)</sup>	Classified or impaired <sup>(1)</sup>	Overdue <sup>(2)</sup>
(HK\$ in millions)								
Loans for use in Hong Kong								
Industrial, commercial and financial								
Property development . . .	24	281	16	18	2	14	3	18
Property investment . . . .	320	1,170	343	961	294	585	232	453
Financial concerns . . . . .	4	24	–	14	–	–	–	4
Stockbrokers . . . . .	–	–	–	–	–	–	–	–
Wholesale and retail trade.	248	456	238	382	218	300	173	221
Manufacturing . . . . .	154	402	138	550	234	298	127	252
Transport and transport equipment. . . . .	4	17	3	25	2	9	96	8
Recreational activities . . .	–	–	–	–	–	–	–	–
Information technology . .	–	1	–	2	–	3	–	–
Others . . . . .	148	404	90	584	68	213	53	182
Individuals								
Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme . . . . .								
	141	679	129	599	98	510	77	465
Loans for purchase of other residential properties . . . . .								
	359	2,350	284	2,078	153	1,650	137	1,302
Credit card advances . . .	17	210	23	245	30	273	29	199
Others . . . . .	159	435	119	314	107	333	93	273
Total loans for use in Hong Kong. . . . .								
	1,578	6,429	1,383	5,772	1,206	4,188	1,020	3,377
Trade finance . . . . .	157	365	105	399	560	494	259	286
Loans for use outside Hong Kong . . . . .								
	253	329	315	375	372	235	216	195
Gross advances to customers . . . . .								
	<u>1,988</u>	<u>7,123</u>	<u>1,803</u>	<u>6,546</u>	<u>2,138</u>	<u>4,917</u>	<u>1,495</u>	<u>3,858</u>

### Notes:

- (1) Classified or impaired loans represent advances which are either classified as “substandard,” “doubtful” or “loss” under our classification of loan quality, or individually assessed to be impaired.
- (2) Advances repayable by regular installments are classified as overdue when an installment payment is past due and remains unpaid.

## SUMMARY OF LOAN IMPAIRMENT ALLOWANCES

The following table sets forth an analysis of our loan impairment allowances for the periods indicated:

	As of December 31,							
	2005		2006		2007		2008	
	Individual assessment	Collective assessment	Individual assessment	Collective assessment	Individual assessment	Collective assessment	Individual assessment	Collective assessment
(HK\$ in millions)								
As of January 1 . . . . .	1,887	2,055	983	731	546	557	381	1,004
(credited)/charged to income statement . . . . .	(1,377)	(1,268)	(1,719)	(71)	(1,280)	595	8	653
Loans written off during the year as uncollectible . .	(1,067)	(27)	(706)	(142)	(172)	(155)	(299)	(176)
Recoveries . . . . .	1,639	–	2,053	62	1,311	30	722	28
Unwind of discount on allowance . . . . .	(99)	(29)	(65)	(23)	(24)	(23)	(12)	(8)
As of December 31 . . . . .	<u>983</u>	<u>731</u>	<u>546</u>	<u>557</u>	<u>381</u>	<u>1,004</u>	<u>800</u>	<u>1,501</u>

## DEPOSITS

The following table sets forth the average balances of our deposits and the average rates paid on our deposits for the periods indicated:

	Year ended December 31,						Nine months ended September 30,	
	2006		2007		2008		2009	
	Average balance	Average rate (%)	Average balance	Average rate (%)	Average balance	Average rate (%)	Average balance	Average rate (%)
(HK\$ in millions, except percentages)								
Demand deposits and current accounts . . . . .	20,139	3.73%	43,707	2.84%	8,997	0.77%	28,612	0.16%
Savings deposits. . . . .	230,682	2.60%	261,245	2.21%	299,810	0.31%	437,454	0.04%
Time, call and notice deposits . . . . .	<u>405,500</u>	3.77%	<u>440,222</u>	3.94%	<u>462,435</u>	2.54%	<u>304,599</u>	0.77%
<b>Total interest-bearing deposits . . . . .</b>	<b><u>656,321</u></b>	<b>3.36%</b>	<b><u>745,174</u></b>	<b>3.27%</b>	<b><u>771,242</u></b>	<b>1.65%</b>	<b><u>770,665</u></b>	<b>0.33%</b>
Non interest-bearing deposits	<u>32,850</u>		<u>36,925</u>		<u>37,220</u>		<u>66,463</u>	
<b>Total deposits . . . . .</b>	<b><u>689,171</u></b>		<b><u>782,099</u></b>		<b><u>808,462</u></b>		<b><u>837,128</u></b>	

## Time, Call and Notice Deposits

The following table sets forth the remaining maturities of our time, call and notice deposits from customers which had a fixed maturity as of September 30, 2009.

	Time, Call and Notice Deposits
	(HK\$ in millions)
On demand . . . . .	5,916
Up to one month . . . . .	166,104
One to three months . . . . .	71,535
Three to 12 months . . . . .	40,260
Over 12 months . . . . .	608
Total . . . . .	<u>284,423</u>

## PROFITABILITY RATIOS AND OTHER DATA

	Year ended December 31,					Nine months ended September 30,
	2004	2005	2006	2007	2008	2009
	(Percentages)					
Return on average total assets <sup>(1)</sup> . . . . .	1.56%	1.66%	1.55%	1.53%	0.63%	1.14%
Return on average equity <sup>(2)</sup> . . . . .	20.1%	19.7%	18.2%	19.0%	8.0%	14.5%
Dividend payout ratio <sup>(3)</sup> .	66.4%	61.3%	67.2%	94.1%	60.8%	36.6%
Net interest spread <sup>(4)</sup> . . .	1.46%	1.48%	1.47%	1.65%	1.75%	1.58%
Net interest margin <sup>(5)</sup> . . .	1.55%	1.71%	1.85%	2.01%	1.93%	1.63%
Cost to income ratio <sup>(6)</sup> . .	34.61%	31.89%	30.93%	28.56%	32.61%	47.24%
Cost to average assets ratio <sup>(7)</sup> . . . . .	0.71%	0.70%	0.72%	0.76%	0.81%	1.09%
Loan to deposit ratio <sup>(8)</sup> . .	49.52%	52.23%	49.25%	51.62%	56.60%	56.87%

(1) Profit for the year divided by daily average balance of total assets.

(2) Profit attributable to shareholders divided by average of the beginning and ending balance of capital and reserves attributable to the equity holders of the bank.

(3) Dividend paid divided by profit attributable to shareholders.

(4) Average interest rate of total interest-earning assets less average interest rate of total interest-bearing liabilities.

(5) Net interest income divided by average interest-earning assets.

(6) Operating expenses divided by net operating income before impairment allowances.

(7) Operating expenses divided by daily average balance of total assets.

(8) Advances to customers divided by customers deposits (including structured deposits).

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*You should read the following discussion and analysis of our financial condition and results of operations together with our Audited Consolidated Financial Statements and Unaudited Condensed Consolidated Financial Information, as well as the sections entitled "Selected Financial Information" and "Selected Statistical Information." Our Consolidated Financial Statements have been prepared in accordance with HKFRS, which differs in some respects from U.S. GAAP. For a discussion of these differences, see "Summary of Certain Differences between HKFRS and U.S. GAAP." We have not attempted to reconcile our Audited Consolidated Financial Statements and Unaudited Condensed Consolidated Financial Information to U.S. GAAP, but had we done so it may have had a material impact on the financial information contained herein.*

*The discussion below contains forward-looking statements and reflects our current views with respect to future events and financial performance. Actual results may differ materially from those anticipated in these forward-looking statements as a result of factors such as those set out under "Forward-Looking Statements." These ratios are not part of our Audited Consolidated Financial Statements or Unaudited Condensed Consolidated Financial Information and have not been audited. In addition, there are risks associated with any investment. Some of the particular risks are set out in the section entitled "Risk Factors." You should read that section carefully before you decide to invest in the Notes.*

### OVERVIEW

We are a major commercial banking group in Hong Kong with a leading market share in our core commercial banking business such as deposits, residential mortgages, corporate loans and syndicated loans. We are one of the three Hong Kong dollar note-issuing banks. We were appointed by the PBOC as the sole clearing bank for Renminbi business in Hong Kong in 2003. With over 270 branches and more than 470 ATMs, as well as other delivery channels in Hong Kong as of September 30, 2009, we offer a comprehensive range of financial products and services to individual and corporate customers. At the same date, we had 23 branches and sub-branches in Mainland China providing local and cross-border banking services to customers in Hong Kong and Mainland China.

In Hong Kong, we are the second largest banking group in terms of asset size, customer deposits and loans. As of December 31, 2008, we had HK\$1,118 billion in total assets, HK\$806 billion in total deposits and HK\$461 billion in gross advances to customers. Our net operating income before impairment allowances in 2008 was HK\$26 billion. As of September 30, 2009, we had HK\$1,197 billion in total assets, HK\$889 billion in total deposits and HK\$507 billion in gross advances to customers. Our net operating income before impairment allowances for the nine months ended September 30, 2009 was HK\$19 billion.

We have three principal lines of business, consisting of personal banking, corporate banking and treasury operations. We provide a comprehensive range of banking products and services to our individual and corporate customers. We also provide Renminbi banking products and services in Hong Kong, such as deposit, exchange, remittance, credit cards and bonds distribution to our individual customers, as well as trade settlement and finance to our corporate customers.

## **FACTORS AFFECTING OUR RESULTS OF OPERATIONS AND FINANCIAL CONDITION**

### **Hong Kong and Mainland China's Economic Conditions**

We conduct most of our operations and generate most of our revenues in Hong Kong. Our results of operations and financial condition are significantly affected by Hong Kong's economic conditions. The economic conditions in Hong Kong are, in turn, significantly affected by a variety of external factors, including the economic, political, legal and demographic environment in Mainland China and throughout Asia and the rest of the world.

The 1997 Asian financial crisis and the subsequent economic downturn in Hong Kong resulted in, among other things, increased provisions which negatively affected our profitability. Hong Kong's economic growth was also affected by the SARS virus in the first half of 2003. Although the Hong Kong economy had, to a great extent, recovered from the impact of SARS in the years subsequent to 2003, it has been adversely affected by the worsening of the global economy resulting from the United States subprime mortgage crisis and the global credit crunch in 2007, and the collapse of Lehman Brothers Inc. in September 2008, which adversely affected global financial markets and the liquidity in global credit markets. These developments resulted in a general contraction of economic development in the United States and most other economies around the world, substantial volatility in equity securities markets globally, fluctuations in foreign currency exchange rates and volatility and tightening of liquidity in global credit markets. While it is difficult to predict how long these conditions will exist and which markets may be affected, these developments have adversely affected, and could continue to adversely affect us for an extended period of time as a result of a potential slowdown in the extension of mortgages and the sale of financial products to customers, increase in capital funding costs and reduction in the interest rate margins from loans and mortgages. If the economic downturn continues, there can be no assurance that Hong Kong's economic conditions or our business and financial condition will not continue to be adversely affected.

Due to our relationship with our parent, BOC, and our strategy to expand our Mainland China business, our performance, to a certain extent, is influenced by Mainland China's economic conditions and the economic measures undertaken by the PRC government. China has experienced rapid economic growth over the past three decades in part due to the PRC government's extensive economic reforms, which have been focused on transforming Mainland China's centrally planned economy to a market-based economy. The real growth of Mainland China's overall economy, ranging from 9.1% to 13.0% annually between 2002 and 2007, to 9.0% in 2008, has led to increased corporate activities as well as significant increases in personal wealth. However, recent adverse economic conditions have lowered Mainland China's growth. Mainland China's real GDP grew at a rate of 8.7% in 2009, and it is expected to grow at a similar rate according to the World Bank.

The global economic downturn adversely impacted Mainland China's growth in 2008, and the PRC government has taken several steps to support economic growth. From the last quarter of 2008 to the end of 2009, the PBOC loosened monetary policies that increased liquidity and lowered the Renminbi reserve requirement ratio. The PRC government implemented a four-trillion Renminbi fiscal stimulus package that is centered on infrastructure type projects. Large liquidity injections in the last quarter of 2008 led to a significant increase in bank lending in 2009. In January 2010, the PBOC raised the Renminbi reserve requirement ratio for banks by 50 basis points in light of the Chinese government's growing concerns that rapidly rising bank lending could fuel asset bubbles and increase the risk of inflation. If the Chinese government continues to tighten its monetary policies, our Mainland China business and our ability to implement our growth strategies in Mainland China could be materially and adversely affected.



## **Competition in the Hong Kong and Mainland China's Banking Industry**

We focus principally on the Hong Kong market for individual and corporate customers. The banking industry in Hong Kong is a mature market and we are subject to increasing competition from many other Hong Kong-incorporated banks and Hong Kong branches of international banks, including competitors that have significantly greater financial and other resources. According to statistics published by the HKMA, as of September 30, 2009, there were 146 international and local licensed banks, competing for a population of approximately seven million people. There is a limited market, especially for individual banking products such as residential mortgage advances, credit cards and personal advances. We expect that further consolidation in the industry, in particular mid-cap Hong Kong banks, will continue to intensify competition. There can be no assurance that we will be able to compete effectively in the face of such increased competition. Increased competition may make it difficult for us to increase the size of our loan portfolio and deposit base and may cause increased pricing competition, which could have an adverse effect on our growth plans, margins, ability to pass on increased costs of funding, results of operations and financial condition.

In particular, since 2000, banks in Hong Kong, including BOCHK, have lowered Mortgage Interest Rates. As future movements in Mortgage Interest Rates are uncertain, there can be no assurance that competition among banks in Hong Kong for residential mortgage advances will not result in further reductions in Mortgage Interest Rates. Further reductions in Mortgage Interest Rates could have an adverse effect on our business, financial condition or results of operations.

Due to the mature state of the Hong Kong banking sector, we intend to continue to expand our retail and corporate lending portfolios by growing our Mainland China-related business. However, we are likely to face increased competition in the Mainland China market from existing local mainland Chinese banks and other foreign banks entering the market. We expect competition from foreign commercial banks to increase significantly as previous restrictions on their geographical presence, customer base and operating licenses in Mainland China were removed in December 2006 pursuant to the PRC's WTO commitments. A number of foreign banks have established locally incorporated banking entities in Mainland China. In addition, the PRC's CEPA with Hong Kong and Macau allows smaller banks from these jurisdictions to operate in Mainland China, which has also increased competition in the banking industry in Mainland China. Many of these banks compete with us for the same customer base and some of them may have greater financial, management and technical resources than us. Further, under Supplement VI to the CEPA, which came into effect on October 1, 2009, banks in Hong Kong that have established branches in the province of Guangdong may now set up sub-branches within the province in any municipality without the need to first establish a branch in the same municipality. With this new provision, the capital requirement for setting up a sub-branch in Guangdong has been lowered. We expect increasing competition from foreign banks for the banking business in Guangdong.

## **Interest Rate Environment**

Our results of operations depend to a great extent on our net interest income. Interest rates applicable to us are sensitive to many factors over which we have no control, including the regulatory framework of the banking and financial sectors in the PRC, domestic and international economic and political conditions and competition. Our net interest income represented 72.8%, 69.1%, 71.7% and 63.8% of our net operating income before impairment allowances for the three years ended December 31, 2006, 2007 and 2008 and the nine months ended September 30, 2009, respectively. We realize income from the spread between income earned on our assets and interest paid on our liabilities. Our net interest spread for the years ended December 31, 2006, 2007 and 2008 and the nine months ended September 30, 2009 were 1.47%, 1.65%, 1.75% and 1.58%, respectively. As some of our assets and liabilities are repriced at different times, we are vulnerable to fluctuations in market interest rates. As a result, volatility in interest rates could have an adverse effect on our business, financial condition, liquidity and results of operations. For instance, our

interest income decreased by 24.6% from 2007 to 2008 primarily due to a decrease in the average yield on interest-earning assets as a result of the low interest rate environment. In addition, a substantial increase in interest rates could raise our funding costs without a proportionate increase in loan yields in the short term (or any increase at all). Rising interest rates would therefore require us to re-balance our assets and liabilities in order to minimize the risk of potential mismatches and maintain our profitability. Rising interest rates may adversely affect the economy in Hong Kong and the financial condition and repayment ability of our corporate and retail borrowers, including holders of credit cards, which in turn may lead to deterioration in our credit portfolio.

## **CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS IN APPLYING ACCOUNTING POLICIES**

We make estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments 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 judgments, 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.

### **Impairment allowances on loans and advances**

We review our loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the income statement, we make judgments as to whether there is any observable evidence 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.

### **Impairment of held-to-maturity and available-for-sale investments**

We review our 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. We make 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 collateralized assets.

For asset/mortgage backed securities (“ABS/MBS”), we adopt a comprehensive methodology in determining whether a particular security is impaired. Under the methodology, we will not only take into consideration the mark-to-market price of the issue and its external credit rating, but also other factors, including the FICO score, vintage, location, adjustable rate mortgage status, delinquencies, level of collateral protection, loan to value ratio and prepayment speed of the underlying assets. Having considered these factors, the ABS/MBS issue has to further pass the required credit enhancement coverage ratio test set by us. This ratio is determined by applying assumptions regarding the default rates based on the available delinquency, foreclosure and real estate-owned data of the ABS/MBS issue.

The methodology and assumptions used for the assessments are reviewed regularly. In evaluating the impairment of ABS/MBS during the year, we continued to consider significant declines in market prices of ABS/MBS to be one of the key indicators of impairment. In addition, due to reduced market liquidity and wider dispersion in indicative prices of certain ABS/MBS held by us, we also ensure that there is additional objective evidence of credit impairment by considering whether there has been a significant adverse change in the credit enhancement coverage ratio, taking into account the reported delinquencies and credit losses incurred in the underlying mortgage portfolio for each security held by us.

Many of the ABS/MBS held by us are complex in structure, and involve cash flows over many years. These future cash flows depend on economic factors such as U.S. residential real estate prices and the performance of the U.S. economy. The recoverable amounts of the securities therefore cannot be predicted with certainty at the current balance sheet date, and additional impairment charges – or releases of impairment charges – may be required in future accounting periods.

### **Fair values of derivatives financial instruments**

The fair values of derivatives financial instruments that are not quoted in active markets are determined by using various 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.

### **Held-to-maturity investments**

We follow 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 judgment. In making this judgment, we evaluate our intention and ability to hold such investments to maturity. If we fail to hold these investments to maturity other than for specific circumstances defined in HKAS 39, such as selling an insignificant amount close to maturity, we 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 amortized cost.

### **Amount recoverable from the Lehman Brothers Minibonds**

In determining the charge to the income statement in respect of the Minibonds, we took into account the estimated aggregate amount paid and payable under the Repurchase Scheme and the voluntary offer (under the voluntary offer, we have made an offer to pay an *ex gratia* amount to customers who would have been qualified as a customer eligible under the Repurchase Scheme but have entered into settlement agreements with us on terms which are financially less favorable than the Repurchase Scheme), the provision made prior to the date of the Repurchase Scheme and the amount recoverable from the Minibonds.

The amount recoverable from the Minibonds is uncertain and depends on a number of factors, including resolution of certain legal matters, which may result in a wide range of recovery outcomes. We have made an assessment of the amount recoverable taking into account such uncertainties. The final amount recovered by us could be different from the assessment and may result in a significant credit being recognized in the income statement in the period when it is realized. See “Risk Factors – Risks Relating to Our Business – We face potential risks in relation to the sales of certain investment products such as the Lehman Brothers Minibonds.”

## RESULTS OF OPERATIONS

### Nine months ended September 30, 2009 compared to the nine months ended September 30, 2008

#### Net Interest Income

Net interest income has historically been the largest component of our net operating income before impairment allowances, representing 69.3% and 63.8% of our net operating income before impairment allowances for the nine months ended September 30, 2008 and 2009, respectively. Our net interest income decreased by 11.0% from HK\$13,910 million for the nine months ended September 30, 2008 to HK\$12,379 million for the corresponding period in 2009, due principally to the lower interest rate environment in Hong Kong as further discussed below.

The following table sets forth, for the periods indicated, the principal components of our interest income and interest expenses:

	Nine months ended September 30,	
	2008	2009
	(HK\$ in millions, except percentages)	
<b>Interest income</b> . . . . .	25,890	16,553
<b>Interest expense</b> . . . . .	(11,980)	(4,174)
<b>Net interest income</b> . . . . .	<u>13,910</u>	<u>12,379</u>
Average balance on interest-earning assets . . . . .	973,489	1,015,353
Average balance on interest-bearing liabilities . . . . .	874,039	888,544
Net interest margin <sup>(1)</sup> . . . . .	1.90%	1.63%
Net interest spread <sup>(2)</sup> . . . . .	1.71%	1.58%

#### Notes:

- (1) The ratio of net interest income to average interest-earning assets.
- (2) The difference between the average yield on interest-earning assets and the average rate on interest-bearing liabilities.

#### Interest Income

Our interest income decreased by 36.1% from HK\$25,890 million for the nine months ended September 30, 2008 to HK\$16,553 million for the corresponding period in 2009, primarily due to a decrease in the average yield on interest-earning assets by 150 basis points from 3.54% for the nine months ended September 30, 2008 to 2.04% for the corresponding period in 2009 as a result of lower market interest rates.

The following table sets forth, for the periods indicated, the principal components of our interest income.

	Nine months ended September 30,	
	2008	2009
	(HK\$ in millions)	
<b>Interest income:</b>		
Cash and due from banks and other financial institutions . . . .	3,944	2,365
Advances to customers . . . . .	12,179	7,957
Listed investments . . . . .	2,279	1,678
Unlisted investments . . . . .	7,174	3,173
Others . . . . .	<u>314</u>	<u>1,380</u>
<b>Total interest income</b> . . . . .	<u>25,890</u>	<u>16,553</u>

#### *Interest income from advances to customers*

The largest component of our interest income has been interest income from advances to customers, representing 47.0% and 48.1% of our total interest income for the nine months ended September 30, 2008 and 2009, respectively. Interest income from advances to customers decreased by 34.7% from HK\$12,179 million for the nine months ended September 30, 2008 to HK\$7,957 million for the corresponding period in 2009, primarily due to a decrease in the average yield on advances to customers resulting from the lower interest rate environment.

#### *Interest income from investments in listed and unlisted securities*

Interest income from listed investments decreased by 26.4% from HK\$2,279 million for the nine months ended September 30, 2008 to HK\$1,678 million for the corresponding period in 2009. Interest income from unlisted investments decreased by 55.8% from HK\$7,174 million for the nine months ended September 30, 2008 to HK\$3,173 million for the corresponding period in 2009. These decreases were primarily due to a decline in the average yield on our interest-earning securities as such securities were repriced and reinvested at lower yield in a lower interest rate environment. The average yield on interest-earning securities decreased by 226 basis points from 4.48% for the nine months ended September 30, 2008 to 2.22% for the corresponding period in 2009.

#### *Interest income from cash and due from banks and other financial institutions*

Interest income from cash and due from banks and other financial institutions decreased by 40.0% from HK\$3,944 million for the nine months ended September 30, 2008 to HK\$2,365 million for the corresponding period in 2009, primarily due to a decrease in our average yield resulting from the lower interest rate environment during the period. The average yield of loans to banks decreased by 102 basis points from 2.34% for the nine months ended September 30, 2008 to 1.32% for the corresponding period in 2009.

#### *Others*

Other interest income increased significantly by HK\$1,066 million from HK\$314 million for the nine months ended September 30, 2008 to HK\$1,380 million for the corresponding period in 2009, reflecting the significant growth in business volume of derivative financial instruments.

#### ***Interest Expense***

Our interest expense decreased by 65.2% from HK\$11,980 million to HK\$4,174 million, primarily due to a decrease in the average rate on interest-bearing liabilities by 137 basis points from 1.83% for the nine months ended September 30, 2008 to 0.46% for the corresponding period in 2009 as a result of the lower interest rate environment, partially offset by a significant increase in interest expense associated with the subordinated loans we received from BOC as further discussed below.

The following table sets forth, for the periods indicated, the principal components of our interest expense.

	Nine months ended September 30,	
	2008	2009
	(HK\$ in millions)	
<b>Interest expense:</b>		
Due to banks, customers and other financial institutions . . . . .	(11,149)	(2,290)
Debt securities in issue . . . . .	(99)	(20)
Subordinated liabilities . . . . .	(118)	(732)
Others . . . . .	(614)	(1,132)
<b>Total interest expense . . . . .</b>	<u>(11,980)</u>	<u>(4,174)</u>

*Interest expense due to banks, customers and other financial institutions*

The largest component of our interest expense has been interest expense due to banks, customers and other financial institutions, representing 93.1% and 54.9% of our total interest expense for the nine months ended September 30, 2008 and 2009, respectively. Interest expense due to banks, customers and other financial institutions decreased by 79.5% from HK\$11,149 million for the nine months ended September 30, 2008 to HK\$2,290 million for the corresponding period in 2009, primarily due to the lower interest rate environment during the period, as well as a significant increase in demand, current and savings deposits as a proportion of our total deposits reflecting a shift of customer preference.

*Interest expense on subordinated liabilities*

Interest expense on subordinated liabilities, which relates to the two subordinated loans we obtained from BOC, increased significantly from HK\$118 million for the nine months ended September 30, 2008 to HK\$732 million for the corresponding period in 2009. This increase was primarily attributable to the fact that we obtained such subordinated loans in June and December 2008, respectively, and as a result, we were subject to higher interest expense for the nine months ended September 30, 2009 as compared to the corresponding period in 2008.

*Others*

Other interest expense increased by 84.4% from HK\$614 million for the nine months ended September 30, 2008 to HK\$1,132 million for the corresponding period in 2009, reflecting the significant growth in business volume of derivative financial instruments.

***Net Interest Spread and Net Interest Margin***

Net interest spread decreased by 13 basis points from 1.71% for the nine months ended September 30, 2008 to 1.58% for the corresponding period in 2009, primarily due to the increased interest expense associated with the acquisition of the subordinated loans, which we obtained in June and December 2008, partially offset by lower interest expense associated with an increase in the proportion of demand, current and savings deposits.

Net interest margin fell by 27 basis points from 1.90% for the nine months ended September 30, 2008 to 1.63% for the corresponding period in 2009, primarily due to a narrowing in the net interest spread and a decrease in contribution from our net free funds (primarily including cost-free capital and current account) under the lower interest rate environment during the period.

## Net Fees and Commission Income

Net fees and commission income represented 21.2% and 26.0% of our net operating income before impairment allowances for the nine months ended September 30, 2008 and 2009, respectively. Our net fees and commission income increased by 18.5% from HK\$4,255 million for the nine months ended September 30, 2008 to HK\$5,043 million for the corresponding period in 2009, primarily due to increases in fee income from securities brokerage, loan origination and credit cards business.

The following table sets forth, for the periods indicated, the principal components of our net fees and commission income.

	Nine months ended September 30,	
	2008	2009
	(HK\$ in millions)	
<b>Fees and commission income:</b>		
Securities brokerage		
Stocks . . . . .	1,729	2,620
Bonds . . . . .	259	19
Credit cards . . . . .	1,025	1,119
Loan . . . . .	423	758
Bills . . . . .	512	465
Payment services . . . . .	365	359
Insurance . . . . .	386	369
Safe deposit box . . . . .	145	147
Currency exchange . . . . .	160	145
Trust services . . . . .	128	127
Funds distribution . . . . .	198	66
Others . . . . .	358	280
Total . . . . .	<u>5,688</u>	<u>6,474</u>
<b>Fees and commission expenses . . . . .</b>	<u>(1,433)</u>	<u>(1,431)</u>
<b>Net fees and commission income . . . . .</b>	<u><u>4,255</u></u>	<u><u>5,043</u></u>

Fee income from stock brokerage increased by 51.5% from HK\$1,729 million for the nine months ended September 30, 2008 to HK\$2,620 million for the corresponding period in 2009, primarily due to an increase in transaction volume of securities trading by our customers.

Fee income from loans increased by 79.2% from HK\$423 million for the nine months ended September 30, 2008 to HK\$758 million for the corresponding period in 2009, primarily due to an increase in the size of our loan portfolio and increased transaction volume of syndicated loans following our appointment as BOC's "Asia Pacific Syndicated Loan Center" in early 2008. In addition, we raised our loan fees to reflect market conditions after September 2008.

Fee income from credit cards business increased by 9.2% from HK\$1,025 million for the nine months ended September 30, 2008 to HK\$1,119 million for the corresponding period in 2009, primarily due to an increase in cardholder spending and merchant acquiring business.

Fee income from bond brokerage decreased significantly from HK\$259 million for the nine months ended September 30, 2008 to HK\$19 million for the corresponding period in 2009. Fee income from funds distribution decreased by 66.7% from HK\$198 million for the nine months ended September 30, 2008 to HK\$66 million for the corresponding period in 2009. These decreases were primarily attributable to decreasing demand for structured products and funds.



Our fees and commission expenses decreased only slightly from HK\$1,433 million for the nine months ended September 30, 2008 to HK\$1,431 million for the corresponding period in 2009, primarily due to a decrease in the fees and commission expenses associated with currency exchange services, which partially offset the increased fees and commission expenses associated with stock brokerage.

### Net Trading Income

The following table sets forth, for the periods indicated, the principal components of our net trading income.

	Nine months ended September 30,	
	2008	2009
	(HK\$ in millions)	
<b>Net gain from:</b>		
Foreign exchange and foreign exchange products . . . . .	1,231	1,061
Interest rate instruments. . . . .	234	154
Equity instruments . . . . .	126	20
Commodities. . . . .	<u>70</u>	<u>78</u>
<b>Total net trading income. . . . .</b>	<u><b>1,661</b></u>	<u><b>1,313</b></u>

Total net trading income decreased by 21.0% from HK\$1,661 million for the nine months ended September 30, 2008 to HK\$1,313 million for the corresponding period in 2009 as further discussed below.

Net trading income from foreign exchange and foreign exchange products decreased by 13.8% from HK\$1,231 million for the nine months ended September 30, 2008 to HK\$1,061 million for the corresponding period in 2009. This was primarily due to a decrease in customer demand for foreign exchange products, in particular, Renminbi exchange transactions and a decrease in the transaction volume of structured deposits due to worsened market demand.

Net trading income from interest rate instruments decreased by 34.2% from HK\$234 million for the nine months ended September 30, 2008 to HK\$154 million for the corresponding period in 2009, primarily due to the recognition of losses on the decrease in fair value of certain debt securities, partially offset by the recognition of gains on the mark-to-market value of interest rate swap contracts.

Net trading income from equity instruments decreased by 84.1% from HK\$126 million for the nine months ended September 30, 2008 to HK\$20 million for the corresponding period in 2009, primarily due to a decline in the investor demand for these products, including equity-linked instruments, as well as a recognition of the decline in fair value of equity warrants and options.

### Net Gain on Investment in Securities

Our net gain on investment in securities increased by 82.5% from HK\$40 million for the nine months ended September 30, 2008 to HK\$73 million for the corresponding period in 2009, primarily due to an increase in net gain from disposal of available-for-sale securities. Our net gain from disposal of available-for-sale securities increased by 68.3% from HK\$41 million for the nine months ended September 30, 2008 to HK\$69 million for the corresponding period in 2009, primarily due to an increased disposal of debt securities at a value higher than their carrying value at the end of 2008.

### Other Operating Income

Our other operating income increased by 6.9% from HK\$317 million for the nine months ended September 30, 2008 to HK\$339 million for the corresponding period in 2009, primarily due to an increase in gross rental income from investment properties as the rental contracts were generally renewed at higher prices during the period.



## Net Charge of Impairment Allowances

Impairment allowances consist primarily of provisions on loans, securities investments and other assets. Net charge of impairment allowances decreased significantly from HK\$5,870 million for the nine months ended September 30, 2008 to HK\$21 million for the corresponding period in 2009.

The following table sets forth, for the periods indicated, the principal components of our impairment allowances.

	Nine months ended September 30,	
	2008	2009
	(HK\$ in millions)	
<b>Advances to customers</b>		
Individually assessed		
new allowances . . . . .	(438)	(183)
releases . . . . .	77	119
recoveries . . . . .	224	248
Subtotal . . . . .	<u>(137)</u>	<u>184</u>
Collectively assessed		
new allowances . . . . .	(434)	(282)
releases . . . . .	35	167
recoveries . . . . .	21	26
Subtotal . . . . .	<u>(378)</u>	<u>(89)</u>
<b>Net (charge)/reversal of loan impairment allowances . . . . .</b>	<u>(515)</u>	<u>95</u>
<b>Available-for-sale securities . . . . .</b>	(2,959)	(206)
<b>Held-to-maturity securities . . . . .</b>	(2,389)	99
<b>Others . . . . .</b>	<u>(7)</u>	<u>(9)</u>
<b>Net (charge) of impairment allowances . . . . .</b>	<u>(5,870)</u>	<u>(21)</u>

We had a net charge of impairment allowances on advances to customers of HK\$515 million for the nine months ended September 30, 2008 compared to a net reversal of HK\$95 million for the corresponding period in 2009. This was primarily due to a decrease in the net charge of allowances (before recoveries) from individual assessment and collective assessment as a result of the improvement in asset quality of loans and advances. An increase in loan recoveries from individual assessment also contributed to the net reversal in 2009.

Net charge of impairment allowances on available-for-sale securities decreased significantly from HK\$2,959 million for the nine months ended September 30, 2008 to HK\$206 million for the corresponding period in 2009. We had a net charge of impairment allowances on held-to-maturity securities of HK\$2,389 million for the nine months ended September 30, 2008 compared to a net reversal of HK\$99 million for the corresponding period in 2009. These decreases were primarily attributable to the increasing disposal of impaired U.S. non-agency residential mortgage-backed securities in the first three quarters of 2009 at a value higher than their carrying value at the end of 2008, contributing to significant write-backs of impairment allowances we previously provided for. In addition, improved market conditions contributed to fewer newly impaired securities which lowered our charge of impairment allowances.

## Operating Expenses

The following table sets forth, for the periods indicated, the principal components of our total operating expenses.

	Nine months ended September 30,	
	2008	2009
	(HK\$ in millions)	
Staff costs (including directors' emoluments) . . . . .	3,713	3,301
Premises and equipment expenses (excluding depreciation) . . . . .	753	806
Depreciation . . . . .	733	755
Lehman Brothers related products . . . . .	—	3,242
Other operating expenses . . . . .	967	1,061
<b>Total operating expenses . . . . .</b>	<b><u>6,166</u></b>	<b><u>9,165</u></b>

Our total operating expenses increased by 48.6% from HK\$6,166 million for the nine months ended September 30, 2008 to HK\$9,165 million for the corresponding period in 2009, primarily due to the expense of HK\$3,242 million relating to the Lehman Brothers Minibonds incident. This increase was partially offset by a decrease of 11.1% or HK\$412 million in staff costs. Our total operating expenses would have decreased by 3.9% or HK\$243 million if the expenses relating to Lehman Brother Minibonds incident were excluded.

## Profit before Taxation

As a result of the foregoing factors, our profit before taxation increased by 35.1% from HK\$8,519 million for the nine months ended September 30, 2008 to HK\$11,510 million for the corresponding period in 2009.

## Profit for the Period

As a result of the foregoing factors, our profit increased by 33.5% from HK\$7,188 million for the nine months ended September 30, 2008 to HK\$9,598 million for the corresponding period in 2009.

## Year ended December 31, 2008 compared to year ended December 31, 2007

## Net Interest Income

Net interest income represented 69.1% and 71.7% of our net operating income before impairment allowances in 2007 and 2008, respectively. Our net interest income increased by 2.5% from HK\$18,540 million in 2007 to HK\$18,999 million in 2008, primarily due to an increase in the average balance of interest-earning assets and change in asset mix, partially offset by a decrease in the average yield on interest-earning assets resulting from the lower interest rate environment.

The following table sets forth, for the years indicated, the principal components of our interest income and interest expenses:

	Year ended December 31,	
	2007	2008
	(HK\$ in millions, except percentages)	
<b>Interest income</b> . . . . .	45,309	34,185
<b>Interest expense</b> . . . . .	(26,769)	(15,186)
<b>Net interest income</b> . . . . .	<u>18,540</u>	<u>18,999</u>
Average balance on interest-earning assets . . . . .	922,819	983,401
Average balance on interest-bearing liabilities . . . . .	820,448	880,099
Net interest margin <sup>(1)</sup> . . . . .	2.01%	1.93%
Net interest spread <sup>(2)</sup> . . . . .	1.65%	1.75%

Notes:

- (1) The ratio of net interest income to average interest-earning assets.
- (2) The difference between the average yield on interest-earning assets and the average rate on interest-bearing liabilities.

### **Interest Income**

Our interest income decreased by 24.6% from HK\$45,309 million in 2007 to HK\$34,185 million in 2008, primarily due to a decrease in the average yield on interest-earning assets from 4.91% in 2007 to 3.48% in 2008, offset by an increase in the average balance on interest-earning assets.

The following table sets forth, for the years indicated, the principal components of our interest income.

	Year ended December 31,	
	2007	2008
	(HK\$ in millions)	
<b>Interest income:</b>		
Cash and due from banks and other financial institutions . . . .	8,311	5,523
Advances to customers . . . . .	20,801	16,255
Listed investments . . . . .	2,500	2,922
Unlisted investments . . . . .	13,046	9,082
Others . . . . .	<u>651</u>	<u>403</u>
<b>Total interest income</b> . . . . .	<u>45,309</u>	<u>34,185</u>

### **Interest income from advances to customers**

The largest component of our interest income has been interest income from advances to customers, representing 45.9% and 47.6% of our total interest income in 2007 and 2008, respectively. Interest income from advances to customers decreased by 21.9% from HK\$20,801 million in 2007 to HK\$16,255 million in 2008, primarily due to a decrease in the average yield on advances to customers resulting from the lower interest rate environment, partially offset by an increase in our loan portfolio. The average yield decreased by 161 basis points from 5.44% in 2007 to 3.83% in 2008. The average balance on advances to customers increased by 11.1% from HK\$382,023 million in 2007 to HK\$424,409 million in 2008.

### *Interest income from investments in listed and unlisted securities*

Interest income from listed investments increased by 16.9% from HK\$2,500 million in 2007 to HK\$2,922 million in 2008. Interest income from unlisted investments decreased by 30.4% from HK\$13,046 million in 2007 to HK\$9,082 million in 2008. Overall, the average yield on interest-earning securities decreased by 69 basis points from 4.92% in 2007 to 4.23% in 2008 as a large amount of securities were repriced or reinvested at lower yields in a lower interest rate environment.

### *Interest income from cash and due from banks and other financial institutions*

Interest income from cash and due from banks and other financial institutions decreased by 33.5% from HK\$8,311 million in 2007 to HK\$5,523 million in 2008, primarily due to a decrease in average yield by 189 basis points from 4.00% in 2007 to 2.11% in 2008, offset by an increase in the average balance by 26.0% from HK\$207,573 million in 2007 to HK\$261,607 million in 2008.

### **Interest Expense**

Our interest expense decreased by 43.3% from HK\$26,769 million in 2007 to HK\$15,186 million in 2008 primarily due to a decrease in the average rate on interest-bearing liabilities by 153 basis points from 3.26% in 2007 to 1.73% in 2008 as a result of the lower market interest rates and change of deposit mix.

The following table sets forth, for the years indicated, the principal components of our interest expense.

	Year ended December 31,	
	2007	2008
	(HK\$ in millions)	
<b>Interest expense:</b>		
Due to banks, customers and other financial institutions . . . . .	(25,895)	(14,037)
Debt securities in issue . . . . .	(103)	(130)
Subordinated liabilities . . . . .	—	(243)
Others . . . . .	(771)	(776)
<b>Total interest expense . . . . .</b>	<u>(26,769)</u>	<u>(15,186)</u>

### *Interest expense due to banks, customers and other financial institutions*

The largest component of our interest expense has been interest expense on due to banks, customers and other financial institutions, representing 96.7% and 92.4% of our total interest expense in 2007 and 2008, respectively. Interest expense due to banks, customers and other financial institutions decreased by 45.8% from HK\$25,895 million in 2007 to HK\$14,037 million in 2008, primarily due to a decrease in the interest expenses on customers' deposits, which was mainly attributable to a decline in the average rate on customers' deposits, partially offset by a slight increase in the average balance on customer deposits.

### *Interest expense on subordinated liabilities*

We obtained two subordinated loans from BOC in 2008 with a carrying amount of HK\$26,604 million as of December 31, 2008 and, as a result, recorded HK\$243 million as interest expense in 2008, as compared to nil in 2007.

### ***Net Interest Spread and Net Interest Margin***

Net interest spread increased by 10 basis points from 1.65% in 2007 to 1.75% in 2008. This increase was mainly attributable to the widened securities spread in the decreasing interest rate environment and growth in higher yielding loans, such as Mainland China-related lending and trade finance. In addition, pricing of new corporate loan facilities was improved in the tightening credit environment, which positively affected our net interest spread.

Net interest margin decreased by eight basis points from 2.01% in 2007 to 1.93% in 2008, primarily due to the decline in contribution from net free funds as market interest rates decreased and to an increase in Renminbi deposits, which generated a lower interest spread.

### **Net Fees and Commission Income**

Net fees and commission income represented 24.6% and 20.6% of our total operating income in 2007 and 2008, respectively. Our net fees and commission income decreased by 17.0% from HK\$6,583 million in 2007 to HK\$5,464 million in 2008, primarily due to a decline in investment-related fee income, such as securities brokerage and funds distribution. The following table sets forth, for the years indicated, the principal components of our net fees and commission income.

	<b>Year ended December 31,</b>	
	<b>2007</b>	<b>2008</b>
	<b>(HK\$ in millions)</b>	
<b>Fees and commission income:</b>		
Securities brokerage		
Stocks . . . . .	3,560	2,380
Bonds . . . . .	211	259
Credit cards . . . . .	1,027	1,220
Bills . . . . .	588	683
Loan . . . . .	347	513
Payment services . . . . .	464	486
Insurance . . . . .	454	449
Funds distribution . . . . .	683	218
Trust services . . . . .	153	173
Guarantees . . . . .	32	37
Others . . . . .	961	1,057
Total . . . . .	8,480	7,475
<b>Fees and commission expenses . . . . .</b>	<b>(1,897)</b>	<b>(2,011)</b>
<b>Net fees and commission income . . . . .</b>	<b><u>6,583</u></b>	<b><u>5,464</u></b>

Fee income from stock brokerage decreased by 33.1% from HK\$3,560 million in 2007 to HK\$2,380 million in 2008, primarily due to lower transaction volume as the financial crisis intensified. On the other hand, fee income from bonds brokerage increased by 22.7% from HK\$211 million in 2007 to HK\$259 million in 2008, primarily due to the introduction of private placement services in the first half of 2008.

Fee income from credit cards service increased by 18.8% from HK\$1,027 million in 2007 to HK\$1,220 million in 2008, primarily due to increases in cardholder spending and merchant-acquiring business.

Fee income from funds distribution decreased by 68.1% from HK\$683 million in 2007 to HK\$218 million in 2008, primarily due to the decreased sales volume of open-end funds as a result of lower customer demand.

Fee income from bills commissions increased by 16.2% from HK\$588 million in 2007 to HK\$683 million in 2008, primarily due to an increase in trade settlement business volume.

Fee income from loans increased by 47.8% from HK\$347 million in 2007 to HK\$513 million in 2008, primarily due to an increase in the transaction volume of syndicated loans underwriting after we were appointed as BOC's "Asia Pacific Syndicated Loan Center" in early 2008.

Our fees and commission expenses increased by 6.0% from HK\$1,897 million in 2007 to HK\$2,011 million in 2008, primarily due to increased expenses in credit cards business, currency exchange service and Renminbi-related business.

### Net Trading Income

The following table sets forth, for the years indicated, the principal components of our net trading income/(loss).

	Year ended December 31,	
	2007	2008
	(HK\$ in millions)	
<b>Net gain/(loss) from:</b>		
Foreign exchange and foreign exchange products . . . . .	800	1,809
Interest rate instruments. . . . .	30	(127)
Equity instruments . . . . .	181	119
Commodities. . . . .	2	113
<b>Total net trading income. . . . .</b>	<u>1,013</u>	<u>1,914</u>

Total net trading income increased by 88.9% from HK\$1,013 million in 2007 to HK\$1,914 million in 2008, primarily due to a significant increase in net trading income from foreign exchange and foreign exchange products by HK\$1,009 million from 2007 to 2008. This increase was primarily attributable to the improvement in trading income from mark-to-market valuations on foreign exchange swap contracts. In addition, the volatile currency markets and the anticipated appreciation of Renminbi which contributed to increasing investor demand for currency-related products in 2008.

Net trading income from interest rate instruments was HK\$30 million in 2007 compared to a net trading loss of HK\$127 million in 2008, primarily due to the mark-to-market loss on interest rate swap contracts.

Net trading income from equity instruments decreased by 34.3% from HK\$181 million in 2007 to HK\$119 million in 2008, primarily due to a decline in the fair value of equity-linked instruments.

Net trading income from commodities increased significantly from HK\$2 million in 2007 to HK\$113 million in 2008, primarily due to higher customer demand for bullion products in a volatile commodity market in 2008.

### Net Loss on Investment in Securities

Our net loss on investment in securities decreased by 71.7% from HK\$53 million to HK\$15 million, primarily due to a decrease in net loss from disposal of available-for-sale securities. Our net loss from disposal of available-for-sale securities decreased by 74.5% from HK\$55 million in 2007 to HK\$14 million in 2008. This decrease was mainly attributable to a decline of loss on disposal of debt securities.

### Other Operating Income

Our other operating income decreased by 42.6% from HK\$756 million in 2007 to HK\$434 million in 2008. Other operating income in 2007 reflected non-recurring income from the initial recognition of fair value of equity securities of VISA Inc. ("VISA") that VISA granted to us in connection with its initial public offering ("IPO").

## Net Charge of Impairment Allowances

Impairment allowances consist primarily of provisions on loans, securities investments and other assets. Net charge of impairment allowances increased significantly from HK\$1,448 million in 2007 to HK\$9,843 million in 2008.

The following table sets forth, for the years indicated, the principal components of our impairment allowances.

	Year ended December 31,	
	2007	2008
	(HK\$ in millions)	
<b>Advances to customers</b>		
Individually assessed		
new allowances . . . . .	(330)	(813)
releases . . . . .	299	83
recoveries . . . . .	<u>1,311</u>	<u>722</u>
Subtotal . . . . .	<u>1,280</u>	<u>(8)</u>
Collectively assessed		
new allowances . . . . .	(625)	(691)
releases . . . . .	–	10
recoveries . . . . .	<u>30</u>	<u>28</u>
Subtotal . . . . .	<u>(595)</u>	<u>(653)</u>
<b>Net reversal/(charge) of loan impairment allowances . . . . .</b>	<b>685</b>	<b>(661)</b>
<b>Available-for-sale securities . . . . .</b>	<b>(289)</b>	<b>(5,109)</b>
<b>Held-to-maturity securities . . . . .</b>	<b>(1,844)</b>	<b>(4,061)</b>
<b>Others . . . . .</b>	<b><u>–</u></b>	<b><u>(12)</u></b>
<b>Net (charge) of impairment allowances . . . . .</b>	<b><u>(1,448)</u></b>	<b><u>(9,843)</u></b>

We had a net charge of impairment allowances on advances to customers of HK\$661 million in 2008 compared to a net reversal of HK\$685 million in 2007, primarily due to an increase in the net charge of allowances (before recoveries) from individual assessment resulting from an increase in new allowances made to cover the formation of newly impaired loans and further deterioration of existing impaired loan as a result of the financial crisis. A decrease in loan recoveries also contributed to the net charge in 2008.

Net charge of impairment allowances on available-for-sale securities increased significantly from HK\$289 million in 2007 to HK\$5,109 million in 2008. Net charge of impairment allowances on held-to-maturity securities increased significantly from HK\$1,844 million in 2007 to HK\$4,061 million in 2008. These increases reflected the fact that we recorded a total amount of HK\$9,170 million on net charge of impairment allowances for our portfolio of U.S. non-agency residential mortgage-backed securities and other debt securities. Given the increasing volatility in global capital markets in 2008, we carried out a comprehensive assessment on our impairment charges in the same year, after taking into account the relevant criteria and specific features of our securities investments.

## Operating Expenses

The following table sets forth, for the years indicated, the principal components of our total operating expenses.

	Year ended December 31,	
	2007	2008
	(HK\$ in millions)	
Staff costs (including directors' emoluments) . . . . .	4,594	4,472
Premises and equipment expenses (excluding depreciation) . . . . .	949	1,064
Depreciation . . . . .	785	990
Other operating expenses . . . . .	<u>1,331</u>	<u>2,110</u>
<b>Total operating expenses . . . . .</b>	<b><u>7,659</u></b>	<b><u>8,636</u></b>

Our total operating expenses increased by 12.8% from HK\$7,659 million in 2007 to HK\$8,636 million in 2008, primarily due to the expense of HK\$769 million relating to the Lehman Brothers Minibonds incident. See "Risk Factors – Risk Relating to Our Business – We face potential risks in relation to the Lehman Brothers Minibonds."

## Profit before Taxation

As a result of the foregoing factors, our profit before taxation decreased by 57.9% from HK\$18,802 million in 2007 to HK\$7,908 million in 2008.

## Profit for the Year

As a result of the foregoing factors, our profit for the year decreased by 56.7% from HK\$15,547 million in 2007 to HK\$6,738 million in 2008.

## Year ended December 31, 2007 compared to year ended December 31, 2006

The following table sets forth, for the years indicated, the principal components of our interest income and interest expense:

	Year ended December 31,	
	2006	2007
	(HK\$ in millions, except percentages)	
<b>Interest income . . . . .</b>	39,856	45,309
<b>Interest expense . . . . .</b>	<u>(24,571)</u>	<u>(26,769)</u>
<b>Net interest income . . . . .</b>	<b><u>15,285</u></b>	<b><u>18,540</u></b>
Average balance on interest-earning assets . . . . .	826,152	922,819
Average balance on interest-bearing liabilities . . . . .	732,895	820,448
Net interest margin <sup>(1)</sup> . . . . .	1.85%	2.01%
Net interest spread <sup>(2)</sup> . . . . .	1.47%	1.65%

Notes:

(1) The ratio of net interest income to average interest-earning assets.

(2) The difference between the average yield on interest-earning assets and the average rate on interest-bearing liabilities.



## Net Interest Income

Net interest income represented 72.8% and 69.1% of our net operating income before impairment allowances in 2006 and 2007, respectively. Our net interest income increased by 21.3% from HK\$15,285 million in 2006 to HK\$18,540 million in 2007 primarily due to increases in both average interest-earning assets and net interest margin.

### Interest Income

Our interest income increased by 13.7% from HK\$39,856 million in 2006 to HK\$45,309 million in 2007 due to an increase in both the average balance of and average yield on interest-earning assets. The average yield on our interest-earning assets increased by nine basis points from 4.82% in 2006 to 4.91% in 2007.

The following table sets forth, for the years indicated, the principal components of our interest income.

	Year ended December 31,	
	2006	2007
	(HK\$ in millions)	
<b>Interest income:</b>		
Cash and due from banks and other financial institutions . . . .	6,915	8,311
Advance to customers . . . . .	18,870	20,801
Listed investment . . . . .	2,393	2,500
Unlisted investment . . . . .	11,105	13,046
Others . . . . .	573	651
<b>Total interest income . . . . .</b>	<u>39,856</u>	<u>45,309</u>

#### *Interest income from advances to customers*

Interest income from advances to customers represented 47.3% and 45.9% of our total interest income in 2006 and 2007, respectively. Interest income from advances to customers increased by 10.2% from HK\$18,870 million in 2006 to HK\$20,801 million in 2007, primarily due to an increase in the average balance of advances to customers from HK\$333,890 million in 2006 to HK\$382,023 million in 2007, partially offset by a decrease in the average yield on loans and advances to customers by 21 basis points from 5.65% in 2006 to 5.44% in 2007, reflecting a reduced Hong Kong Prime rate and increased pricing pressure from competition.

#### *Interest income from investments in listed and unlisted securities*

Interest income from listed investments increased by 4.5% from HK\$2,393 million in 2006 to HK\$2,500 million in 2007. Interest income from unlisted investments increased by 17.5% from HK\$11,105 million in 2006 to HK\$13,046 million in 2007. These increases were primarily attributable to an increase in the average yield on the interest-earning listed and unlisted securities, as we reinvested a portion of our matured lower yield securities into higher yield securities. The average yield on interest-earning listed and unlisted securities increased by 32 basis points from 4.60% in 2006 to 4.92% in 2007. The average balance on our interest-earning listed and unlisted securities increased by 7.6% from HK\$293,414 million in 2006 to HK\$315,761 million in 2007.

### *Interest income from cash and due from banks and other financial institutions*

Interest income from cash and due from banks and other financial institutions increased by 20.2% from HK\$6,915 million to HK\$8,311 million, primarily due to an increase in prevailing money market rates resulting in an increase in the average yield on loans to banks of nine basis points from 3.91% in 2006 to 4.00% in 2007, as well as an increase in the average balance of our loans to banks by 17.2% from HK\$177,070 million in 2006 to HK\$207,573 million in 2007.

### *Interest Expense*

Our interest expense increased by 8.9% from HK\$24,571 million in 2006 to HK\$26,769 million in 2007 due to an increase in the average balance of interest-bearing liabilities, partially offset by a decrease in the average rate on customers deposits. The average balance of our interest-bearing liabilities increased by 11.9% from HK\$732,895 million in 2006 to HK\$820,448 million in 2007. The average rate on our interest-bearing liabilities were 3.35% and 3.26% in 2006 and 2007, respectively.

The following table sets forth, for the years indicated, the principal components of our interest expense.

	Year ended December 31,	
	2006	2007
	(HK\$ in millions)	
<b>Interest expense:</b>		
Due to banks, customers and other financial institutions . . . . .	(23,391)	(25,895)
Debt securities in issue . . . . .	(112)	(103)
Others . . . . .	(1,068)	(771)
<b>Total interest expense . . . . .</b>	<u>(24,571)</u>	<u>(26,769)</u>

### *Interest expense due to banks, customers and other financial institutions*

The largest component of our interest expense has been interest expense on due to banks, customers and other financial institutions, representing 95.2% and 96.7% of our total interest expense in 2006 and 2007, respectively. Interest expense due to banks, customers and other financial institutions increased by 10.7% from HK\$23,391 million in 2006 to HK\$25,895 million in 2007, primarily due to an increase in the average rate resulting from higher market interest rates in 2007 and an increase in the average balance of deposits.

### *Net Interest Spread and Net Interest Margin*

Net interest spread increased by 18 basis points from 1.47% in 2006 to 1.65% in 2007, primarily due to an increase in the average yield of interest-earning assets as a result of repricing or reinvestment of lower yield investments and a shift of asset mix, as well as a widened deposit spread.

Net interest margin increased by 16 basis points from 1.85% in 2006 to 2.01% in 2007, primarily due to an increase of 18 basis points in our net interest spread, partially offset by a slight decline in the contribution from our net free funds.

## Net Fees and Commission Income

Net fees and commission income represented 18.7% and 24.6% of our net operating income before impairment allowances in 2006 and 2007, respectively. Our net fees and commission income increased by 67.6% from HK\$3,927 million in 2006 to HK\$6,583 million in 2007, primarily due to an increase in fee income from stock brokerage, funds distribution and credit card business.

The following table sets forth, for the years indicated, the principal components of our net fees and commission income.

	Year ended December 31,	
	2006	2007
	(HK\$ in millions)	
<b>Fees and commission income:</b>		
Securities brokerage		
Stocks . . . . .	1,383	3,560
Bonds . . . . .	105	211
Credit cards . . . . .	807	1,027
Bills . . . . .	537	588
Loan . . . . .	273	347
Payment services . . . . .	418	464
Insurance . . . . .	343	454
Funds distribution . . . . .	317	683
Trust services . . . . .	118	153
Guarantees . . . . .	44	32
Others . . . . .	841	961
Subtotal . . . . .	<u>5,186</u>	<u>8,480</u>
<b>Fees and commission expenses . . . . .</b>	<u>(1,259)</u>	<u>(1,897)</u>
<b>Net fees and commission income . . . . .</b>	<u><u>3,927</u></u>	<u><u>6,583</u></u>

Fee income from stock brokerage increased by 157.4% from HK\$1,383 million in 2006 to HK\$3,560 million in 2007, primarily due to increasing transaction volume of stock trading activities by our customers. On the other hand, fee income from bonds brokerage increased by 101.0% from HK\$105 million in 2006 to HK\$211 million in 2007, primarily reflecting the distribution of structured financial products.

Fee income from funds distribution increased by 115.5% from HK\$317 million in 2006 to HK\$683 million in 2007, primarily due to the launch of our open-end funds and certain thematic and China equity funds.

Income from credit cards service increased by 27.3% from HK\$807 million in 2006 to HK\$1,027 million in 2007, primarily due to increases in cardholder spending and merchant acquiring business.

Our fees and commission expenses increased by 50.7% from HK\$1,259 million in 2006 to HK\$1,897 million in 2007, primarily due to the growth in transaction volume as we expanded our business.

## Net Trading Income

The following table sets forth, for the years indicated, the principal components of our net trading income.

	Year ended December 31,	
	2006	2007
	(HK\$ in millions)	
<b>Net gain from:</b>		
Foreign exchange and foreign exchange products . . . . .	1,113	800
Interest rate instruments. . . . .	304	30
Equity instruments . . . . .	72	181
Commodities. . . . .	<u>78</u>	<u>2</u>
<b>Total net trading income. . . . .</b>	<u><u>1,567</u></u>	<u><u>1,013</u></u>

Our total net trading income decreased by 35.4% from HK\$1,567 million in 2006 to HK\$1,013 million in 2007, primarily due to the decrease in net trading income from foreign exchange and foreign exchange products, as well as the decline in net trading income from interest rate instruments.

Net trading income from foreign exchange and foreign exchange products decreased by 28.1% from HK\$1,113 million in 2006 to HK\$800 million in 2007, primarily due to the recognition of losses on the mark-to-market value of foreign exchange swap contracts.

Net trading income from interest rate instruments decreased by 90.1% from HK\$304 million in 2006 to HK\$30 million in 2007, primarily due to the recognition of losses on mark-to-market value of our interest rate swap contracts.

## Net Loss on Investment in Securities

Our net loss on investment in securities increased significantly by HK\$48 million from HK\$5 million in 2006 to HK\$53 million in 2007, primarily due to an increase in net loss from disposal of available-for-sale securities. Our net loss from disposal of available-for-sale securities increased significantly by HK\$48 million from HK\$7 million in 2006 to HK\$55 million in 2007. This increase was mainly attributable to an increase in disposal of debt securities with lower quality.

## Other Operating Income

Our other operating income increased significantly by HK\$430 million from HK\$326 million in 2006 to HK\$756 million in 2007, primarily reflecting non-recurring income in 2007 from the initial recognition of fair value of equity securities of VISA which VISA granted to us in connection with its IPO.

## Net Reversal/(Charge) of Impairment Allowances

Impairment allowances consist primarily of provisions charged on loans, securities investments and other assets.

The following table sets forth, for the years indicated, the principal components of our impairment allowances.

	Year ended December 31,	
	2006	2007
	(HK\$ in millions)	
<b>Advances to customers</b>		
Individually assessed		
new allowances . . . . .	(647)	(330)
releases . . . . .	313	299
recoveries . . . . .	2,053	1,311
Subtotal . . . . .	<u>1,719</u>	<u>1,280</u>
Collectively assessed		
new allowances . . . . .	(194)	(625)
releases . . . . .	203	–
recoveries . . . . .	62	30
Subtotal . . . . .	<u>71</u>	<u>(595)</u>
<b>Net reversal of loan impairment allowances . . . . .</b>	<b>1,790</b>	<b>685</b>
<b>Available-for-sale securities . . . . .</b>	<b>–</b>	<b>(289)</b>
<b>Held-to-maturity securities . . . . .</b>	<b>–</b>	<b>(1,844)</b>
<b>Properties, plant and equipment . . . . .</b>	<b>4</b>	<b>–</b>
<b>Net reversal/(charge) of impairment allowances . . . . .</b>	<b><u>1,794</u></b>	<b><u>(1,448)</u></b>

Net reversal of impairment allowances on advances decreased by 61.7% from HK\$1,790 million in 2006 to HK\$685 million in 2007, primarily due to decreases in both loan recoveries and release of allowances. Net loan impairment charge from individual assessment (before recoveries) decreased, primarily due to the decline in new allowances as loan quality continued to improve. Net loan impairment charge from collective assessment (before recoveries) increased, mainly attributable to growth of our loan portfolio and the continuous refinement of our collective assessment methodology.

Given the increasing market volatility and credit exposures with regard to structured financial products originated in the U.S., we made a HK\$2,133 million charge of impairment allowances on our portfolio of securities, including available-for-sale and held-to-maturity securities.

### Operating Expenses

The following table sets forth, for the years indicated, the principal components of our total operating expenses.

	Year ended December 31,	
	2006	2007
	(HK\$ in millions)	
Staff costs (including directors' emoluments) . . . . .	3,968	4,594
Premises and equipment expenses (excluding depreciation) . . . . .	863	949
Depreciation . . . . .	670	785
Other operating expenses . . . . .	994	1,331
<b>Total operating expenses . . . . .</b>	<b><u>6,495</u></b>	<b><u>7,659</u></b>

Our total operating expenses increased by 17.9% from HK\$6,495 million in 2006 to HK\$7,659 million in 2007, primarily due to increases in staff costs and promotion and marketing expenses for our business growth.

## Profit before Taxation

As a result of the foregoing factors, our profit before taxation increased by 11.3% from HK\$16,893 million in 2006 to HK\$18,802 million in 2007.

## Profit for the Year

As a result of the foregoing factors, our profit for the year increased by 10.8% from HK\$14,035 million in 2006 to HK\$15,547 million in 2007.

## SUMMARY BUSINESS SEGMENTAL RESULTS

We categorize our business into three business segments: personal banking, corporate banking and treasury operations. 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 interest rates and foreign exchange positions of the Bank.

The following table sets forth, for the periods indicated, our net operating income before impairment allowances of our principal business segments.

	Year ended December 31,						Nine months ended September 30,			
	2006		2007		2008		2008		2009	
	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
(HK\$ in millions, except percentages)										
Personal banking . . . . .	10,052	47.9%	14,075	52.5%	10,690	40.4%	8,532	42.5%	7,828	40.3%
Corporate banking . . . . .	6,696	31.9%	7,669	28.6%	8,211	31.0%	6,324	31.5%	5,955	30.7%
Treasury . . . . .	5,148	24.5%	6,075	22.6%	8,057	30.4%	5,668	28.3%	5,365	27.7%
Others <sup>(1)</sup> . . . . .	303	1.4%	424	1.6%	975	3.7%	632	3.1%	1,343	6.9%
Elimination . . . . .	(1,199)	(5.7%)	(1,429)	(5.3%)	(1,453)	(5.5%)	(1,090)	(5.4%)	(1,089)	(5.6%)
<b>Net operating income before impairment allowances . . . . .</b>	<b>21,000</b>	<b>100%</b>	<b>26,814</b>	<b>100%</b>	<b>26,480</b>	<b>100%</b>	<b>20,066</b>	<b>100%</b>	<b>19,402</b>	<b>100%</b>

Notes:

(1) Others primarily include our holdings of premises, investment properties, equity investments and interests in associates.

## Nine months ended September 30, 2009 compared to nine months ended September 30, 2008

Net operating income before impairment allowances generated from our personal banking business segment decreased by 8.3% from HK\$8,532 million for the nine months ended September 30, 2008 to HK\$7,828 million for the corresponding period in 2009, primarily due to the decrease in both net interest income and net trading income, which was partly offset by the increase in fee income from stock brokerage in light of the rising stock market in Hong Kong. The decrease in net interest income was mainly attributable to the narrower deposit spread resulting from the lower interest rate environment. The decrease in net trading income was mainly attributable to a decline in foreign exchange activities and the distribution of structured products.

Net operating income before impairment allowances generated from our corporate banking business segment decreased by 5.8% from HK\$6,324 million for the nine months ended September 30, 2008 to HK\$5,955 million for the corresponding period in 2009, primarily due to a decrease in net interest income partially offset by an increase in other operating income. The decrease in net interest income was mainly attributable to the narrower deposit spread resulting from the low market interest rate environment, which was partially offset by the improvement in the average pricing of new corporate loans. The increase in other operating income was primarily attributable to the growth in fee income from corporate lending business, such as syndicated loans.

Net operating income before impairment allowances generated from our treasury segment decreased by 5.3% from HK\$5,668 million for the nine months ended September 30, 2008 to HK\$5,365 million for the corresponding period in 2009, primarily due to the decrease in net interest income. The decrease in net income was primarily attributable to the decline in contribution of net free funds in the low interest rate environment and the higher funding cost associated with our two subordinated loans.

#### **Year ended December 31, 2008 compared to year ended December 31, 2007**

Net operating income before impairment allowances generated from our personal banking segment decreased by 24.0% from HK\$14,075 million in 2007 to HK\$10,690 million in 2008, primarily due to the decrease in net interest income and other operating income. The decrease in net interest income was primarily attributable to the narrower deposit spread as market interest rates declined. The decrease in other operating income was attributable to a decline in investment-related fee income, such as stock brokerage and funds distribution as the global financial crisis intensified. A non-recurring gain in 2007 from the initial recognition of the fair value of the stocks granted by VISA also caused a decrease in other operating income.

Net operating income before impairment allowances generated from corporate banking segment increased by 7.1% from HK\$7,669 million in 2007 to HK\$8,211 million in 2008, primarily due to the increase in net interest income and net fees and commission income. The increase in net income was attributable to an increase in average loans and advances, partially offset by the narrower deposit spread as market interest rates declined. The increase in net fees and commission was primarily attributable to an increase in fee income from loan and bills services.

Net operating income before impairment allowances generated from treasury segment increased by 32.6% from HK\$6,075 million in 2007 to HK\$8,057 million in 2008, primarily due to an increase in net interest income and net trading income. The increase in net interest income was primarily due to the higher interest spread on our debt securities portfolio with lower funding cost as market rates declined. The increase in net trading income was mainly attributable to improved mark-to-market valuation on our foreign exchange swap contracts. The anticipated appreciation of Renminbi also increased customer demand for currency-related products in 2008, which contributed to an increase in net trading income.

#### **Year ended December 31, 2007 compared to year ended December 31, 2006**

Net operating income before impairment allowances generated from personal banking segment increased by 40.0% from HK\$10,052 million in 2006 to HK\$14,075 million in 2007, primarily due to an increase in net interest income and net fees and commission income. The increase in net interest income was mainly attributable to the growth of mortgage loans and other consumer lending in addition to the widening of our deposit spread. The increase in net fees and commission income was mainly attributable to the increased volume of stock brokerage and fund distribution.

Net operating income before impairment allowances generated from corporate banking segment increased by 14.5% from HK\$6,696 million in 2006 to HK\$7,669 million in 2007, primarily due to an increase in net interest income and net fees and commission income. The increase in net interest income was primarily attributable to the growth in average loans and advances. The increase in net fees and commission income was mainly attributable to the growth of loans and bills commission, as well as the increased fee income from trust services and payment services.

Net operating income before impairment allowances generated from treasury segment increased by 18.0% from HK\$5,148 million in 2006 to HK\$6,075 million in 2007, primarily due to an increase in net interest income, partially offset by the decrease in net trading income. The increase in net interest income was primarily attributable to the growth of surplus funds and higher average yield on investments. The decrease in net trading income was primarily attributable to the loss on foreign exchange swap contracts and the decline in trading income from interest rate instruments and commodities, which was partially offset by an increase in trading income of equity instruments after the successful launch of structured notes and equity warrants.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **Liquidity**

We finance our lending and investment operations principally through deposits from customers and deposits and balances of banks and other financial institutions.

### **Financial Condition**

#### **September 30, 2009 compared to December 31, 2008**

##### *Assets*

Our total assets increased by 7.1% from HK\$1,117,996 million as of December 31, 2008 to HK\$1,197,325 million as of September 30, 2009, primarily due to increases in advances and other accounts, cash and balances with banks and other financial institutions, placements with banks and other financial institutions maturing between one and 12 months.

- Advances and other accounts increased by 10.1% from HK\$470,220 million as of December 31, 2008 to HK\$517,791 million as of September 30, 2009, primarily due to an increase in our advances to customers. This was mainly attributable to an increase in our corporate loans and residential mortgage businesses.
- Cash and balances with banks and other financial institutions increased by 10.0% from HK\$153,268 million as of December 31, 2008 to HK\$168,551 million as of September 30, 2009, primarily due to an increase in placements with banks and other financial institutions maturing within one month.
- Placements with banks and other financial institutions maturing between one and 12 months increased by 9.8% from HK\$89,718 million as of December 31, 2008 to HK\$98,486 million as of September 30, 2009, as we extended the maturity of our inter-bank placements with an aim to achieve higher return.



## *Liabilities*

Our total liabilities increased by 6.4% from HK\$1,035,781 million as of December 31, 2008 to HK\$1,101,821 million as of September 30, 2009, primarily due to the increases in deposits from customers, which were partially offset by a decrease in financial liabilities at fair value through profit or loss.

- Deposits from customers (including structured deposits reported as financial liabilities at fair value through profit or loss on the balance sheet) increased by 9.4% from HK\$814,805 million as of December 31, 2008 to HK\$891,414 million as of September 30, 2009, primarily due to an increase in savings deposits, which was partially offset by decreases in time, call and notice deposits. In addition, demand deposits and current accounts also increased, primarily due to IPO subscription proceeds.
- Financial liabilities at fair value through profit or loss decreased by 54.5% from HK\$21,938 million as of December 31, 2008 to HK\$9,988 million as of September 30, 2009, primarily due to decreases in both short positions in Exchange Fund Bills and certificates of deposit issued.

## **December 31, 2008 compared to December 31, 2007**

### *Assets*

Our total assets increased by 7.6% from HK\$1,039,230 million as of December 31, 2007 to HK\$1,117,996 million as of December 31, 2008, primarily due to increases in placements with banks and other financial institutions maturing between one and 12 months, advances and other accounts, and derivative financial instruments, partially offset by the decreases in investment in securities and cash and balances with banks and other financial institutions.

- Placements with banks and other financial institutions maturing between one and 12 months increased by 68.8% from HK\$53,154 million as of December 31, 2007 to HK\$89,718 million as of December 31, 2008, primarily due to increasing inter-bank placements we conducted in response to the lower interest rate environment in 2008.
- Advances and other accounts increased by 11.9% from HK\$420,212 million as of December 31, 2007 to HK\$470,220 million as of December 31, 2008, primarily due to increases in our loans to corporate and individual customers, as well as loans for use outside Hong Kong as a result of the implementation of our business strategies to expand our Mainland China loan portfolio, and an increase in our syndicated loan business after we were appointed as BOC's "Asia-Pacific Syndicated Loan Center" in early 2008.
- Cash and balances with banks and other financial institutions decreased by 3.6% from HK\$159,052 million as of December 31, 2007 to HK\$153,268 million as of December 31, 2008, primarily due to the decrease in placements with banks and other financial institutions maturing within one month, which was partially offset by an increase in Renminbi deposits from participating banks placed with the PBOC.
- Investment in securities decreased by 2.6% from HK\$297,048 million as of December 31, 2007 to HK\$289,353 million as of December 31, 2008, primarily due to a decrease in fair value of certain structured financial instruments.

### *Liabilities*

Our total liabilities increased by 8.4% from HK\$955,938 million as of December 31, 2007 to HK\$1,035,781 million as of December 31, 2008, primarily due to the increases in deposits and balances of banks and other financial institutions, and deposits from customers.

- Deposits and balances of banks and other financial institutions increased by 46.5% from HK\$60,599 million as of December 31, 2007 to HK\$88,779 million as of December 31, 2008, primarily due to an increase in deposits and balances of other banks.
- Deposits from customers (including structured deposits reported as financial liabilities at fair value through profit or loss on the balance sheet) increased by 1.8% from HK\$800,206 million as of December 31, 2007 to HK\$814,805 million as of December 31, 2008, primarily due to the increases in demand deposits and current accounts as well as savings deposits, which was partially offset by the decreases in time, call and notice deposits as customers preferred deposit products of higher liquidity.

### **December 31, 2007 compared to December 31, 2006**

#### *Assets*

Our total assets increased by 13.7% from HK\$913,789 million as of December 31, 2006 to HK\$1,039,230 million as of December 31, 2007, primarily due to increases in cash and balances with banks and other financial institutions, and advances and other accounts, which was partially offset by the decrease in investment in securities.

- Cash and balances with banks and other financial institutions increased by 51.1% from HK\$105,236 million as of December 31, 2006 to HK\$159,052 million as of December 31, 2007, primarily due to an increase in inter-bank placements maturing within one month.
- Advances and other accounts increased by 19.1% from HK\$352,844 million as of December 31, 2006 to HK\$420,212 million as of December 31, 2007, primarily due to an increase in our loans to corporate and individual customers, in particular loans for use outside Hong Kong as a result of the implementation of our new business initiatives and an increase in lending activities from our Mainland China operations.
- Investment in securities decreased by 1.7% from HK\$302,091 million as of December 31, 2006 to HK\$297,048 million as of December 31, 2007, primarily due to decreases in securities classified as loans and receivables.

#### *Liabilities*

Our total liabilities increased by 14.7% from HK\$833,369 million as of December 31, 2006 to HK\$955,938 million as of December 31, 2007, primarily due to the increases in deposits from customers and deposits and balances of banks and other financial institutions.

- Deposits from customers (including structured deposits reported as financial liabilities at fair value through profit or loss on the balance sheet) increased by 13.6% from HK\$704,701 million as of December 31, 2006 to HK\$800,206 million as of December 31, 2007, primarily due to the increases in demand deposits, current accounts and savings deposits, as well as time, call and notice deposits.
- Deposits and balances of banks and other financial institutions increased by 23.6% from HK\$49,034 million as of December 31, 2006 to HK\$60,599 million as of December 31, 2007, primarily due to the increase in deposits and balances and inter-bank placements.

## Capital Adequacy

Since December 31, 1989, locally incorporated banks have been subject to capital adequacy standards similar to those set out in the Basel Accord, with a minimum risk adjusted capital adequacy ratio of 8.0%. As of September 30, 2009, our consolidated core capital ratio was 11.44% and consolidated capital adequacy ratio was 16.22%. The Banking (Amendment) Ordinance 2005, enacted on July 6, 2005, put in place a legislative framework for the implementation in Hong Kong of Basel II. In line with the timetable set by BCBS for its members, the implementation of Basel II commenced in Hong Kong in January 2007 to further strengthen the soundness and stability of the banking system while maintaining sufficient consistency that capital adequacy regulation will not be a significant source of competitive inequality among active banks. We established the Internal Capital Adequacy Assessment Process (the “ICAAP”), through which we assess each material risk associated with our main activities by pre-defined assessment models and a comprehensive judgment of the overall risk profile taking into account our corporate governance policies.

The following table sets forth details of our core and supplementary capital and capital adequacy ratios in accordance with the HKMA’s guidelines as of December 31, 2008 and September 30, 2009.

	As of December 31, 2008	As of September 30, 2009
	(HK\$ in millions, except percentages)	
<b>Core capital:</b>		
Paid up ordinary share capital . . . . .	43,043	43,043
Reserves . . . . .	18,049	25,427
Profit and loss account . . . . .	2,956	4,933
Minority interests . . . . .	1,124	1,214
	65,172	74,617
Deductions from core capital . . . . .	(1,536)	(3,914)
Core capital . . . . .	63,636	70,703
<b>Supplementary capital:</b>		
Fair value gains arising from holdings of available-for-sale securities . . . . .	87	295
Collective loan impairment allowances . . . . .	1,502	1,420
Regulatory reserve . . . . .	4,503	4,861
Term subordinated debt . . . . .	26,583	26,861
	32,675	33,437
Deductions from supplementary capital . . . . .	(1,536)	(3,914)
Supplementary capital . . . . .	31,139	29,523
<b>Total capital base after deductions . . . . .</b>	<b>94,775</b>	<b>100,226</b>
<b>Capital adequacy ratios (consolidated basis):</b>		
Capital adequacy ratio . . . . .	16.17%	16.22%
Core capital ratio . . . . .	10.86%	11.44%

## Capital Expenditures

Our capital expenditures for the years ended December 31, 2006, 2007 and 2008 and the nine months ended September 30, 2009 were HK\$736 million, HK\$1,145 million, HK\$814 million and HK\$257 million, respectively. Our capital expenditures generally relate to the acquisition and renovation of premises, purchase of other fixed assets such as motor vehicles, furniture, fixtures, equipment and upgrade of our IT systems.

## OFF-BALANCE SHEET ITEMS

As of September 30, 2009, the net notional amounts of our foreign currency derivative financial instruments, which are principally used to reduce the Group's exposure to currency movements, were HK\$5,046 million.

## 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:

	Year ended December 31,			September 30,
	2006	2007	2008	2009
	(HK\$ in millions)			
Direct credit substitutes . . . . .	1,285	2,120	1,419	2,003
Transaction-related contingencies . . . . .	7,150	7,075	10,153	9,669
Trade-related contingencies . . . . .	20,942	29,081	22,481	28,228
Commitments that are unconditionally cancellable without prior notice . . . . .	—	50,034	103,684	150,723
Other commitments with an original maturity of				
– under one year or which are unconditionally cancellable . . . . .	113,064	—	—	—
– up to one year . . . . .	—	84,809	63,257	19,224
– over one year . . . . .	45,345	58,189	52,400	43,252
	<u>187,786</u>	<u>231,308</u>	<u>253,394</u>	<u>253,099</u>
Credit risk weighted amount . . . . .	<u>30,076</u>	<u>47,356</u>	<u>40,252</u>	<u>30,237</u>

## DIVIDEND POLICY

We may pay dividends out of our distributable reserves in accordance with Hong Kong law generally and the Articles of Association. The declaration of dividends is subject to the discretion of the Board of Directors and any final dividend for a financial year is subject to shareholders' approval. Whether any dividends will be declared or paid and the amounts of dividends actually paid to holders of Shares will depend upon a number of factors, including:

- our financial results;
- regulatory requirements;
- capital requirements;
- shareholders' interests; and
- any other factors considered relevant by the Board of Directors.

Dividends will be declared in Hong Kong dollars. The Board of Directors may declare interim dividends at any time in accordance with the Articles of Association.

## BUSINESS

### OVERVIEW

We are a major commercial banking group in Hong Kong with a leading market share in our core commercial banking business such as deposits, residential mortgages, corporate loans and syndicated loans. We are one of the three Hong Kong dollar note-issuing banks. We were appointed by the PBOC as the sole clearing bank for Renminbi business in Hong Kong in 2003. With over 270 branches and more than 470 ATMs, as well as other delivery channels in Hong Kong as of September 30, 2009, we offer a comprehensive range of financial products and services to individual and corporate customers. At the same date, we had 23 branches and sub-branches in Mainland China providing local and cross-border banking services to customers in Hong Kong and Mainland China.

In Hong Kong, we are the second largest banking group in terms of asset size, customer deposits and loans. As of December 31, 2008, we had HK\$1,118 billion in total assets, HK\$806 billion in total deposits and HK\$461 billion in gross advances to customers. Our net operating income before impairment allowances in 2008 was HK\$26 billion. As of September 30, 2009, we had HK\$1,197 billion in total assets, HK\$889 billion in total deposits and HK\$507 billion in gross advances to customers. Our net operating income before impairment allowances for the nine months ended September 30, 2009 was HK\$19 billion.

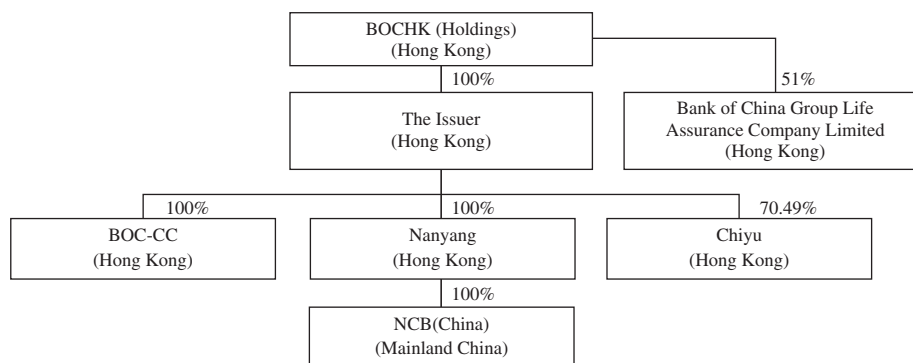
We have three principal lines of business, consisting of personal banking, corporate banking and treasury operations. We provide a comprehensive range of personal banking products and services to our individual customers, including deposits, mortgages, personal loans, remittances, credit cards, insurance, investment product services and personal wealth management services. We provide our corporate and institutional customers with a variety of banking products and services, including corporate deposit, corporate loans such as syndicated loans and trade finance, and non-interest income-based products and services such as syndicated loan arrangements, trade finance arrangements, cash management and custody as well as insurance services. We also provide Renminbi banking products and services in Hong Kong, such as deposit, exchange, remittance, credit cards and bonds distribution to our individual customers, as well as trade settlement and finance to our corporate customers. We conduct treasury operations primarily through our investment management and global markets units. While our investment management unit participates in inter-bank money market transactions and manages our investment portfolio and liquidity, our global markets unit provides sales and distribution services to our customers with respect to their foreign exchange and derivative transactions as well as other treasury activities.

We have made, and will continue to make, substantial investments in our technology platform and distribution capabilities. In addition to our extensive network of branches, self-service banking centers and ATMs, we also offer 24-hour automated telephone banking and online banking services. These resources enable us to deliver a broad range of banking products and services through multiple delivery channels that are convenient to our customers.

### Organizational Structure

On October 1, 2001, substantially all of the commercial banking businesses and related assets and liabilities of nine entities were transferred to Po Sang Bank Limited, whose name was changed to Bank of China (Hong Kong) Limited. We are the principal operating subsidiary of BOCHK (Holdings), which was listed on the main board of the HKSE on July 25, 2002. We have three principal subsidiaries: Nanyang Commercial Bank, Limited (“**Nanyang**”), Chiyu Banking Corporation Limited (“**Chiyu**”), and BOC Credit Card (International) Limited (“**BOC-CC**”). On August 1, 2009, we transferred almost all our Mainland China operations (previously conducted by BOCHK’s branches and sub-branches in Mainland China) to Nanyang Commercial Bank (China), Limited (“**NCB(China)**”), a subsidiary of Nanyang incorporated in Mainland China. NCB(China) provides a wide range of local and cross-border banking services to our individual and corporate customers.

The following chart sets forth our corporate organization, principal operational subsidiaries and shareholding structure as of September 30, 2009.



## Strategy

Our objective is to become a premier financial services group with an extensive base in Hong Kong, a solid presence in Mainland China and a strategic foothold in Asia. The principal components of our strategy are as follows:

### *Strengthen Our Overall Leading Position in Hong Kong's Banking Sector*

We intend to leverage our core competency to further consolidate our leading position in Hong Kong's commercial banking business. We will continue to strengthen client relationships, accelerate product innovation and enhance product penetration in order to maintain our market leadership in personal and corporate banking products and services, such as deposits, mortgage loans, corporate loans, syndicated loans and stock brokerage.

### *Diversify Our Sources of Revenue to Achieve a Sustainable Growth*

We aim to strengthen our business capabilities for a more balanced and sustainable revenue platform. We intend to continue to diversify our revenue sources by providing comprehensive products and services to meet customer needs. We intend to enhance the contribution of our non-interest income businesses for a more diversified revenue mix by growing our fee-based income businesses, such as investment and brokerage, insurance, personal wealth management, cash management and custody. By offering a total solution through an integrated service platform and enhanced service capabilities, we aim to be the premier bank for customers.

### *Extend Our Leadership in Offshore Renminbi Business*

We intend to leverage our unique advantage as the sole Renminbi clearing bank in Hong Kong and further develop our offshore Renminbi banking business. Given our solid experience and leading market position, we believe we are well positioned to capture the rising opportunities from the growing significance of Renminbi in the global economy and the favorable environment for increasing Renminbi regionalization. We intend to accelerate our offshore Renminbi business development to offer more diversified and comprehensive Renminbi banking products and services to both individual and corporate customers. As the first bank in Hong Kong to launch a wide spectrum of Renminbi trade settlement and finance services, we plan to broaden our service scope and deepen our customer relationships. In addition, we plan to further strengthen our relationships and cooperation with a number of commercial banks in ASEAN and other related countries to promote our clearing services and other banking business.

## ***Leverage Our Relationship with BOC to Increase Our Presence in Greater China and the Asia-Pacific Region***

We intend to enhance our cooperation with BOC to better serve our customers, maximize cross-selling efforts and expand our product range. The collaboration between BOCHK and BOC is complementary and exists at all levels ranging from customer relationship management to back office processing functions. We also intend to continue to promote business cooperation through enhanced customer referral and sharing of research resource. With our close cooperation with BOC, we intend to capture the emerging business opportunities in Mainland China and the Asia-Pacific region for mutual benefits. We aim to expand our strategic foothold in Asia and play an increasing role in the BOC Group's global strategy.

## **OUR PRINCIPAL BUSINESS ACTIVITIES**

We have three principal lines of business, consisting of personal banking, corporate banking and treasury operations. The following table sets forth our net operating income before impairment allowances attributable to each line of business for the periods indicated:

	Year ended December 31,						Nine months ended September 30,			
	2006		2007		2008		2008		2009	
	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
(HK\$ in millions, except percentages)										
Personal banking . . . . .	10,052	47.9%	14,075	52.5%	10,690	40.4%	8,532	42.5%	7,828	40.3%
Corporate banking . . . . .	6,696	31.9%	7,669	28.6%	8,211	31.0%	6,324	31.5%	5,955	30.7%
Treasury . . . . .	5,148	24.5%	6,075	22.6%	8,057	30.4%	5,668	28.3%	5,365	27.7%
Others <sup>(1)</sup> . . . . .	303	1.4%	424	1.6%	975	3.7%	632	3.1%	1,343	6.9%
Eliminations. . . . .	(1,199)	(5.7%)	(1,429)	(5.3%)	(1,453)	(5.5%)	(1,090)	(5.4%)	(1,089)	(5.6%)
Net operating income before impairment allowances . . .	<u>21,000</u>	<u>100.0%</u>	<u>26,814</u>	<u>100.0%</u>	<u>26,480</u>	<u>100.0%</u>	<u>20,066</u>	<u>100.0%</u>	<u>19,402</u>	<u>100.0%</u>

*Note:*

(1) Others primarily include our holdings of premises, investment properties, equity investments and interests in associates.



## Personal Banking

The following table sets forth, for the periods indicated, the financial results of our personal banking business.

	Year ended December 31,			Nine months ended September 30,	
	2006	2007	2008	2008	2009
	(HK\$ in millions)				
Net interest income. . . . .	7,003	8,144	6,511	5,225	4,280
Other operating income. . . . .	<u>3,049</u>	<u>5,931</u>	<u>4,179</u>	<u>3,307</u>	<u>3,548</u>
Net operating income before impairment allowances . . . . .	10,052	14,075	10,690	8,532	7,828
Operating expenses. . . . .	<u>(4,853)</u>	<u>(5,829)</u>	<u>(5,669)</u>	<u>(4,377)</u>	<u>(4,324)</u>
Operating profit before impairment allowances . . . . .	5,199	8,246	5,021	4,155	3,504
Net charge of impairment allowances . . . . .	(37)	(112)	(129)	(24)	(110)
Others . . . . .	<u>(18)</u>	<u>(5)</u>	<u>—</u>	<u>—</u>	<u>—</u>
Profit before taxation . . . . .	<u><u>5,144</u></u>	<u><u>8,129</u></u>	<u><u>4,892</u></u>	<u><u>4,131</u></u>	<u><u>3,394</u></u>

## General

We are a leader in the personal banking sector in Hong Kong. By leveraging our broad customer base and extensive network, we maintain leading positions in deposits, residential mortgage loans and retail securities brokerage. We conduct our personal banking business primarily through our personal banking unit. We market our retail products and services through a combination of our branch network and ATMs in Hong Kong and Mainland China and other delivery channels such as telephone banking and online banking services. For the nine months ended September 30, 2009, our personal banking operations represented 40.3% of our net operating income before impairment allowances.

## Personal Deposit Products

We offer three principal deposit products to our individual customers, including current account deposits, savings account deposits and time deposits. In addition, we provide several specialized deposit products, including the following:

*Fixed Deposit with Monthly Interest Payment.* This product allows our customers to receive monthly interest payments on their fixed deposits before the maturity date. These deposits generally offer higher levels of interest income than time deposits.

*Foreign Currency Deposit.* Our multi-currency savings account incorporates up to 12 different foreign currencies, and allows our customers to switch among these foreign currencies to take advantage of interest and exchange rate movements. Our fixed foreign currency deposit account offers our customers various maturity terms to meet their liquidity requirements.

*Renminbi Deposit.* We have been offering Renminbi deposit to personal customers since 2004, including “Exchange Express” which provides convenient Renminbi exchange service through our branch network and online banking service.



## ***Personal Loan Products and Services***

We offer to our customers a wide range of personal loan products, including residential mortgage loans, Hong Kong government guaranteed home ownership scheme loans, unsecured personal loans, tax loans and other retail loans. We offer these products primarily through our branch network. We also use a variety of direct sales channels to promote different types of personal loan products. For example, our customers can make appointments for mortgage loan applications through our online banking services.

*Residential Mortgage Loans.* We believe we are a leader in residential mortgage lending in Hong Kong. As of September 30, 2009, the aggregate outstanding amount of our residential mortgage loans was HK\$124,902 million, representing 24.6% of our gross advances to customers or 81.0% of our total outstanding individual loans at that date. We offer residential mortgage loans at preferential interest rates to customers who have stable sources of income. For properties valued below HK\$20 million, borrowers may obtain residential mortgage loans for an amount up to 70% of the property value or purchase price, whichever is lower. In addition, the maturity of a mortgage loan may be as long as 30 years. Given the historic volatility in the Hong Kong property market, we operate with rigorous risk assessment and control in our mortgage business. The credit quality of our residential mortgages remained sound with the delinquency and rescheduled loan ratio at a level of 0.06% as of September 30, 2009.

*Home Ownership Scheme Loans.* We are an active participant in various Hong Kong government guaranteed home financing schemes, including the home ownership scheme. Unlike residential mortgage loans, borrowers may obtain loans for an amount up to 95% of the property value under this scheme, and the loan is repayable over a period of 25 years in equal installments. As of September 30, 2009, the aggregate outstanding amount of our home ownership scheme loans (include private sector participation scheme and tenants purchase scheme) was HK\$12,332 million.

*Unsecured Personal Loans.* We offer unsecured personal loans for amounts determined by different risk factors of different customer segments. These loans are either revolving or repayable in monthly installments.

*Tax Loans.* We offer tax loans to customers for amounts which are generally repayable over a maximum period of 18 months.

*Other Retail Loans.* We also offer loans collateralized by deposits and investment securities, overdraft facilities and a series of other products designed to offer added value and convenience to our customers. The terms of our secured loans depend in part on the type of collateral.

## ***Non-Interest Income-Based Services***

### ***Personal Wealth Management Services***

We offer personal wealth management services to our customers who maintain total assets under management of over HK\$500,000. Through personal wealth management services we offer in our Wealth Management Centers, we are able to deliver a one-stop banking solution to our high net-worth customers. Currently, we have an extensive network of 138 Wealth Management Centers located in branches throughout Hong Kong. Our personal wealth management services include providing a variety of financial products, priority counter services, standby secured overdraft facilities, 24-hour emergency assistance and financial planning services to our customers. Currently, we have already developed a team of dedicated and qualified relationship managers who offer cash management, securities trading and funds and bond trading services that are tailored to our customers' financial needs.

### *Investment and Funds Distribution Services*

We offer a range of investment services to our individual customers, including securities, funds, foreign exchange and bullion trading. We provide these investment services to individual customers in Hong Kong and receive commissions and other income from their trading activities.

We have built a leading retail securities brokerage operation in Hong Kong. In 2009, we were able to capture new business opportunities from the recovery of the Hong Kong stock market and launched promotions on our securities margin trading service by offering commission discounts and special lending rates.

We offer a wide spectrum of funds from over 20 selected fund managers at the choice of our customers. Our fund services help customers grasp global investment opportunities by investing in a broad range of regions, sectors and asset classes. Customers can make fund investments at our branches or via internet banking.

### *Insurance Services*

We also act as a sales agent for insurance services. Through our branches and online banking system, we offer our customers a wide range of insurance products, such as life insurance, medical insurance, home insurance and accident insurance provided by BOCHK (Holdings)'s affiliates and other insurance companies, including Bank of China Group Life Assurance Company Limited ("**BOC Life**"). We received approximately HK\$369 million in commissions for sales of insurance products during the nine months ended September 30, 2009.

We have recently expanded our product range and are tailoring new products for customers.

### *Other Personal Banking Products and Services*

We also offer a series of other personal banking products and services to meet the diverse needs of our individual customers. These products and services include safe deposit boxes, auto payments, remittances, direct debit services, trustee services, money exchange, travelers' checks and gift checks.

### *Credit Card Business*

We are one of the largest credit card issuers in Hong Kong. We conduct our credit card business through our wholly owned subsidiary, BOC-CC. We launched our credit card business in 1980. We charge annual fees for most credit card accounts, earn interest from our customers and generate fees from our merchant acquiring business in Hong Kong and Mainland China. For the nine months ended September 30, 2009, we received approximately HK\$1,119 million in fee and commissions from our credit card business.

### *Credit Card Products and Services*

Currently, our credit cards are honored and accepted by over 20 million international establishments through our association with VISA and MasterCard international organizations. In recent years, we have received various awards from VISA and MasterCard for card growth, card issuance, market share, merchant expansion and fraud control.

We offer a comprehensive range of credit card products that cater to general as well as specialized markets. Our primary credit card products include China Union Pay ("**CUP**") Dual Currency Credit Card, Platinum, Titanium, Gold and VISA/MasterCard Classic cards. We also offer other credit card products designed for younger individuals, such as U-Point Card, for use over the Internet, such as Intown Virtual Card, and for businesses, such as Commercial and Purchasing Card. We also offer "y not" Credit Card to target our female customers. We charge interest on the overdue outstanding balances on our credit cards. As of September 30, 2009, the total outstanding credit card balance (before provision) was approximately HK\$6,703 million.

In December 2008, we launched “BOC CUP Dual Currency Credit Card” and had issued around 400,000 cards to our customers by the end of 2009. CUP Dual Currency Credit Card is our first credit card offering options in dual currency settlement. It is designed for international travelers between Mainland China, Hong Kong, and Macau, as well as across the world. A CUP Dual Currency Credit Card links to both a Hong Kong dollar and a Renminbi account. Card spending in Mainland China can be settled in Renminbi whereas spending in Hong Kong and overseas can be settled in Hong Kong dollars.

We have been cooperating with BOC to provide administrative and processing support for the Great Wall International Card since 1997. The Great Wall International Card is a single foreign currency credit card offered by BOC primarily to Mainland China customers who travel and conduct transactions outside Mainland China. Currently, we have four different foreign-currency credit cards, in USD, Euro, GBP and HKD.

#### *Merchant Acquiring Business*

We generally charge merchants a fee for processing credit card transactions in Hong Kong, Macau and Mainland China. This fee is generally based on a percentage of the amount of each credit card transaction processed. Despite intense competition, we continue to maintain our leading position in the merchants acquiring markets in Mainland China through our cooperation with BOC.

#### *Credit Card Management and Monitoring*

BOC-CC’s risk management practices generally follow our risk management principles and policies. The functions of BOC-CC’s risk management are independent of other credit card operations. Our credit card procedures generally follow the international practices recommended by VISA and MasterCard.

We write off delinquent accounts that are in default for 180 days from the payment due date. The delinquency ratio of our credit card balance was 0.29% as of December 31, 2008 and 0.31% as of September 30, 2009. Our annualized charge-off rates for the year ended December 31, 2008 and the nine months ended September 30, 2009 were approximately 2.22% and 3.00%, respectively.

We monitor our customers’ repayment patterns strictly to minimize the risks associated with our credit card business. We regularly review the credit risk of all promotion programs to minimize credit loss and identify and monitor high balance and high risk accounts by updating our customer financial information. We take a proactive approach in monitoring and analyzing cardholder behavior to identify potential credit problems and to manage our customer relationship.

#### *Customer Coverage and Marketing*

Currently, our customer services are primarily conducted through our branch network, although banking transactions are also supported by direct channels. We are implementing measures to enhance product awareness and to promote a marketing culture among our staff. We continuously upgrade our sales, service and operation models to cater to customer needs and market changes. Our marketing efforts differentiate among mass, affluent and high net worth customers, and we provide more personalized services to the higher net-worth customers. We also market our products and services through other distribution channels, such as online banking services and road shows. See the section headed “– Distribution Network.”

We continue to exploit the growth potential of mass individual customers for expanding our personal banking business. For example, in 2008, we launched a promotion campaign for the i-Free Integrated Account service (“i-Free”) which provides customers with a convenient multi-dimensional banking service covering different banking areas. The service was repositioned to appeal to younger clients. We also launched various acquisition campaigns bundled with MPF, Renminbi deposits and payroll services. As a result, the total number of i-Free customers and related assets maintained with us increased significantly in 2008 and 2009.

In addition, we have an “Operational Customer Relationship Management System” to provide front-line staff with an integrated customer contact platform to conduct sales and provide services, thus enhancing customer experience and reinforcing our marketing capabilities. In addition, we promote our brand image and market awareness through a series of marketing campaigns with the help of various incentives.

### Corporate Banking

The following table sets forth, for the periods indicated, the financial results of our corporate banking business.

	Year ended December 31,			Nine months ended September 30,	
	2006	2007	2008	2008	2009
	(HK\$ in millions)				
Net interest income. . . . .	5,009	5,739	5,949	4,597	3,959
Other operating income. . . . .	<u>1,687</u>	<u>1,930</u>	<u>2,262</u>	<u>1,727</u>	<u>1,996</u>
Net operating income before impairment allowances . . . . .	6,696	7,669	8,211	6,324	5,955
Operating expenses. . . . .	<u>(1,653)</u>	<u>(1,940)</u>	<u>(2,143)</u>	<u>(1,695)</u>	<u>(1,568)</u>
Operating profit before impairment allowances . . . . .	5,043	5,729	6,068	4,629	4,387
Net reversal/(charge) of impairment allowances . . . . .	1,827	797	(544)	(499)	199
Others . . . . .	<u>(3)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Profit before taxation . . . . .	<u><u>6,867</u></u>	<u><u>6,526</u></u>	<u><u>5,524</u></u>	<u><u>4,130</u></u>	<u><u>4,586</u></u>

### General

We are a leader in the corporate banking sector in Hong Kong. We conduct our corporate banking business primarily through our corporate banking unit. Our corporate banking products include both loan products and non-interest income-based services. We deliver our corporate banking products and services through a combination of our branch network, service centers, correspondent banks and online banking (“**CBS Online**”). We are a major credit provider to local companies, covering large corporate and small and medium-sized enterprise (“**SME**”) customers in Hong Kong. For the nine months ended September 30, 2009, our corporate banking operations represented 30.7% of our net operating income before impairment allowances.

### Corporate Loan Products

Our principal corporate loan products are syndicated loans, trade finance, project finance and asset finance. As part of our business strategy, we intend to continue to grow our conventional corporate lending business, especially syndicated loans and trade finance. We also provide special financial products and services that are specifically tailored to the needs of our SME customers. In recognition of our quality services and contribution to the SME business, we received, for the second consecutive year, the “SME’s Best Partner Award 2009” by the Hong Kong Chamber of Small and Medium Business Limited. As of September 30, 2009, the outstanding balance of our corporate loan portfolio was HK\$345,480 million. We offer a substantial portion of our corporate loans on a floating rate basis.

### *Syndicated Loans*

We provide syndicated loans to our customers to meet their needs for larger loans. We participate in syndicated loans as an arranger, underwriter or lender. Our syndicated loan activities have increased significantly over the past few years. According to Basis Point, a major publication in the Asia-Pacific syndication market, we ranked as the largest arranger among banks in Hong Kong and Macau in terms of the volume of syndicated loans underwritten for the nine months ended September 30, 2009. We have been the BOC Group's "Asia-Pacific Syndicated Loan Center" since January 2008, which further expanded our loan syndication business in the region. We intend to continue our active participation in syndicated loans to maintain our market share and to grow our fee income from loan syndication activities.

### *Trade Finance*

Our trade finance primarily involves import and export financing. Our import financing products and services include letters of credit, trust receipts, import loans and invoice financing. Our corporate customers who are engaged in the import business typically request that we issue letters of credit to support their payment obligations to sellers of goods. Some of our corporate customers also rely on trust receipts, import loans and invoice financing to support their cash flow. For our customers who are engaged in the export business, we offer letter of credit negotiation, bills purchase, invoice discounting and packing loans to assist them in managing their liquidity. We often provide a package of working capital financing that may consist of various trade finance products and services to meet our corporate customers' needs in their trading business.

### *Project Finance*

We offer project finance to our customers for a wide range of business purposes, including infrastructure development and construction, energy projects and acquisition financing. Our project loans are generally secured by the underlying project assets. In addition, we generally obtain guarantees from project sponsors.

### *Revolving Loans*

Generally, we provide revolving loans to our larger corporate customers to meet their special working capital or cash flow needs. A borrower may draw on the revolving loan in part or in full and repay the loan whenever there are surplus funds or at final maturity of the loan. The borrower may draw on repaid amounts of the loan other than the final maturity repayment. Revolving loans are the largest component of our working capital finance.

### *Overdraft Facilities*

Overdraft facilities are provided to borrowers to finance a temporary cash flow shortfall, and are one of the most common forms of working capital finance in Hong Kong. Consistent with lending practices of other banks in Hong Kong, our overdraft facilities are generally secured by real property or cash deposits. We provide a line of credit up to a pre-established amount based on the borrower's projected level of cash deficits. An overdraft facility is typically provided to borrowers on a floating interest rate basis. We earn interest on a monthly basis based on the daily outstanding amounts. The facility is generally provided for a period of up to twelve months subject to repayment on demand, with a review after twelve months.

## *Asset Finance*

We offer various types of asset finance to our corporate customers to meet their capital needs for acquisition of industrial and commercial properties, machinery and transportation equipment. Our principal asset finance loan products include commercial mortgage loans and lease financing and hire purchase loans.

- *Commercial Mortgage Loans.* We offer mortgage loans to our corporate customers for the purchase of real property. Our mortgage products allow our corporate customers to borrow as much as 70% of the appraised property value or the purchase price, whichever is lower. The repayment periods can be as long as 20 years.
- *Lease Financing and Hire Purchase Loans.* We provide lease financing and hire purchase loans to our customers to finance their capital expenditure needs for acquisition of machinery and transportation equipment. We generally require our lease financing and hire purchase loans to be secured.

## *Non-Interest Income-Based Products and Services*

Our principal non-interest income-based services include syndicated loan arrangement services, credit facility arrangement services, trade finance arrangement services and insurance agency services. Going forward, while we continue to grow our principal non-interest income-based products, we also intend to expand our market shares in cash management and custody services.

*Syndicated Loan Arrangement Services.* We are an active participant in the syndicated loan market in Hong Kong and earn fees when we act as arranger, underwriter or lender, as well as participant, for syndicated loans. See the section headed “– Corporate Loan Products – Syndicated Loans.”

*Credit Facility Arrangement Services.* We generally charge a fee for arranging and renewing credit facilities. As we have a large amount of corporate loans, these fees have been an important income source for our non-interest income-based services.

*Trade Finance Arrangement Services.* We provide letters of credit, shipping guarantees and inward and outward bill collections as well as a variety of trade products to our corporate customers for trade finance purposes. We charge fees for the issuance of new letters of credit and for the amendment of the terms of, and the increase of the amount of, existing letters of credit. We receive commissions from providing shipping guarantees and inward and outward bill collections to our customers.

*Cash Management Products and Services.* We offer our corporate customers cash management products and services including CBS Online, payment and collection services, and liquidity management products. These products and services help our customers to manage their daily receivables and payment requirements as well as their liquidity needs so as to generate maximum interest income and minimize interest expense for them. We consider fees generated from providing cash management products and services an important source of our non-interest income and believe that many of our customers are in need of value-added cash management services. In 2009, we became the U.S. dollar settlement bank in Hong Kong for the Real Time Gross Settlement System linkage between Hong Kong and Mainland China. We also launched a new bill payment feature in our cheque deposit machines to help our customers to collect funds. These types of cash management services not only enhance our competitive edge by capturing higher transaction volume but also encourage our clients to use their accounts with us as their major operating accounts.

We intend to enhance our cash management services by leveraging CBS Online to create a scalable platform, consolidating and improving existing basic cash management products available on CBS Online and leveraging BOC’s cash management access and distribution network.



*Custody Products and Services.* To facilitate the cross-border investment flows of corporate and institutional clients and to better serve their investment-related needs globally, we have started offering custody products and services since late 2006. Currently, our products include domestic custody, global custody, fund-related services, escrow services and other customized solutions for institutional investors, corporate intermediaries, various types of funds, and, to a lesser extent, high net-worth individuals.

In January 2008, we were appointed by a joint venture investment bank in Mainland China as the foreign custodian for its first Qualified Domestic Institutional Investor (“**QDII**”) product, the first broker-type QDII product ever approved in Mainland China. In 2009, we have further strengthened our relationship and product capabilities with recovery of the IPO and QDII markets. We believe that custody business will be an important source of fee income and can be easily bundled with other products for offering total solutions to key clients. Our custody business will also form part of the global product platform of BOC.

*Other Non-Interest Income-Based Services.* Other non-interest income-based services offered to our corporate customers through our branch network and CBS Online include payment and remittance services, securities trading services and MPF services.

### ***Corporate Deposit Products***

We offer our corporate customers the same types of current, fixed and savings deposit products as those offered to our individual customers. See the section headed “– Personal banking – Retail Deposit Products” for a description of our current, fixed and savings deposit products.

### ***Our Corporate Lending Practices***

We analyze a corporate borrower’s credit risk based on a number of factors, including the quality of business, financial condition, strength of management and, to the extent applicable, the collateral. In addition, we also evaluate the industry risk associated with the corporate borrower. See the section headed “– Risk Management – Credit Risk – Credit Risk Management.” Some of our corporate loans by outstanding principal amount are secured, fully or partially, by collateral. In most cases where our loans are secured by collateral, we have a first charge on the borrower’s real property. Furthermore, we may take security on cash deposits or other financial assets such as marketable securities. Unsecured loans are generally supported by corporate guarantees or personal guarantees.

As part of our overall strategy to improve our risk management capacities, we will continue to enhance credit approval, monitoring and evaluation practices that emphasize, among other factors, the profitability, cash flow, liquidity and net worth position of the borrower. See the section headed “– Risk Management – Credit Risk Management” for a more detailed discussion of our credit risk management procedures.

### ***Corporate Loan Pricing***

We price our corporate loans at a spread above inter-bank market rates or at a premium or discount over the prime rate with reference to our base lending rates based on the following factors:

- the financial condition of the borrower, including its profitability, liquidity, cash flow and net worth position;
- the purpose of the loan;
- the collateral available;
- market conditions; and
- the term of the loan.

Our asset and liability management committee fixes our base lending rates based on various factors, including:

- interest rate and inflation expectations;
- the market demand for loans; and
- our cost of funds.

### ***Customer Base***

We have a strong customer base in most of the business sectors in Hong Kong, particularly in the real property development and real property investment and transport and transport equipment sectors. As of September 30, 2009, loans to property investment companies, property development companies and transport and transport equipment companies accounted for approximately 14.2%, 5.3% and 5.5%, respectively, of our gross advances to customers. We intend to continue to optimize our customer base with focus on creditworthy corporate and high net-worth individual customers and strengthening our relationship with them. We also intend to focus on sectors where we believe there are potential for significant growth and where they are consistent with our risk management policies.

### ***Customer Coverage and Marketing***

We have a solid customer base covering major corporate and SMEs. Our existing customer base has significant potential for future growth. We intend to increase our marketing initiatives to existing corporate customers while identifying and acquiring potential customers across the region.

In order to provide solutions to the increasingly complex and specific needs of our customers, we intend to deliver our corporate banking products and services through an integrated customer-focused organizational structure. In particular, we have established the following four divisions, each focusing on a targeted segment, to better serve our customers:

- a corporate division, which is responsible for developing our business with the large corporate customers, mainly including top multinational and blue chip companies;
- a commercial division, which provides products and services to middle market companies;
- an SME division under which we have set up six commercial centers in different geographic districts in Hong Kong so as to provide products and services to our SME customers with greater convenience; and
- a financial institutions division, which specializes in providing products and services to banks, non-bank financial institutions such as insurance companies, stock brokerage firms, asset management companies, and public institutions.

In each of the divisions, there are dedicated relationship managers overseeing the activities of their respective assigned customers and marketing our products and services to these customers. We have unified our marketing strategy in order to encourage the cross-selling of products and services. Our relationship managers work regularly with executives in other departments to increase cross-selling opportunities and expand our relationship with our customers. These include executives from departments handling foreign exchange, cash management and other non-interest income-based services. Concurrently, our global markets unit works closely with our corporate banking unit to provide and market foreign exchange and derivative products to our corporate customers. In addition, we also intend to leverage the strength and broad coverage of the personal wealth management services of our personal banking operations to target owners and senior management of our corporate customers.



To improve the effectiveness of our cross-selling efforts, we have taken measures to integrate and update customer information. We believe these measures allow us to implement our recently launched proactive customer targeting program.

## **Treasury Operations**

The following table sets forth, for the periods indicated, the financial results of our treasury operations.

	Year ended December 31,			Nine months ended September 30,	
	2006	2007	2008	2008	2009
	(HK\$ in millions)				
Net interest income. . . . .	4,406	5,869	7,178	4,539	4,190
Other operating income. . . . .	<u>742</u>	<u>206</u>	<u>879</u>	<u>1,129</u>	<u>1,175</u>
Net operating income before impairment allowances . . . . .	5,148	6,075	8,057	5,668	5,365
Operating expenses. . . . .	<u>(521)</u>	<u>(627)</u>	<u>(831)</u>	<u>(585)</u>	<u>(544)</u>
Operating profit before impairment allowances . . . . .	4,627	5,448	7,226	5,083	4,821
Net charge of impairment allowances . . . . .	–	(2,133)	(9,170)	(5,348)	(107)
Others . . . . .	<u>(2)</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>
Profit/(loss) before taxation. . . . .	<u>4,625</u>	<u>3,315</u>	<u>(1,944)</u>	<u>(265)</u>	<u>4,714</u>

## **General**

We conduct our treasury operations primarily through two separate units: the investment management unit and the global markets unit. The investment management unit is responsible for liquidity management and investment portfolio management, while the global markets unit principally provides sales and distribution services to our customers in foreign exchange, derivative transactions, securities and bullion trading. For the nine months ended September 30, 2009, our treasury operations represented 27.7% of our net operating income before impairment allowances.

## **Investment Management Unit**

The key functions of our investment management unit are: (i) to conduct inter-bank money market transactions to manage our liquidity and (ii) to manage our investment portfolio in capital markets investments, primarily debt securities.

## **Inter-Bank Money Markets and Liquidity Management**

We are one of the leading participants in the inter-bank money market in Hong Kong. We are usually a net provider of inter-bank funds. As of September 30, 2009, we had total deposits and balances of banks and other financial institutions of HK\$81,871 million, which accounted for approximately 7.43% of our total liabilities, and had total loans to banks of HK\$189,938 million, which accounted for approximately 15.86% of our total assets.

Our investment management unit is responsible for managing our liquidity position. The objective of our liquidity management is to achieve a reasonable return on our liquid assets while complying with the requirements of the Banking Ordinance, the guidelines of the HKMA and the liquidity management guidelines set by our assets and liability management committee. In particular, we seek to have sufficient cash and other liquid assets to handle contingencies. See the section headed “– Risk Management – Liquidity Risk Management.”

#### *Investment Portfolio Management*

We prudently invest in securities for our own account, primarily Hong Kong dollar- and U.S. dollar-denominated debt securities issued by banks and other financial institutions, and debt securities issued by governments, central banks and public sector entities in the Group of Seven (“G-7”) countries and in Australia, which we also consider to be low risk. As of September 30, 2009, the aggregate carrying value of our debt securities investments was HK\$305,081 million. Generally, approximately 92% of our investment portfolio consists of debt securities with a minimum credit rating of “A” by S&P, Moody’s or Fitch (including issuer rating distribution for debt securities with no issue rating).

Our investment management unit manages our investment portfolio under guidelines approved by our asset and liability management committee within risk limits approved by our Risk Committee.

#### *Global Markets Unit*

We provide foreign exchange and derivatives trading services to our customers through the global markets unit. Currently, our global markets unit is primarily responsible for:

- providing sales and distribution services in foreign exchange, derivatives, funds, bullion and insurance products;
- managing our trading accounts in the inter-bank foreign exchange and derivatives markets;
- engaging in primary underwriting and secondary market trading of bonds denominated in RMB, HKD, USD and the other currencies; and
- innovating new treasury products to meet the diverse needs of our customers.

#### *Foreign Exchange*

We generate the majority of our foreign exchange revenues from our retail and corporate foreign exchange services. We are an active participant in the Hong Kong inter-bank foreign exchange market. For the nine months ended September 30, 2009, our net gain from foreign exchange and foreign exchange products was approximately HK\$1,061 million.

We have increased our efforts to provide bulk deal services to increase our market share in handling significant foreign exchange transactions for large customers. We have dedicated treasury marketing teams to assist our corporate banking units with the sales and distribution capabilities for our foreign exchange products and services.

We are an active dealer in inter-bank spot foreign exchange transactions. We provide 24-hour dealing and order execution services to our personal and corporate banking units, branches of BOC and other banking institutions.

In addition, we conduct wholesale money exchange transactions through the inter-bank currency markets. We believe we are a leader in money exchange transactions in Hong Kong. We have a stable wholesale and inter-bank customer base for our money exchange business, and have accumulated extensive experience and capability in handling large money exchange transactions.

## *Derivatives*

We are an active dealer in Hong Kong's inter-bank derivatives market. We conduct derivatives transactions for our own account for hedging purposes. Our derivatives activities primarily involve effecting transactions for interest rate swaps, forward rate agreements, interest rate futures and options, cross currency interest rate swap, currency options and bullion options to meet our customers' and our own hedging and yield enhancement needs. In particular, we introduced Renminbi non-deliverable forward and Renminbi non-deliverable interest rate swaps to hedge Renminbi-related risks.

## *Other Activities*

Our bullion trading activities include the supply and purchase of bullion materials, bullion consignment, deferred settlement bullion trading, gold loan financing and physical bullion trading.

In addition, we also provide comprehensive treasury services and solutions to corporate entities, in particular Mainland China clients. Since the launch of Renminbi-denominated bonds in Hong Kong in 2007, we have been the leading Renminbi bonds underwriter, placing bank and market maker in Hong Kong.

## **Renminbi Banking Business**

With the approval from the State Council of Mainland China Renminbi business in Hong Kong began in 2004, and since then the scope of Renminbi business has been expanded in line with the policies of the PBOC. We are the sole Renminbi clearing bank for Renminbi business in Hong Kong. We offer a wide range of Renminbi products and services to both individual and corporate customers. We have established our leadership in major Renminbi businesses.

Our Renminbi retail products and services include deposits, exchange, remittance and dual currency cards. We focus on providing integrated Renminbi services, such as "RMB Remittance Express" and "RMB Exchange Express." In December 2008, we pioneered the world's first BOC CUP dual currency credit card in Hong Kong, using both RMB and HKD as the settlement currencies. We have issued around 400,000 dual currency cards, specifically designed to cater for Hong Kong-Mainland China cross-border travelers needs, in just one year after its launch. In the same year, we were the first bank in Hong Kong to launch dual currency withdrawal services at 75 MTR stations, bringing additional convenience to our customers traveling to and from Mainland China.

For our corporate customers, we provide Renminbi cash deposit, remittance, and fund transfer services. We have also enhanced our "RMB Merchant Link" service to provide a one-stop solution for our corporate customers, facilitating their cash management while helping them hedge against exchange rate risk arising from cross-border trade. Following the launch of the "Pilot Renminbi Trade Settlement Scheme" in July 2009, we launched a wide spectrum of Renminbi trade settlement and finance services, enabling our corporate customers to conduct Renminbi trade transactions such as bills collection, letter of credit issuance, invoice financing, as well as packing and import loans. With the increasing significance of the Renminbi in the global economy, we believe that there will be increasing demand for Renminbi as the settlement currency for cross-border trade transactions. The newly introduced Renminbi trade service will broaden the scope of our Renminbi services in Hong Kong.

We also established our leadership in the issuance and distribution of Renminbi-denominated bonds in Hong Kong. From the launch of Renminbi-denominated bonds in Hong Kong in 2007 to the end of 2009, there have been 13 Renminbi-denominated bond issues, of which we have lead-managed 11, including the first Mainland China sovereign bond issued offshore by the PRC Government acting through the Ministry of Finance in October 2009. Capitalizing on our strong distribution network, we also maintained a leading market share for the bond distribution.

On December 24, 2003, we were appointed by the PBOC as the clearing bank for Renminbi business in Hong Kong. In 2004, we began to offer Renminbi clearing services in relation to deposit, exchange, remittance and bank cards. Following the initiation of the “Administrative Rules on Pilot Program of Renminbi Settlement of Cross-Border Trade Transactions,” we, as the sole Renminbi clearing bank in Hong Kong, signed the “Clearing Agreement in Relation to Renminbi Business” with the PBOC on July 4, 2009. Our new Renminbi clearing service for trade settlement was launched on July 6, 2009. This new Renminbi clearing service will increase the source channels and the usage of Renminbi funds. In addition, international enterprises will have greater flexibility in selecting the settlement currency of cross-border trade transactions and increasing their capability to hedge exchange risk, minimize costs, and boost the efficiency and profitability of cross-border transactions.

We also aim to become the offshore Renminbi clearing and settlement center in Southeast Asia. In November 2009, we signed the “Agreements for Clearing and Settlement of Renminbi Trade Settlement” with a number of commercial banks in the ASEAN and neighboring regions and countries, including Bank Central Asia, Bank of China Bangkok Branch, Bank of China Manila Branch, Bank of China Jakarta Branch, Bank of China Singapore Branch and Bank of China (Malaysia) Berhad. These banks will act as direct participants for Renminbi Real Time Gross Settlement in Hong Kong. In addition to providing a wide range of Renminbi services, including deposits, foreign exchanges, remittances, bonds and trade finance for their corporate clients in trade settlement, these banks will be able to participate in the Renminbi inter-bank money market in Hong Kong and provide other Renminbi businesses as approved by the related regulatory authorities. Going forward, we believe our Renminbi clearing and settlement business will benefit from our cooperation with these ASEAN banks.

## **BUSINESS OF NANYANG AND CHIU**

Nanyang and Chiu, our principal banking subsidiaries in Hong Kong, continue to conduct their businesses as separate legal entities with their own governance structure. Through our representation on their boards of directors, we maintain our supervision over the management of Nanyang and Chiu, especially in the areas of finance, risk management, audit and information technology. Furthermore, Nanyang and Chiu pursue consistent and complementary business strategies as BOCHK. We also set broad guidelines on the overall strategic direction of both Nanyang and Chiu. Nanyang and Chiu are allowed to tailor their product offerings to their distinct customer segments within the constraints of these guidelines.

In general, the scope of Nanyang’s and Chiu’s personal banking, corporate banking and treasury operations and the range of their products and services are substantially similar to those of BOCHK. They generally complement BOCHK’s business, products and services and deliver their products and services through similar distribution channels. As of September 30, 2009, Nanyang and Chiu had 41 and 24 branches in Hong Kong, respectively, and in 2007 Nanyang established a wholly owned subsidiary, NCB(China), with 19 branches and sub-branches in Mainland China. Nanyang also has one branch in Shanghai, Mainland China, and one branch in San Francisco, California, the United States. Chiu has three branches and sub-branches in Mainland China, which are permitted to conduct only limited Renminbi businesses.

The following table sets forth certain balance sheet and earnings information relating to Nanyang and Chiyu as of and for the six months ended June 30, 2009.

	Nanyang		Chiyu		BOCHK Group
	Amount	As % of Group	Amount	As % of Group	Amount
	(HK\$ in millions)				
Loans <sup>(1)</sup>	68,600	14.40	15,110	3.17	476,288
Deposits <sup>(2)</sup>	95,347	11.52	32,121	3.88	827,622
Total assets	124,639	11.17	39,183	3.51	1,115,586
Net operating income before impairment allowances	1,560	12.17	467	3.64	12,820
Net (charge)/reversal of impairment allowances	(3)	0.27	13	-1.17	(1,115)
Profit attributable to shareholders	871	13.17	275	4.16	6,613

*Notes:*

(1) Computed as gross advances to customers before impairment allowances.

(2) Represents current, fixed, savings and other deposits from customers, including structured deposits.

Nanyang's profit attributable to shareholders was HK\$1,713 million in 2006, HK\$2,057 million in 2007, HK\$1,016 million in 2008 and HK\$871 million for the six months ended June 30, 2009, which represented 12.4% of our profit attributable to shareholders in 2006, 13.5% in 2007, 15.6% in 2008 and 13.2% for the six months ended June 30, 2009. Chiyu's profit attributable to shareholders was HK\$560 million in 2006, HK\$775 million in 2007, HK\$591 million in 2008 and HK\$275 million for the six months ended June 30, 2009, which represented 4.0% of our profit attributable to shareholders in 2006, 5.1% in 2007 and 9.1% in 2008 and 4.2% for the six months ended June 30, 2009.

Although the business operations of Nanyang and Chiyu form a part of our Group business, they also offer products and services under their own brand names and, from time to time, compete for business with each other as well as with BOCHK and BOC.

## MAINLAND CHINA BUSINESS

On May 4, 2009, we obtained the approval of the China Banking Regulatory Commission ("CBRC") allowing BOCHK's Mainland China branches and sub-branches to restructure into NCB(China). On August 1, 2009, we transferred almost all our Mainland China business (previously conducted by BOCHK's branches and sub-branches in Mainland China) to NCB(China). This restructuring not only enables us to fully explore the potential of our Mainland China business and capitalize on our unique strengths, but also signifies a major move by NCB(China) to expand its business network.

NCB(China) is registered as a wholly foreign-owned bank in Mainland China and is solely owned by BOCHK through Nanyang. Headquartered in Shanghai, NCB(China) provides comprehensive banking products and services to individual and corporate customers through its branch network which covers eight major cities and municipalities in Mainland China, including Beijing, Shanghai, Guangzhou (including Panyu), Shenzhen, Haikou, Dalian, Hangzhou, and Nanning. As of September 30, 2009, the Group had 23 branches and sub-branches in Mainland China to meet local and cross-border needs of our Hong Kong and Mainland China customers. Of these, 19 branches and sub-branches of NCB(China) are approved to conduct the full range of Renminbi businesses, three branches and sub-branches of Chiyu are permitted to conduct limited Renminbi businesses and the Shanghai branch of Nanyang is approved to operate foreign exchange business only. Through our relationship with BOC, we have access to a distribution network of over 10,000 domestic branches and subsidiaries across Mainland China.

Going forward, NCB(China) intends to enhance its cooperation with BOC in Mainland China to maximize cross-selling, increase the product range and jointly develop customized financial products. We are also continuing to expand our cross-border financial services to better serve the specific needs of our individual and corporate customers in Mainland China and Hong Kong.

## **DISTRIBUTION NETWORK**

We deliver our personal and corporate banking products and services through a variety of distribution channels, ranging from our branch network to self-service machines, phone banking center and the Internet.

### **Branch Network**

As of September 30, 2009, we had 297 branches, including 23 branches and sub-branches located in Mainland China and one in San Francisco, the United States. We also had 138 Wealth Management centers located in our branches. Our branches in Hong Kong cover large customer bases and provide us with a strong community presence as well as a market information collection channel. The Wealth Management centers are designed to provide more personalized services to our high net worth customers.

It is our goal to continuously optimize the service scope and coverage of our branch network in Hong Kong. Under this initiative, some of our full service branches will be modified into one of the following three types of retail branches: (i) flagship branches, (ii) general branches; and (iii) satellite branches.

Since 2006, we have closed or consolidated 18 branches that were located in overlapping service locations or in areas with changing demographic composition of customers. In the meantime, we have established new branches in strategic locations not covered by our existing branch network.

### **Self-Service Banking Centers and ATMs**

As of September 30, 2009, the Group had 134 self-service banking centers and more than 470 ATMs in Hong Kong. Besides branch locations, our self-service banking centers and ATMs are situated in various other locations including shopping malls, the airport, residential areas, hospitals, college campuses, and all major transportation hubs in Hong Kong. We are a member of Joint Electronic Teller Services Limited (“JETCO”), an electronic banking terminal network among banks in Hong Kong and Macau, which consists of over 1,450 ATMs in Hong Kong. Our customers can access their accounts and effect banking transactions through any JETCO ATM.

Customers use our self-service banking centers and ATMs for a variety of functions, including HKD and RMB cash withdrawal, balance inquiry, fund transfer and bill payment. We are a market leader in offering Renminbi cash withdrawal through our ATMs for debit cardholders of our Bank as well as those of other JETCO member banks in Hong Kong. ATM cards issued by banks in the CUP network, global PLUS ATM network and the local JETCO ATM network can conduct transactions using our ATMs, and we receive a fee for some of these transactions. The CUP is the China Union Pay network that provides both credit and debit payment services, and the PLUS ATM network is a world-wide electronic cash access terminal network operated by the VISA Global ATM Network.

To encourage customers to use automated banking facilities, we continuously enhance our service network by establishing new self-service banking centers and installing more ATMs, check deposit machines and cash deposit machines.



## **Corporate Service Centers**

In addition to our branch network, we deliver our products and services to our corporate customers through relationship managers from our corporate division, commercial division, SME division and financial institutions division. We currently have six commercial centers offering easy access to SMEs.

## **Online Banking**

Since its launch in 2000, our online banking service has grown rapidly. We offer Internet Banking service to our individual customers and CBS Online platform to our corporate customers in Hong Kong.

Our individual customers can obtain financial information and perform various transactions through our Internet Banking service, including balance enquiry, fund transfer, bill payments, securities trading, foreign exchange trading and wealth management services. The majority of our stock trading transactions are processed through the Internet. We believe that the Internet Banking service provides our individual customers with convenient and flexible ways of accessing our products and services, while allowing us to reduce operating costs. Our customers can also enjoy preferential handling fees for selective products using our Internet Banking service.

We intend to further exploit this distribution channel by expanding the scope of our products and services offered through our Internet Banking platform and by enhancing its technological capabilities. In 2009, we launched the new online application for credit card and insurance services and extended online trading hours of certain businesses, providing customers with more efficient online banking services.

Our corporate customers can access our CBS Online platform to review account balances, effect electronic remittances, issue letters of credit, release payroll, set up auto pay, trade securities and obtain information on loans, such as credit limit and interest rates. In 2009, we upgraded the CBS Online platform and launched investment functions and online applications for corporate insurance services where our corporate customers can enroll in a wide variety of business insurance products. We also introduced a new online trade finance service and corporate credit card service in 2009.

## **Phone Banking and Customer Service Center**

Our individual customers can access their accounts and conduct securities and foreign exchange transactions over the telephone by calling our customer services representatives. Wealth management customers can call us for general banking services and transactions, and corporate customers for general enquiry services. Currently, our customer service representatives primarily handle calls for securities and foreign exchange trading transactions and inbound and/or outbound calls for marketing products and services relating to insurance, credit cards and personal loans. For more convenience, customers can also conduct general banking services through our interactive voice response system. Taking advantage of the revival of the Hong Kong stock market in 2009, we expanded the capacity of our automated trading telephone lines to capture potential business opportunities.

## **RISK MANAGEMENT**

We believe that sound risk management is crucial to the success of any organization. In our daily operation, we attach a high degree of importance to risk management and emphasize that a balance must be struck between risk control and business growth and development. The principal types of risk inherent in our businesses are credit risk, interest rate risk, market risk, liquidity risk, operational risk, reputation risk, legal and compliance risk and strategic risk.

### **Risk Management Governance Structure**

Our 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. We have

a sound risk management organizational structure which implements 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 our highest decision-making authority and has the ultimate responsibility for risk management. The Board, with the assistance of its committees, has the primary responsibility for the formulation of risk management strategies and for ensuring that we have an effective risk management system to implement these strategies. The Risk Committee (the “**RC**”), a standing committee established by the Board of Directors, is responsible for overseeing our 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 Audit Committee assists the Board in fulfilling its role in overseeing the internal control system.

The Chief Executive (the “**CE**”) is responsible for managing our various types of risks, approving risk management policies and material risk exposures or transactions within his authority delegated by the Board of Directors. The Chief Risk Officer (the “**CRO**”) assists the CE in fulfilling his responsibilities for the day-to-day management of risks. The CRO is responsible for initiating new risk management strategies, projects and measures that will enable us 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 CRO 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.

Our various units have their respective 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 different kinds of risks. Risk management units have the primary responsibilities for drafting, reviewing and updating risk management policies and procedures.

Our principal banking subsidiaries, Nanyang and Chiyu, are subject to risk policies that are consistent with those of BOCHK. These subsidiaries execute their risk management strategies independently and report to our management on a regular basis.

### **Credit Risk Management**

Credit risk is the risk that a customer or counterparty will be unable or unwilling to meet its obligations under a contract. It arises principally from the lending, trade finance and treasury businesses, and covers inter-bank transactions, foreign exchange and derivative transactions as well as investments in bonds and securities. The Chief Credit Officer reports directly to the CRO and is responsible for the management of credit risk and for the formulation of all credit policies and procedures. The Chief Analytics Officer reports directly to the CRO and is responsible for the development and maintenance of internal rating models and rating criteria. 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 generally required to be independently reviewed and objectively assessed by risk management units. For retail exposures, a credit scoring system is used to process retail credit transactions. The Credit Risk Assessment Committee comprises experts from our credit and other functions and is responsible for making an independent assessment of all credit facilities which require the approval of a Deputy Chief Executive or above.

Our internal loan grading system divides loans into five categories with reference to the HKMA’s guidelines. The Risk Management Department (the “**RMD**”) provides regular credit management information reports and ad hoc reports to the Management Committee, RC and Board of Directors to facilitate their continuous monitoring of credit risk.



For investments in debt securities and securitization assets, 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, we set customer limits to manage the credit risk involved and follow the same approval and control processes as those for loans and advances. Ongoing monitoring and stop-loss procedures are established.

In 2007, we adopted a comprehensive methodology for determining whether a particular ABS/MBS was impaired. Under the current methodology, we not only take into consideration the mark-to-market price of the issue and its external credit rating, but also additional factors such as the FICO score, vintage, collateral location, ARM status, delinquencies, level of collateral protection, loan-to-value ratio and prepayment speed of the underlying assets. After these factors have been considered, the ABS/MBS issue must also meet our required credit enhancement coverage ratio. This ratio is determined by applying assumptions regarding the default rates, based on the available delinquency, foreclosure and REO data of the ABS/MBS issue.

### **Market Risk Management**

We define market risk as the risk of loss arising from adverse movements in the value of financial instruments held in the trading book, which includes interest rate-related contracts and equity-related contracts held for trading purposes as well as all foreign exchange-related and commodity-related contracts held by us.

Our market risk management framework comprises three levels. The Board of Directors and its Risk Committee are the ultimate decision-making authorities, responsible for the establishment of the risk management framework and policies, approval of high-level risk limits and oversight of the effectiveness of the market risk management system. Senior management formulates risk management procedures and monitors the implementation of these procedures to ensure that risk policies and limits set by the Board are being complied with. The RMD is responsible for the day-to-day independent monitoring of market risk exposures and regularly reporting the risk to senior management.

Market risk is managed within various major risk limits approved by the RC, which include Value-at-Risk (“VAR”) limit, stop-loss limit, stress test limit and risk positions or risk factor sensitivity limit. Limits are also divided into sub-limits for more detailed control. For example, there are sub-limits set on different risk product types, namely interest rates, foreign exchange, commodities and equities; there are also sub-limits on different tenors as well as different products to ensure that the portfolio is adequately diversified.

Market risk is also controlled by restricting trading book operations to trade within a list of permissible instruments authorized by senior management. Any new product is required to go through rigorous new product due diligence procedures to make sure that all risks that arise are thoroughly identified and properly assessed before launch.

Stress testing is employed both as a risk limit and as a risk measurement tool to supplement the limitations of the VAR model, which is a statistical method based on historical data. Stress testing is a risk management tool for estimating risk exposures under stressed conditions arising from extreme but plausible market or macroeconomic movements. Our trading book market risk stress testing program includes, but is not limited to, sensitivity testing on changes in risk factors with various degrees of severity, as well as scenario analysis based on historical events, including the 1987 equity market crash, the 1994 bond market crash, the 1997 Asian financial crisis, the September 11 event in the United States in 2001 and the financial crisis in 2008. Our stress-testing regime provides senior management with an assessment of the financial impact of identified extreme events on our market risk exposures.

We hold adequate capital to withstand loss arising from trading activity. Currently, market risk capital charge is calculated based on the regulator-prescribed standardized approach. To enhance market risk management capability and improve capital utilization, we plan to apply for the use of the internal model approach to calculate market risk capital charge based on our VAR model in the near future.

### **Banking Book Interest Rate Risk (“IRRBB”) Management**

We define IRRBB as the risk of loss in earnings or economic value arising from adverse movements of interest rates affecting our banking book positions. Our IRRBB exposures are mainly structural. The major types of IRRBB 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; and
- Option risk – exercise of the options in assets, liabilities and off-balance sheet items inducing a change in the cash flows of assets and liabilities.

The IRRBB management framework comprises three levels. The RC is the ultimate decision-making authority. It sanctions our risk appetite and “Interest Rate Risk Management Policy,” which sets out the framework and the methodologies to identify, measure, monitor and control IRRBB. The Asset and Liability Management Committee (the “ALCO”) formulates risk management procedures and monitors the implementation of these procedures to ensure that risk policies and limits set by the Board are being complied with. The Risk Management Department is responsible for the day-to-day independent monitoring of IRRBB exposures, while the Asset and Liability Management Department is responsible for assisting the ALCO to optimize the balance sheet structure and allocation within the approved risk management framework.

Our IRRBB is centralized at the treasury function for day-to-day management through an effective fund transfer pricing mechanism and is measured and monitored on a daily basis. Gap analysis is one of the tools used to measure our exposure to repricing risk and yield curve risk. A metric of position limits is established to control the mismatch position in each currency and in each time band. Based on this repricing gap, sensitivities of earnings and economic value to interest rate changes (Net Interest Income impact and Economic Value impact) are assessed through a standardized interest rate shock of 200 basis points. Limits on Net Interest Income impact and Economic Value impact, which are the risk appetite sanctioned by RC, are controlled within an approved percentage of the projected net interest income for the year and the latest capital base respectively. The impact of basis risk is gauged by ratios of assets to liabilities with similar pricing basis and the projected change in net interest income arising from the imperfect correlation in the adjustment of the rates earned and paid on instruments with different interest rate basis. These results are reported to the RC and ALCO on a monthly basis. In particular for our investment portfolio, sensitivity limits like PVBP (Price Value per Basis Point) and Greeks limits are established. In addition, a profit-and-loss management alert limit is set up to control the revaluation impact of the banking book’s financial instruments on our earnings.

Notwithstanding the above, regular stress testing is conducted to assess and control the impact of interest rate movements and the induced changes in asset/liability items on our earnings and economic value under a system of stress scenarios.

## **Liquidity Risk Management**

We define liquidity risk as the risk that we may not be able to meet obligations as they fall due or fund asset growth without incurring unacceptable losses.

Our liquidity risk management framework comprises three levels. The RC is the ultimate decision-making authority. It is responsible for compliance with regulatory requirements and sanctions our liquidity risk tolerance and “Liquidity Risk Management Policy,” which sets out the framework and the methodologies to identify, measure, monitor and control liquidity risk. The ALCO formulates risk management procedures and monitors the implementation of these procedures to ensure that internal and regulatory requirements are fulfilled. The Risk Management Department is responsible for the independent monitoring of liquidity positions while the Asset and Liability Management Department is responsible for assisting the ALCO to optimize the balance sheet structure and allocation within the approved risk management framework.

Daily management of liquidity is carried out by the treasury function by centralizing all sources and uses of our fund into the funding pool. We fund our operations principally by accepting deposits from retail and corporate depositors. In addition, we may issue certificates of deposits to secure long-term funds. Funding may also be secured through adjusting the asset mix in our investment portfolio. We use the majority of funds raised to extend loans, to purchase debt securities or to conduct inter-bank placements.

We have developed a robust mechanism which aims at enabling us to meet, even under adverse market conditions, all our maturing repayment obligations on time, and to fund all our asset growth and strategic opportunities without forced liquidation of our assets at short notice. The objective is achieved through daily management of actual and projected cash flows under normal and stress liquidity conditions, maintenance of a highly liquid asset portfolio, maintenance of a liquid balance sheet structure and establishment of a diversified portfolio of liabilities. We have set up three key risk indicators: a one-month liquidity ratio, a one-month mismatch ratio and a loan-to-deposit ratio which are the major tools sanctioned by the RC for managing liquidity risk on a regular basis. The results are reported to the RC and the ALCO on a monthly basis. We manage our liquidity position in the currency in which we have active business, and we have established triggers in monitoring the stability and concentration of our deposits.

In addition, regular stress testing is conducted to assess and control the impact on our liquidity position under an institution-specific and a general market crisis. The testing results are used in setting liquidity limits, adjusting cash-flow management and reviewing the liquidity profile of the investment portfolio. Moreover, we have formulated an effective contingency plan, with proper early warning signals, timely monitoring procedures and contingency funding arrangements and procedures.

## **Operational Risk Management**

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. This risk is inherent in every aspect of our business operations and confronted in our day-to-day operational activities.

We have put in place an effective internal control process which requires the establishment of detailed policies and control procedures for all key activities. Proper segregation of duties and authorization is the fundamental principle followed by us. Corporate-level policy on operational risk management is approved by the RC.

We have adopted the “Three Lines of Defense” model for our operational risk management framework. Individual business units are the first line of defense, responsible for managing and reporting operational risks specific to their business units by applying the respective tools such as key risk indicators, self-assessment and operational risk events reporting mechanism to identify, assess and control the risks

inherent in their business processes, activities and products. The Operational Risk and Compliance Department (“**ORCD**”) together with certain operational risk-related functions within BOCHK are the second line of defense. In addition to formulating the operational risk management policy and procedure, ORCD is responsible for developing and introducing operational risk management tools, monitoring the performance and results of operational risk management in various units, assessing operational risk profile, recording operational risk data and reporting operational risk events to RC and senior management in order to assist the overall management of our operational risk. Certain functional departments, including the Human Resources Department, Information Technology Department, Legal Service Center, Corporate Services Department, Financial Management Department and General Accounting and Accounting Policy Department, are required to carry out the corporate-level operational risk management for the risk areas under their functional responsibility and to provide other units with professional advice and training in respect of certain operational risk categories. The Audit Department is the third line of defense, responsible for conducting independent audits of the operational risk management activities regarding their compliance and effectiveness.

We also take out insurance to mitigate unforeseeable operational risks. Business continuity plans are in place to support business operations in the event of an emergency or disaster. Adequate backup facilities are maintained and periodic drills are conducted.

### **Reputation Risk Management**

Reputation risk is the risk that negative publicity regarding our 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, we have formulated and duly followed our 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.

The Lehman Brothers Minibonds incident has had an adverse impact on our reputation. We are handling customer complaints cautiously so as to minimize the reputation risk.

### **Legal and Compliance Risk Management**

Legal risk is the risk that unenforceable contracts, lawsuits or adverse judgments may disrupt or otherwise negatively affect our operation or financial condition. Compliance risk is the risk of legal or regulatory sanctions, financial loss, or loss to reputation that the Bank may suffer as a result of any failure to comply with all applicable laws and regulations. Compliance risks are managed by ORCD, which reports directly to the CRO. All legal matters are handled by Legal Services Centre (“**LSC**”), which reports to the Chief Operating Officer. ORCD oversees legal risk management and is assisted by LSC. As part of our corporate governance framework, policy for the management of legal and compliance risk is approved by the RC.

### **Strategic Risk Management**

Strategic risk generally refers to the risks that may induce immediate or future negative impact on our financial and market positions because of poor strategic decisions, improper implementation of strategies and lack of response to the market. The Board of Directors reviews and approves the policy for the management of strategic risks. Key strategic issues have to be fully evaluated and properly endorsed by senior management and the Board.

We will regularly review our business strategies to cope with the latest market situation and developments.

## **Capital Management**

The major objective of capital management is to maximize shareholders' total return while maintaining a healthy capital adequacy position commensurate with our overall risk profile. We periodically review our capital structure and adjust the capital mix where appropriate to achieve the targeted weighted average cost of capital. The ALCO monitors our capital adequacy position. We have complied with all the statutory capital standards for all periods.

To comply with the HKMA's requirements as stated in the Supervisory Policy Manual "Supervisory Review Process," we have implemented our 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 is assessed. Scorecard methodology has been used to evaluate our 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 utilization.

## **Stress Testing**

We supplement the analysis of various types of risks with stress testing. Stress testing is a risk management tool for estimating our risk exposures under stressed conditions arising from extreme but plausible market or macroeconomic movements. These tests are conducted on a regular basis by various risk management units and the ALCO monitors the results against limits approved by RC. The Financial Management Department reports the combined stress test results to the Board and RC regularly.

## **Anti-Money Laundering and Anti-Terrorism Financing Measures**

We have organized our operations and activities in accordance with all applicable laws, regulations and guidelines, including the HKMA's anti-money laundering guidelines. We place great importance on our anti-money laundering/anti-terrorism financing monitoring and set up an anti-money laundering committee in 2001, chaired by our Chief Risk Officer, to supervise and coordinate activities in this area. The objectives of this committee include:

- managing our risk exposure in relation to anti-money laundering/anti-terrorism financing;
- ensuring that proper anti-money laundering/anti-terrorism financing control procedures have been properly implemented with reference to prevailing guidelines and circulars of legal and regulatory bodies; and
- coordinating among various departments and branches on anti-money laundering/anti-terrorism financing activities.

We have implemented internal anti-money laundering/anti-terrorism financing guidelines and suspicious transaction reporting procedures to facilitate our staff's understanding of their anti-money laundering/anti-terrorism financing obligations and responsibilities. Regular and continuous training will be provided to our front line employees. We have also set up a dedicated suspicious transaction reporting system to facilitate the identification, monitoring and reporting of suspicious transactions.

In addition, we continually seek to improve our anti-money laundering/anti-terrorism financing controls and procedures by identifying areas which require improvement and taking appropriate measures to implement more stringent internal monitoring and control procedures.

## **Risk Management Practices of Nanyang and Chiyu**

The risk management strategies and policies of Nanyang and Chiyu, our subsidiary banks, generally follow those of BOCHK. In addition, Nanyang and Chiyu have generally implemented risk management controls and procedures that are in compliance with our risk management controls and procedures. Within this general risk management framework, Nanyang and Chiyu may conduct their existing risk management practices according to their own specific circumstances. Both Nanyang and Chiyu have established organizational structures for their risk management operations that are similar to BOCHK's structure.

## **BACK OFFICE PROCESSING**

Our bank-wide operation unit is responsible for the delivering of banking services to our customers in a timely and cost-effective manner. We adopt the centralized processing approach in our bank-wide operation unit. Major functions supported by this unit include the following:

- account opening;
- loan processing;
- trade finance processing;
- confirmation and settlement of treasury products;
- Renminbi clearing;
- distribution and collection of bank notes;
- cash management services; and
- account reconciliation.

Our bank-wide operation unit has established performance metrics for the measurement of productivity and is committed to provide reliable back office service through various process re-engineering initiatives. Manual data input functions of our bank-wide operation unit are being relocated to a low-cost processing center in Mainland China to improve the cost effectiveness of our back office processing.

## **TECHNOLOGY**

The Information Technology ("IT") department has an experienced team of professionals providing technological support to our operations, including customer services, transaction processing, risk management and financial management. A robust system environment is the key to the achievement of our overall business strategies and will enhance our overall efficiency, the quality of our customer service and our risk and financial management. We have invested and will continue to invest in our IT systems and in the past have engaged external IT consultants for major IT projects. Our IT hardware and software are sourced from various vendors which are well-known brands in their respective areas of expertise.

We have adopted a variety of security measures, including advanced firewall technologies, digital security certificates, intruder detection software and internet security strategies to provide a high level of network security. To enhance the reliability of our operations, we have also established operational disaster recovery centers in Hong Kong away from headquarters and an IT service center in Shenzhen. We have an experienced IT team. Currently, we cooperate with external experts to improve our systems, in order to leverage our substantial industry knowledge and ensure that best practices can be implemented.



## **COMPETITION**

As of September 30, 2009, there were 146 licensed banks in Hong Kong. Competition from both Hong Kong-incorporated and foreign licensed banks is intense. In addition, we compete for customers with restricted license banks, deposit-taking companies and insurance companies in certain areas of business. Furthermore, we compete with consumer finance companies for personal banking services and investment banks and other financial intermediaries for investment and other financial services. Competition in the Hong Kong banking industry is primarily based on the range and quality of the product and service offerings, customer convenience and pricing. See the section headed “Risk Factors – Risks Relating to Our Business – The increasing competition in Hong Kong and Mainland China banking industry could adversely affect our profitability.”

In addition, the Hong Kong banking industry is undergoing consolidation, with a number of significant mergers and acquisitions taking place in recent years. In particular, international and Chinese financial institutions have been establishing or strengthening their presence, and larger domestic financial institutions have been consolidating their market position in the Hong Kong banking market through acquisitions of banks, finance companies and stock brokerage firms. We expect that merger and acquisition activities in the Hong Kong banking industry will continue, and the industry may face further consolidation. We expect that further consolidation in the industry, in particular among mid-cap Hong Kong banks, will continue to intensify competition.

We believe that we have a competitive advantage due to our strong market reputation and leading presence in the commercial banking market in Hong Kong as well as BOC’s strong support in Mainland China. In personal banking, our integrated banking services, together with our large customer base and extensive distribution network, provide us with significant cross-selling opportunities with our individual customers. Our extensive experience in serving Mainland China customers through our credit card business and our relationship with BOC also allow us to develop our customer base. In corporate banking, we have increasingly benefited from our continued active participation in syndicated loans and diverse trade finance products and services. Our relationships with BOC in Mainland China have also been a competitive advantage in expanding our customer base. For a further discussion of the risks of competition we face in Hong Kong and Mainland China, see “Risk Factors – Risks Relating to Our Business – The increasing competition in Hong Kong and Mainland China banking industry could adversely affect our profitability.”

## **EMPLOYEES**

We had 12,633, 12,974, 12,983 and 12,569 full-time employees as of December 31, 2006, 2007 and 2008, and September 30, 2009, respectively. We have not experienced any strikes or other material labor disputes, and we consider our relations with our employees to be good. Most of our employees do not belong to any labor union. Substantially all of our employees are located in Hong Kong. We have no current intention to retrench our staff.

Our staff compensation packages include a performance-based bonus depending on the scope of the employee’s responsibility and the performance targets that have been achieved. In addition, bonuses for our senior management are linked to our results of operations.

We have adopted a performance measurement system under which our employees are evaluated annually. This performance measurement system applies to every level of our permanent employees. Under the system, each supervisor of an employee conducts an annual review of the employee’s performance based on a number of different criteria such as business volume, profitability, market share and asset quality. The result of the review is the basis for promotions, pay rises, bonuses or remedial actions.

In addition to basic compensation, we also currently offer our employees residential mortgage loans at preferential interest rates. Moreover, our employees are eligible to participate in our exempted retirement schemes, MPF and other employee benefit plans. Under the exempted retirement schemes, the employee contributes 5% of his or her salary to the schemes on a monthly basis, and we contribute 5% to 15% of the employee's salary to the schemes on a monthly basis, depending on his or her years of service. The MPF, to which both we and our employees contribute, is a retirement scheme required by Hong Kong law. Under the mandatory provident fund requirements, we and each employee are presently required to contribute 5% of the employee's relevant income to the fund on a monthly basis, subject to a maximum monthly contribution of HK\$1,000 for each employee. We have made all required contributions to date.

We believe that training our employees is essential in promoting a new culture in our organization. The human resources department of the Bank focuses on facilitating changes in our corporate, risk management and marketing culture through continuous training of our employees. We have a dedicated training center where we conduct regular training programs for our employees. Management and executive trainees normally undergo a training module of approximately 30 months in length. We also offer courses conducted by both internal and external faculty. In addition to ongoing on-the-job training, we provide courses in specific areas or specialized operations to employees on a need-based basis, with training program modules varying from half a day to few days in length, covering subjects such as risk management procedures and anti-money laundering control procedures.

## **PROPERTIES**

Our registered office is located at The Bank of China Tower, No. 1 Garden Road, Hong Kong. As of September 30, 2009, we had a principal network consisting of 297 branches, more than half of which are located on properties owned by us, while the remaining facilities are located on leased properties. We also have properties owned or leased by our subsidiaries in Hong Kong, Mainland China, Macau, and the United States.

## **INSURANCE**

We utilize a broad insurance program, which provides our operations with coverage that we believe is appropriate for the associated risks. Where appropriate, we take out: (i) cash-in-transit insurance, (ii) contractors' all risks insurance, (iii) public liability insurance, (iv) accidental damage to property insurance, and (v) insurance to mitigate unforeseeable operational risks. Most of our insurance protections include coverage for physical loss and damage as well as third party liability. We periodically review our insurance coverage to ensure that we have adequate coverage.

## **LEGAL PROCEEDINGS**

We are party to various legal proceedings in the ordinary course of our business. Although we cannot accurately predict the outcome of these matters, we do not expect any proceeding to have a material adverse effect on our consolidated financial position and results of operations. We make provision for potential liabilities when we deem them probable and reasonably estimable. These provisions are based on current information and legal advice and are adjusted from time to time according to developments.



## ASSETS AND LIABILITIES

### ASSETS

The three principal components of our interest-earning assets consist of loans to banks, interest-earning securities and loans and advances to customers. The following table sets forth, for the years/periods indicated, the average balances of the principal components of our assets:

	Year ended December 31,			Nine months ended September 30,
	2006	2007	2008	2009
	(average balances, HK\$ in millions)			
Loans to banks . . . . .	177,070	207,573	261,607	239,246
Interest-earning securities . . . . .	293,414	315,761	283,599	301,671
Loans and advances to customers . . . . .	333,890	382,023	424,409	462,462
Other interest-earning assets . . . . .	21,778	17,462	13,786	11,974
<b>Total interest-earning assets . . . . .</b>	<b>826,152</b>	<b>922,819</b>	<b>983,401</b>	<b>1,015,353</b>
Non interest-earning assets . . . . .	78,288	90,861	85,919	105,994
<b>Total average assets . . . . .</b>	<b><u>904,440</u></b>	<b><u>1,013,680</u></b>	<b><u>1,069,320</u></b>	<b><u>1,121,347</u></b>

### Foreign Exposure

We have foreign exposure with respect to each of the three principal components of our assets. The HKMA defines “exposure” as all potential losses which might result should a counterparty default. This includes, among others, claims and contingent liabilities recorded both on and off our balance sheet and any exposure to a counterparty that is liable as a guarantor.

We believe that, given the generally high credit quality of both the foreign counterparties with respect to our loans to banks and the issuers of our interest-earning securities, our exposure to these entities does not present a significant level of risk. Our loans to foreign banks were primarily to high-quality international institutions in both Mainland China and elsewhere and we generally do not consider these entities to present significant credit risks.

Our interest-earning debt securities of foreign issuers were largely issued by banks and other financial institutions, and included securities issued by governments and central banks as well as public sector entities in G-7 countries and in Australia, which we also consider to be low risk.

In addition to the above foreign exposure to banks and other financial institutions, we are also exposed to foreign risk with respect to loans to entities with exposure to Mainland China. Our loans with Mainland China exposure consist of loans to non-bank Chinese entities (“NBCEs”) as defined by the HKMA.

NBCEs consist of:

- International trust and investment corporations and their subsidiaries and trust and investment corporations;
- “Red chip” companies and their subsidiaries. “Red chip companies” are companies incorporated outside Mainland China and listed in Hong Kong, at least 35% of whose shareholding is held directly by either (i) Chinese entities, i.e., state-owned organizations, provincial or municipal authorities in Mainland China; or (ii) listed or privately owned Hong Kong or non-Mainland China-incorporated entities which are controlled by Chinese entities;
- H-shares companies and their subsidiaries. “H-shares companies” refers to state-owned Chinese enterprises whose shares are listed in Hong Kong;
- Other state, provincial or municipal government-owned entities and their subsidiaries;
- Other entities incorporated or established in Mainland China;
- Companies and individuals outside Mainland China where the loan is granted for use in Mainland China;
- Other counterparties where the exposure is considered by us to be non-bank China exposure; and
- Exposures incurred by our subsidiaries in Mainland China.

The following table sets forth the total outstanding principal amount of our customer loans to NBCEs as of June 30, 2009:

	As of June 30, 2009			Individually assessed impairment allowances
	On-balance sheet exposure	Off-balance sheet exposure	Total exposure	
	(HK\$ in millions)			
Mainland China entities . . . . .	81,756	38,683	120,439	37
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China . . . .	22,472	16,480	38,952	66
Other non-bank Mainland China exposures.	16,341	6,814	23,155	39
Total . . . . .	<u>120,569</u>	<u>61,977</u>	<u>182,546</u>	<u>142</u>

NBCEs may be subject to political, regulatory, systemic, operational, and management risks associated with operating in Mainland China. As part of our business strategy, we intend to capitalize on our relationship with BOC to further access the Mainland China financial markets. This may result in an increase in the volume of our loans to borrowers located in Mainland China. However, we believe that our credit approval, monitoring and evaluation practices will allow us to manage the credit quality of our loans to these borrowers.

The following table illustrates the foreign exposure of assets in currency terms, as of September 30, 2009:

	As of September 30, 2009							
	Renminbi	U.S. Dollars	HK Dollars	Euro	Japanese Yen	Pound Sterling	Others	Total
	(HK\$ in millions)							
<b>Assets</b>								
Cash and balances with banks and other financial institutions . . . . .	54,202	42,309	66,939	397	314	1,630	2,760	168,551
Placements with banks and other financial institutions maturing between one and 12 months . . . . .	406	55,011	31,232	4,250	–	3,163	4,424	98,486
Financial assets at fair value through profit or loss . . . . .	617	1,981	9,414	–	–	–	60	12,072
Derivative financial instruments . . . . .	–	845	17,689	84	2	–	102	18,722
Hong Kong SAR Government certificates of indebtedness . . . . .	–	–	37,560	–	–	–	–	37,560
Advances and other accounts . . . . .	15,723	106,712	381,517	4,368	1,218	42	8,211	517,791
Investment in securities								
Available-for-sale securities . . . . .	2,123	94,185	40,834	22,115	17,675	1,670	28,241	206,843
Held-to-maturity securities . . . . .	1,745	30,351	24,045	6,587	1,839	355	7,623	72,545
Loans and receivables . . . . .	–	2,887	10,475	905	–	–	–	14,267
Interests in associates . . . . .	–	–	89	–	–	–	–	89
Investment properties. . . . .	30	–	8,994	–	–	–	–	9,024
Properties, plant and equipment . . . . .	365	–	24,936	–	–	–	–	25,301
Other assets (including deferred tax assets) . . . . .	185	641	14,845	127	58	148	70	16,074
<b>Total assets. . . . .</b>	<b>75,396</b>	<b>334,922</b>	<b>668,569</b>	<b>38,833</b>	<b>21,106</b>	<b>7,008</b>	<b>51,491</b>	<b>1,197,325</b>

The following table sets forth, at the dates indicated, gross advances to customers categorized by the locations of the counterparties, after taking into account the transfer of risk in respect of such advances where appropriate:

	As of December 31,			As of September 30,
	2006	2007	2008	2009
	(HK\$ in millions)			
Hong Kong . . . . .	306,897	351,080	375,233	406,206
Mainland China . . . . .	22,984	39,050	55,318	71,332
Other locations . . . . .	17,195	22,910	30,623	29,420
	<u>347,076</u>	<u>413,040</u>	<u>461,174</u>	<u>506,958</u>

## Gross Loans and Advances to Customers

### Concentration of Advances to Customers by Industry Sectors

The following table sets forth, at the dates indicated, gross advances to customers by industry sectors of the borrowers and as a percentage of gross advances to customers:

	As of December 31,						As of September 30,	
	2006		2007		2008		2009	
	Amount	% of gross advances to customers	Amount	% of gross advances to customers	Amount	% of gross advances to customers	Amount	% of gross advances to customers
(HK\$ in millions, except percentages)								
<b>Loans for use in Hong Kong</b>								
<b>Industrial, commercial and financial</b>								
Property development . . . . .	19,290	5.56%	17,979	4.35%	19,856	4.31%	26,667	5.26%
Property investment . . . . .	55,943	16.12%	65,963	15.97%	71,374	15.48%	72,009	14.20%
Financial concerns . . . . .	10,721	3.09%	12,346	2.99%	12,312	2.67%	11,524	2.27%
Stockbrokers . . . . .	65	0.02%	242	0.06%	124	0.03%	5,314	1.05%
Wholesale and retail trade . . . . .	13,019	3.75%	13,572	3.29%	18,156	3.94%	20,066	3.96%
Manufacturing . . . . .	12,417	3.58%	14,468	3.50%	16,410	3.56%	23,223	4.58%
Transport and transport equipment . . . . .	15,548	4.48%	21,001	5.08%	21,590	4.68%	27,879	5.50%
Recreational activities . . . . .	33	0.01%	30	0.01%	139	0.03%	309	0.06%
Information technology . . . . .	1,586	0.46%	2,009	0.49%	6,049	1.31%	4,978	0.98%
Others . . . . .	20,158	5.81%	21,046	5.10%	23,529	5.10%	34,859	6.88%
<b>Individuals</b>								
Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme . . . . .	14,236	4.10%	13,969	3.38%	13,477	2.92%	12,332	2.43%
Loans for the purchase of other residential properties . . . . .	96,953	27.92%	106,583	25.80%	116,303	25.22%	124,902	24.64%
Credit card advances . . . . .	4,806	1.38%	5,761	1.39%	6,553	1.42%	6,703	1.32%
Others . . . . .	9,501	2.74%	10,686	2.59%	11,452	2.48%	10,333	2.04%
Total loans for use in Hong Kong . . . . .	274,276	79.02%	305,655	74.00%	337,324	73.15%	381,098	75.17%
Trade finance . . . . .	16,865	4.86%	24,275	5.88%	24,555	5.32%	27,514	5.43%
Loans for use outside Hong Kong . . . . .	55,935	16.12%	83,110	20.12%	99,295	21.53%	98,346	19.40%
Gross advances to customers . . . . .	<u>347,076</u>	<u>100.00%</u>	<u>413,040</u>	<u>100.00%</u>	<u>461,174</u>	<u>100.00%</u>	<u>506,958</u>	<u>100.00%</u>

## ***Maturities of Loans***

The following table sets forth the maturities of our loan portfolio as of September 30, 2009.

	As of September 30, 2009							
	On demand	Up to one month	One – three months	Three – 12 months	One – five years	Over five years	Indefinite	Total
	(HK\$ in millions)							
<b>Assets</b>								
Advances and other accounts								
– advances to customers . . . . .	31,737	12,607	30,015	65,346	221,420	142,988	852	504,965
– trade bills . . . . .	46	4,074	4,669	222	–	–	–	9,011
– advances to banks and other financial institutions . . . . .	15	77	500	396	2,827	–	–	3,815
<b>Total . . . . .</b>	<b>31,798</b>	<b>16,758</b>	<b>35,184</b>	<b>65,964</b>	<b>224,247</b>	<b>142,988</b>	<b>852</b>	<b>517,791</b>

## ***Distribution by Loan Size***

The following table sets forth, as of September 30, 2009, the volume of our outstanding corporate loans to customers categorized by loan size:

	As of September 30, 2009
	% of gross advances to customers
Up to and including HK\$50 million . . . . .	22.73%
Above HK\$50 million up to and including HK\$500 million . . . . .	31.11%
Above HK\$500 million . . . . .	46.16%
<b>Total . . . . .</b>	<u>100.00%</u>

### ***Distribution by Product Type***

The following table sets forth, as of the dates indicated, our gross advances before loan impairment allowances categorized by product type:

	<b>The Group</b>		
	<b>2006</b>	<b>2007</b>	<b>2008</b>
	<b>(HK\$ in millions)</b>		
Advances to customers			
Personal			
– Mortgages . . . . .	111,870	121,663	130,980
– Credit cards . . . . .	4,713	5,641	6,445
– Other . . . . .	12,779	14,382	14,321
Corporate			
– Commercial loans . . . . .	200,849	247,079	284,873
– Trade finance . . . . .	16,865	24,275	24,555
	347,076	413,040	461,174
Trade bills . . . . .	3,128	5,334	7,609
Advances to banks and other financial institutions . . .	3,743	3,223	3,738
Total . . . . .	<u>353,947</u>	<u>421,597</u>	<u>472,521</u>

### ***Borrower Concentration***

In accordance with the Banking Ordinance and the HKMA's guidelines, our credit exposure to any one person or a group of connected persons under the same management control must not exceed 25% of the sum of our core and supplementary capital unless the exposure is to the Hong Kong government or other Hong Kong authorized institutions or is secured by cash deposits, guarantees or other security approved by the HKMA. Our aggregate credit exposure to individual large customers to whom we have an exposure greater than 10% of our capital base is and has been within the HKMA's cluster limit. Further, we are in compliance with the HKMA's Supervisory Policy Manual with respect to large exposure and risk concentrations.

### ***Classified Loans***

#### ***Loan Impairment Policies***

We first assess whether objective evidence of impairment exists individually for financial assets that are individually significant. If we determine that no objective evidence of impairment exists for an individually assessed financial asset, we include the asset in a group of financial assets with similar credit risk characteristics and collectively assess 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 recognized 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 recognized 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.

The calculation of the present value of the estimated future cash flows of a collateralized 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 recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognized in the income statement.

### ***Loan Grading System***

Our internal loan grading system divides credit assets into five categories with reference to the 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 our 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 jeopardize repayment.

"*Doubtful*" represents loans where collection in full is improbable and we expect to sustain a loss of principal and/or interest, taking into account the net realizable value of the collateral.

"*Loss*" represents loans which are considered uncollectible after all collection options (such as the realization of collateral or the institution of legal proceedings) have been exhausted.



## Impairment Allowances

The following table sets forth, at the dates indicated, our individually and collectively assessed impairment allowances by industry sectors of the borrowers.

	As of December 31,						As of September 30,	
	2006		2007		2008		2009	
	Individually assessed impairment allowance	Collectively assessed impairment allowance	Individually assessed impairment allowance	Collectively assessed impairment allowance	Individually assessed impairment allowance	Collectively assessed impairment allowance	Individually assessed impairment allowance	Collectively assessed impairment allowance
(HK\$ in millions)								
Loans for use in Hong Kong								
Industrial, commercial and financial								
Property development . . . . .	4	37	3	52	1	66	2	58
Property investment . . . . .	28	110	14	187	30	312	22	331
Financial concerns . . . . .	–	26	–	43	1	56	–	37
Stockbrokers . . . . .	–	–	–	–	–	–	–	23
Wholesale and retail trade . . . . .	61	26	85	41	71	98	70	86
Manufacturing . . . . .	42	26	37	48	138	80	59	116
Transport and transport equipment . . . . .	2	30	1	60	1	81	4	64
Recreational activities . . . . .	–	–	–	–	–	–	–	1
Information technology . . . . .	–	3	–	6	–	19	–	13
Others . . . . .	29	41	16	65	13	83	16	79
Individuals								
Loans for the purchase of flats in								
Home Ownership Scheme, Private Sector								
Participation Scheme and Tenants								
Purchase Scheme . . . . .	20	4	8	13	4	12	2	7
Loans for purchase of other								
residential properties . . . . .	23	29	18	81	7	74	2	38
Credit card advances . . . . .	–	65	–	63	–	71	–	73
Others . . . . .	57	9	50	14	57	20	56	16
Total loans for use in Hong Kong . . . . .	266	406	232	673	323	972	233	942
Trade finance . . . . .	98	35	73	77	355	108	209	116
Loans for use outside Hong Kong . . . . .	182	116	76	254	122	421	131	362
Gross advances to customers . . . . .	<u>546</u>	<u>557</u>	<u>381</u>	<u>1,004</u>	<u>800</u>	<u>1,501</u>	<u>573</u>	<u>1,420</u>

The following table sets forth, at the dates indicated, the new impairment allowances charged to income statement, and classified or impaired loans written off during the year by industry sectors of the borrowers.

	As of December 31,					
	2006		2007		2008	
	New impairment allowances	Classified or impaired loans written-off	New impairment allowances	Classified or impaired loans written-off	New impairment allowances	Classified or impaired loans written-off
	(HK\$ in millions)					
Loans for use in Hong Kong						
Industrial, commercial and financial						
Property development . . . . .	8	–	25	–	28	–
Property investment . . . . .	39	288	99	9	139	5
Financial concerns . . . . .	2	–	22	–	24	–
Stockbrokers . . . . .	–	–	–	–	–	–
Wholesale and retail trade . . . . .	90	81	149	98	120	103
Manufacturing . . . . .	170	207	58	18	249	125
Transport and transport equipment . . . . .	2	–	31	–	34	–
Recreational activities . . . . .	–	6	–	–	–	–
Information technology . . . . .	–	–	3	–	9	–
Others . . . . .	64	4	77	5	34	8
Individuals						
Loans for the purchase of flats in						
Home Ownership Scheme, Private						
Sector Participation Scheme and						
Tenants Purchase Scheme . . . . .	24	4	13	4	1	1
Loans for purchase of other						
residential properties . . . . .	34	7	79	1	8	–
Credit card advances . . . . .	138	116	124	126	157	141
Others . . . . .	106	50	50	50	61	47
Total loans for use in Hong Kong . . . . .	677	763	730	311	864	430
Trade finance . . . . .	99	37	76	15	374	26
Loans for use outside Hong Kong . . . . .	65	48	149	1	266	19
Gross advances to customers . . . . .	<u>841</u>	<u>848</u>	<u>955</u>	<u>327</u>	<u>1,504</u>	<u>475</u>

### ***Ten Largest Classified or Impaired Loans***

As of September 30, 2009, we had outstanding classified or impaired loans with aggregate gross advances of HK\$1,495 million, of which the 10 largest customer groups represented 33.31% of our outstanding classified or impaired loans and 0.10% of our loan portfolio.

### ***Collateral***

We collateralize our loans primarily with real property mortgages. In addition, to a lesser extent, we secure loans with general fixed and floating charges on assets and letters of credit and obtain performance guarantees and pledges from borrowers and related entities.

Under our existing policies and practices, acceptable collateral should have the following characteristics:

- stable price;
- liquid resale market;
- market value that can be easily determined;
- clear and unencumbered title; and
- likelihood of recovery through specific performance without significant legal or other obstacles.

Security interests in real property in Hong Kong are perfected by the registration of a deed of mortgage or legal charge with the Hong Kong Land Registry; security interests in equity securities and certain property and undertakings of Hong Kong companies may need to be perfected by registration with the Hong Kong Companies Registry.

In Hong Kong, foreclosure on real property or current assets generally requires a written application to a court, which may result in delays. The sale of equity securities and other property pursuant to a security interest does not usually require court proceedings. We generally sell collateral through private sales, tenders or public auctions.

Collateral held against overdue or impaired loans is primarily covered by charges over real estate-related assets such as commercial and residential premises for corporate loans and mortgages over residential properties for personal loans. The Hong Kong property market is cyclical, and property prices in general have been volatile in the past decade, with the result that the security coverage of our loans may be affected.

Our policy is to revalue collateral of our loans on an annual basis for pass loans, on a semi-annual basis for special mention, and on a quarterly basis for substandard, doubtful and loss loans. We immediately revalue the collateral of a loan once the loan has been overdue for more than three months. In addition, we revalue collateral when we determine that an event has occurred that could affect the value of the collateral or when we otherwise determine that a revaluation is appropriate. We generally use an independent appraiser to determine the value of the collateral for all of our loans, and update the value by using publicly available property indices on a portfolio basis. Before accepting a guarantee, we evaluate the financial condition of the guarantor and the performance of other loans guaranteed by the guarantor.

We occasionally encounter difficulties in realizing the full value of our collateral in respect of real property due to, among other things, delays in forced sale proceedings, defects in the perfection of collateral, fraudulent transfers by borrowers and unfavorable market conditions.

Administrative or other delays generally do not result in significant decreases in the value of the assets collateralizing our loans.

For syndicated loans, we have consortium banking arrangements with other banks, and the risk of each borrower is limited to the amount of our participation. The agent of a syndicate will arrange for an independent valuation of the collateral to be provided to each of the participants when necessary.

### **Securities Investments**

Our securities investments consist of listed and unlisted debt securities issued primarily by sovereigns, public sector entities, banks and other institutions and corporate entities. We account for these securities on our balance sheet as available-for-sale securities, held-to-maturity securities or loans and receivables.

The following table sets forth, at the dates indicated, the carrying value of the components of our securities investments:

	As of December 31,			As of September 30,
	2006	2007	2008	2009
	(HK\$ in millions)			
<b>Available-for-sale securities issued by:</b>				
Sovereigns . . . . .	13,180	13,402	70,274	56,757
Public sector entities . . . . .	6,933	9,673	9,202	21,851
Banks and other financial institutions . . .	34,873	43,854	70,576	111,932
Corporate entities . . . . .	45,403	33,589	21,313	16,303
Total available-for-sale . . . . .	100,389	100,518	171,365	206,843
<b>Held-to-maturity securities issued by:</b>				
Sovereigns . . . . .	1,768	1,814	1,079	1,304
Public sector entities . . . . .	21,166	20,530	12,481	3,481
Banks and other financial institutions . . .	102,823	108,547	71,426	56,770
Corporate entities . . . . .	39,831	34,537	20,407	10,990
Total held-to-maturity . . . . .	165,588	165,428	105,393	72,545
<b>Loans and receivables issued by:</b>				
Banks and other financial institutions . . .	36,114	31,102	12,595	14,267
Total loans and receivables . . . . .	36,114	31,102	12,595	14,267
<b>Total securities</b> . . . . .	302,091	297,048	289,353	293,655

#### Loans to Banks and Other Financial Institutions

We have significant exposure to banks and other financial institutions in the form of:

- balances with banks and other financial institutions;
- placements (maturing within one month);
- placements (maturing between one and 12 months);
- advances to banks and other financial institutions; and
- trade bills.

We are a net lender of inter-bank funds. The following table sets forth, at the dates indicated, the amount of our loans to banks and other financial institutions by loan type:

	As of December 31,			As of
	2006	2007	2008	September 30,
				2009
	(HK\$ in millions)			
Cash and short-term funds				
Balances with banks and other financial institutions . . . . .	4,247	6,126	7,544	3,370
Placements with banks and other financial institutions (maturing within one month) . . . . .	74,263	118,965	75,334	75,256
Placements with banks and other financial institutions (maturing between one and 12 months) . . . . .	56,373	53,154	89,718	98,486
Advances to banks and other financial institutions . . . . .	3,743	3,223	3,738	3,815
Trade bills <sup>(1)</sup> . . . . .	<u>3,128</u>	<u>5,334</u>	<u>7,609</u>	<u>9,011</u>
Total loans to banks and other financial institutions . . . . .	<u>141,754</u>	<u>186,802</u>	<u>183,943</u>	<u>189,938</u>
Total loans to banks and other financial institutions (net) <sup>(2)</sup> . . . . .	<u>92,720</u>	<u>126,203</u>	<u>95,164</u>	<u>108,067</u>

(1) Our trade bills are outward documentary bills.

(2) Net of deposits and balances of banks and other financial institutions.

## LIABILITIES AND SOURCES OF FUNDS

Our funding operations are designed to ensure both a stable source of funds and effective liquidity management. We continuously adjust our funding operations to minimize funding costs and, to the extent necessary, match currencies and maturities with those of our loan portfolio.

We fund our customer loan and securities investment operations principally through customer deposits and short term deposits of banks and other financial institutions, which are primarily short term in nature. Our customer deposits consist of retail savings, time and current deposit accounts, as well as specialized fixed, foreign currency and other deposit products.

A significant majority of our deposits mature in three months or less. We believe that our deposit base is stable. The following table sets forth the exposure to interest rate risk of certain of our liabilities as of September 30, 2009 categorized by the earlier of contractual repricing or maturity dates:

	As of September 30, 2009						
	Up to one month	One – three months	Three – 12 months	One – five years	Over five years	Non- interest bearing	Total
	(HK\$ in millions)						
<b>Liabilities</b>							
Hong Kong SAR currency notes in circulation . . . . .	–	–	–	–	–	37,560	37,560
Deposits and balances of banks and other financial institutions. . . . .	74,473	1,960	3,938	–	–	1,500	81,871
Financial liabilities at fair value through profit or loss . . . . .	5,414	2,862	1,619	93	–	–	9,988
Derivative financial instruments. . . . .	–	–	–	–	–	15,557	15,557
Deposits from customers . . . . .	729,958	73,236	39,303	519	–	45,951	888,967
Debt securities in issue at amortized cost. . . . .	–	78	–	–	–	–	78
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	9,619	94	324	301	–	30,386	40,724
Subordinated liabilities . . . . .	–	27,076	–	–	–	–	27,076
<b>Total liabilities</b> . . . . .	<u>819,464</u>	<u>105,306</u>	<u>45,184</u>	<u>913</u>	<u>–</u>	<u>130,954</u>	<u>1,101,821</u>
Interest sensitivity gap . . . . .	(193,514)	118,130	37,334	105,819	26,972	763	95,504

## MANAGEMENT

### DIRECTORS AND SENIOR MANAGEMENT

Information concerning our Directors and senior management is set forth below:

Name	Age	Position
Mr. XIAO Gang . . . . .	51	Chairman of the Board of Directors and Non-executive Director
Mr. LI Lihui. . . . .	57	Vice Chairman of the Board of Directors and Non-executive Director
Mr. HE Guangbei . . . . .	55	Vice Chairman of the Board of Directors and Chief Executive
Mr. LI Zaohang . . . . .	54	Non-executive Director
Mr. ZHOU Zaiqun . . . . .	57	Non-executive Director
Mdm. ZHANG Yanling . . . . .	58	Non-executive Director
Mr. GAO Yingxin. . . . .	47	Executive Director and Deputy Chief Executive
Dr. FUNG Victor Kwok King . . . . .	64	Independent Non-executive Director
Mr. KOH Beng Seng. . . . .	59	Independent Non-executive Director
Mr. SHAN Weijian . . . . .	56	Independent Non-executive Director
Mr. TUNG Chee Chen . . . . .	67	Independent Non-executive Director
Mr. TUNG Savio Wai-Hok . . . . .	58	Independent Non-executive Director
Mdm. YANG Linda Tsao. . . . .	83	Independent Non-executive Director
Mr. LAM Yim Nam . . . . .	57	Deputy Chief Executive
Mr. ZHUO Chengwen. . . . .	39	Chief Financial Officer
Mr. CHEUNG Yau Shing . . . . .	48	Chief Risk Officer
Mr. WONG David See Hong. . . . .	56	Deputy Chief Executive
Mr. LEE Alex Wing Kwai. . . . .	51	Chief Operating Officer
Mr. LI Jiuzhong . . . . .	47	Deputy Chief Risk Officer
Mr. YEUNG Jason Chi Wai. . . . .	54	Company Secretary

The Board of Directors provides guidance and strategic direction with respect to our operations and supervises our operations through its committees, comprising the Audit Committee, the Risk Committee, the Nomination and Remuneration Committee and the Strategy and Budget Committee.

Our day-to-day operations are directed by our senior management. Our senior management is comprised of our Chief Executive, our three Deputy Chief Executives (separately responsible for the personal banking, corporate banking and treasury, business planning and finance and business support services strategic business units of the Group), our Chief Financial Officer, our Chief Risk Officer, our Chief Operating Officer and our Company Secretary. Our Chief Executive, our Deputy Chief Executives, our Chief Financial Officer, our Chief Risk Officer and our Chief Operating Officer have significant experience in the banking industry in Hong Kong and/or Mainland China. Our senior management is remunerated by the Bank and is incentivized to act in the best interests of the Group.

Each of Nanyang and Chiyu continues to conduct its business as a separate legal entity with its own operational structure. The Bank maintains its supervision over the management of Nanyang and Chiyu, in particular, in the areas of finance, risk management, audit and classified loan management, through its representation on their boards of directors.



## DIRECTORS

**Mr. XIAO Gang**, aged 51, is Chairman of the Board of Directors of the Bank. Mr. Xiao was Chairman and President of BOC from March 2003 to August 2004 and has been Chairman of BOC since its restructuring in August 2004. Prior to joining BOC, Mr. Xiao joined the PBOC in 1981 and had served various positions in the PBOC, including Director of the Research Bureau, Head of the China Foreign Exchange Trading Center, Director of the Planning and Treasury Department, Assistant Governor and Director of the Monetary Policy Department, Assistant Governor and President of Guangdong Branch of the PBOC and Director of the Guangdong Branch of the State Administration of Foreign Exchange. Mr. Xiao served as Deputy Governor of the PBOC from 1998 to 2003. He was also Chairman of China Association of Banks from June 2003 to December 2004. Mr. Xiao graduated from Renmin University of China with a Master's degree in Law.

**Mr. LI Lihui**, aged 57, is Vice Chairman of the Board of Directors and Chairman of the Nomination and Remuneration Committee of the Bank. He is currently the Vice Chairman and the President of BOC. Prior to joining BOC in August 2004, Mr. Li served as the Deputy Governor of Hainan Province from September 2002 to August 2004. Mr. Li was an Executive Vice President of Industrial and Commercial Bank of China ("ICBC") from July 1994 to September 2002 and served in a number of positions at ICBC from January 1989 to July 1994, including the Deputy General Manager of the Fujian Branch, the Chief Representative of the Singapore Representative Office and the General Manager of the International Business Department. Mr. Li has been serving as the Chairman of BOC International Holdings Limited and Bohai Industry Investment Management Limited since June 2005 and December 2006, respectively. Mr. Li graduated from the Economics Department of Xiamen University in 1977 and obtained a Doctorate in Economics from the Guanghua School of Management of Peking University in 1999.

**Mr. HE Guangbei**, aged 55, is Vice Chairman and Chief Executive with overall responsibility for the business and operations of the Bank and a member of the Strategy and Budget Committee of the Bank. He is also Chairman of Nanyang, NCB(China), Chiyu and BOC Life, Vice Chairman of Hong Kong General Chamber of Commerce, and Director of Hong Kong Interbank Clearing Limited, HKICL Services Limited and Hong Kong Note Printing Limited. He is the designated representative of BOCHK to the Hong Kong Association of Banks where he served as the presiding Chairman in 2008. He holds various public positions which include member of the HKMA Exchange Fund Advisory Committee and Banking Advisory Committee, member of the Hong Kong Government Commission on Strategic Development, Board member of Hong Kong Airport Authority, Honorary President of the Hong Kong Chinese Enterprises Association and general committee member of the Hong Kong General Chamber of Commerce. Mr. He joined BOC in 1980 and, since then, he has assumed various positions at BOC and was posted to its New York Branch and Paris Branch. He was Managing Director of BOC from 1999 to 2004 and Executive Vice President from 2000 to 2003. Mr. He graduated from the Beijing Second Foreign Languages Institute in 1979 with a Bachelor's degree and obtained a Master's degree in International Management Studies from the University of Texas at Dallas in 1985.

**Mr. LI Zaohang**, aged 54, is a Non-executive Director and a member of the Risk Committee and the Nomination and Remuneration Committee of the Bank. He joined China Construction Bank ("CCB") in 1980 and held various positions, including Manager, Branch Manager, General Manager of various departments at CCB's Head Office and Executive Vice President. In 2000, Mr. Li joined BOC as Executive Vice President and has served as Managing Director and Executive Director, successively. Mr. Li graduated from Nanjing University of Information Science and Technology.

**Mr. ZHOU Zaiqun**, aged 57, is a Non-executive Director and a member of the Audit Committee and the Strategy and Budget Committee of the Bank. He is also Chairman of BOC-CC. Mr. Zhou is currently an Executive Director and Executive Vice President of BOC. He was a Managing Director of BOC from 2000 to 2004. He has over 20 years' experience in the banking industry. He was General Manager of ICBC, Beijing Branch from 1999 to 2000 and General Manager of the Planning and Financial Department of ICBC from 1997 to 1999. Mr. Zhou obtained a Master's degree from Dongbei University of Finance and Economics in 1997.

**Mdm. ZHANG Yanling**, aged 58, is a Non-executive Director and a member of the Risk Committee and the Strategy and Budget Committee of the Bank. She is also Executive Vice President of BOC, Chairman of Bank of China (UK) Limited and BOC Aviation Pte. Ltd. and Vice Chairman of BOCI. Mdm. Zhang has been Vice Chairman of ICC Commission on Banking Technique and Practice since 2003. Mdm. Zhang joined BOC in 1977. She was Executive Assistant President of BOC from 2000 to 2002. Mdm. Zhang was General Manager of BOC, Milan Branch from 2000 to 2001 and General Manager of the Legal Department of BOC from 2001 to 2002. She was Deputy General Manager of the Training Department of BOC from 1992 to 1997, General Manager of the Banking Department from 1997 to 2000 and Managing Director of BOC from 2000 to 2004. She graduated from Liaoning University in 1977 with a Bachelor's degree and obtained a Master's degree from Wuhan University in 1999.

**Mr. GAO Yingxin**, aged 47, is an Executive Director of the Bank as well as the Deputy Chief Executive in charge of Corporate Banking and Financial Institutions. He is also Vice Chairman of NCB(China) and Director of Nanyang and Bank of China Group Insurance Company Limited. Before joining the Bank, he was President and Chief Operating Officer of BOCI. Mr. Gao joined the BOC Group in 1986 and began working on financing projects for various industries at BOC's Head Office in Beijing. In 1999, he became General Manager of Corporate Banking at BOC Head Office, where he was responsible for managing and building BOC Group's customer relationships with and global financing for multinational corporations and premium domestic clients in Mainland China. He was also in charge of BOC's major financing projects. From 1995 to 1996, he worked for the Finance Department of Northern Telecom (Nortel) Head Office in Canada. Mr. Gao graduated from the East China University of Science and Technology in Shanghai with a Master's degree in Engineering in 1986.

**Dr. FUNG Victor Kwok King**, aged 64, is an Independent Non-executive Director and a member of the Audit Committee and the Nomination and Remuneration Committee of the Bank. Dr. Fung holds Bachelor's and Master's Degrees in Electrical Engineering from the Massachusetts Institute of Technology and a Doctorate in Business Economics from Harvard University. He is Group Chairman of Li & Fung group of companies, including publicly listed Li & Fung Limited, Integrated Distribution Services Group Limited, Convenience Retail Asia Limited and Trinity Limited. He is also an Independent Non-executive Director of CapitaLand Limited in Singapore and Baosteel Group Corporation in the PRC. He retired as Independent Non-executive Director of Orient Overseas (International) Limited, and Non-executive Director of Hup Soon Global Corporation Limited, both in April 2009. In public service, Dr. Fung is Chairman of the International Chamber of Commerce. He is a member of the Chinese People's Political Consultative Conference and became Vice Chairman of China Center for International Economic Exchanges since March 2009. He is a member of the Commission on Strategic Development of the Hong Kong Government. Dr. Fung is also Chairman of the Greater Pearl River Delta Business Council and the Hong Kong – Japan Business Cooperation Committee. From 1991 to 2000, he was Chairman of the Hong Kong Trade Development Council and, from 1996 to 2003, he was the Hong Kong representative on the APEC Business Advisory Council. He was also Chairman of the Hong Kong Airport Authority from June 1999 to May 2008, and Chairman of the Council of The University of Hong Kong from September 2001 to November 2009. In 2003, the Government awarded Dr. Fung the Gold Bauhinia Star for distinguished services to the community.

**Mr. KOH Beng Seng**, aged 59, is an Independent Non-executive Director, Chairman of the Risk Committee and a member of the Audit Committee of the Bank. Mr. Koh is currently the Chief Executive Officer of Octagon Advisors Pte Ltd, a business and management consulting company based in Singapore. He is also an Independent Non-executive Director of three Singaporean listed companies, Singapore Technologies Engineering Ltd, Fraser and Neave Limited and Great Eastern Holdings Limited, Director of Sing Han International Financial Services Limited and Director of Japan Wealth Management Securities Company Limited. Mr. Koh was deputy president of United Overseas Bank ("UOB") and a member of UOB's Executive Committee from 2000 to 2004. During this period, he was in charge of UOB's operations, delivery channels, information technology, corporate services and risk management and

compliance functions and played a key role in driving the successful integration of Overseas Union Bank and UOB in 2001. Prior to that, Mr. Koh spent over 24 years at the Monetary Authority of Singapore, where he made significant contributions to the development and supervision of the Singaporean financial sector in his capacity as Deputy Managing Director, Banking & Financial Institutions Group. He has also served as a Director of Chartered Semiconductor Manufacturing and as a part-time advisor to the International Monetary Fund. Mr. Koh holds a Bachelor's degree in Commerce from Nanyang University in Singapore and a Master's degree in Business Administration from Columbia University in the United States.

**Mr. SHAN Weijian**, aged 56, is an Independent Non-executive Director, Chairman of the Audit Committee and a member of the Nomination and Remuneration Committee of the Bank. Mr. Shan is currently a Partner of TPG Capital and Director of a number of companies, including Shenzhen Development Bank Co., Ltd., TCC International Holdings Limited, Changhwa Commercial Bank, Ltd., Taiwan Cement Corporation and Taishin Financial Holdings Co., Ltd. He was a Managing Director of JP Morgan, a Director of Korea First Bank, an assistant professor at the Wharton School of the University of Pennsylvania and an Investment Officer at the World Bank in Washington DC. Mr. Shan graduated from the Beijing Institute of Foreign Trade with a major in English in 1979. He obtained a Master's degree in Business Administration from the University of San Francisco in 1981, and received a Master of Arts degree in Economics and a PhD degree in Business Administration from the University of California at Berkeley in 1984 and 1987, respectively.

**Mr. TUNG Chee Chen**, aged 67, is an Independent Non-executive Director and a member of the Audit Committee and the Nomination and Remuneration Committee of the Bank. Mr. Tung is also the Chairman and Chief Executive Officer of Orient Overseas (International) Limited. He is an Independent Non-executive Director of a number of listed companies, including Zhejiang Expressway Company Limited, PetroChina Company Limited, Wing Hang Bank Limited, U-Ming Marine Transport Corp., Sing Tao News Corporation Limited and Cathay Pacific Airways Limited. Mr. Tung was educated at the University of Liverpool, United Kingdom, where he obtained a Bachelor's degree in Science in 1964. He later obtained a Master's degree in Mechanical Engineering from the Massachusetts Institute of Technology in 1966.

**Mr. TUNG Savio Wai-Hok**, aged 58, is an Independent Non-executive Director and a member of the Audit Committee, the Risk Committee and the Strategy and Budget Committee of the Bank. Mr. Tung is one of the founding partners of Investcorp, where he was a Managing Director and Head of the Technology Investment Group until February 2009. He remains an advisor and Chairman of the Technology Investment Committee. Before joining Investcorp in 1984, he worked for Chase Manhattan Bank for about 11 years, holding various positions in its front, middle and back offices and served in its offices in New York, Bahrain, Abu Dhabi and London. Mr. Tung has served on the boards of many of the Investcorp portfolio companies, including Club Car, Circle K, Saks Fifth Avenue, Simmons Mattresses, Star Market and Stratus Computer. He is currently the Chairman of Wireless Telecom Group. He is also a board member and treasurer of the Aaron Diamond AIDS Research Center, an affiliate of Rockefeller University and a board member of "The Committee of 100," a Chinese-American organization in the U.S. Mr. Tung holds a BSc in Chemical Engineering from Columbia University of New York. He is a trustee of Columbia University. He is also on the board of the Columbia Investment Management Company and chairs the Finance Committee of Columbia University and is a member of the Columbia University Medical Center ("Health Science") Committee.

**Mdm. YANG Linda Tsao**, aged 83, is an Independent Non-executive Director of the Bank. She is the Chairlady of the Strategy and Budget Committee and a member of the Audit Committee and the Nomination and Remuneration Committee of the Bank. Since 2000, Mdm. Yang has chaired the Asian Corporate Governance Association ("ACGA"), a non-profit, member supported organization based in Hong Kong. ACGA is committed to promoting sound corporate governance practices among Asian

business enterprises through education, research, and advocacy. She serves on the board of “The Committee of 100,” a Chinese-American organization in the U.S. and the Advisory Board of The Pacific Pension Institute and trustee of The Asia Foundation in San Francisco. The foundation has 17 field offices in Asia. Appointed by President Clinton as Ambassador and Executive Director to the Asian Development Bank in 1993, Mdm. Yang was the first Asian and first woman appointed by the U.S. Government to serve on the board of a multilateral financial institution. At her retirement in December 1999, the then U.S. Secretary of the Treasury Dr. Larry Summers presented her with the Distinguished Service Award of the Treasury Department for her contribution in playing a key role in shaping assistance programs to affected countries during the Asian Financial Crisis 1997-1998 improving governance and accountability in the banks’ operation and strengthening the banks’ private sector development strategy. Before that, she was California’s Savings and Loan Commissioner and Vice President of the Board of Administration of the Public Employees’ Retirement System of the State of California and Vice Chairman of its Investment Committee. Mdm. Yang graduated from St. John’s University in Shanghai and earned her Master of Philosophy degree (Economics) from Columbia University in New York.

#### **OTHER SENIOR MANAGEMENT PERSONNEL**

**Mr. LAM Yim Nam**, aged 57, is the Deputy Chief Executive in charge of Personal Banking and Product Management, Channel Management and BOC-CC. He is also a Director of BOC-CC and BOC Life. Mr. Lam has over 29 years’ experience in the banking industry. From 1989 to 1998, he was Deputy General Manager of the Kwangtung Provincial Bank, Hong Kong Branch. Mr. Lam was Deputy General Manager of BOC, Hong Kong Branch from 1998 to 1999, and Acting General Manager of the National Commercial Bank, Hong Kong Branch from 2000 to 2001. Mr. Lam graduated from the Chinese University of Hong Kong with a Bachelor’s degree and a Master’s degree in Business Administration.

**Mr. ZHUO Chengwen**, aged 39, is the Chief Financial Officer of the Bank. He is also a Director of Nanyang and NCB(China). Prior to joining the Bank, Mr. Zhuo was a Deputy General Manager in the Financial Management Department of BOC responsible for various financial management functions of the BOC Group, including financial planning, accounting policy, financial compliance, management reporting and financial disclosure. Mr. Zhuo has assumed a financial management role for over 10 years with BOC Group in Beijing and New York and has extensive knowledge and experience in financial management. Mr. Zhuo graduated from Peking University with a Bachelor’s degree in Economics in 1992 and a Master’s Degree in Economics in 1995 and was awarded a MBA Degree by the City University of New York in 2005. Mr. Zhuo has been a member of the Chinese Institute of Certified Public Accountants, the American Institute of Certified Public Accountants and the Hong Kong Institute of Certified Public Accountants since 1995, 2005 and 2009, respectively.

**Mr. CHEUNG Yau Shing**, aged 48, is the Chief Risk Officer of the Bank in charge of the Bank’s overall risk management function, overseeing the Bank’s Risk Management Department and Operational Risk and Compliance Department. Upon expiry of his employment contract at the end of February 2010, Mr. Cheung will cease to act as the Chief Risk Officer and be succeeded by Mr. Li Jiuzhong.

**Mr. WONG David See Hong**, aged 56, is the Deputy Chief Executive of the Bank with overall responsibility for the financial market businesses which include Global Markets, Global Transaction Banking, Investment Management and Insurance, and other capital market-related businesses. He is also a Director of BOC Life. Prior to joining the Bank, Mr. Wong was Corporate Executive Vice President and Country Executive of ABN AMRO Bank (“ABN”) and was responsible for ABN’s operations in Southeast Asia. He joined ABN in 1995 and has held various senior positions within ABN, including Regional Head of Financial Markets, Country Executive in Singapore, and Managing Director of the Hong Kong Branch. Mr. Wong has spent the last 25 years in the banking sector and has extensive knowledge and experience in treasury and financial markets. Mr. Wong served as a board member of Energy Market Authority till March 31, 2009. He continues to serve as a board member of the Civil Service College in Singapore and



serves as Customer Advisory Board Member of Thomson Reuters in Hong Kong from August 2009. Mr. Wong graduated from the University of Singapore with a Bachelor's Degree in Business Administration and was awarded a Master's degree in Science in Investment Management by the Hong Kong University of Science and Technology. He was awarded the Financial Industry Certified Professional from the Institute of Banking and Finance, Singapore. He has also received the Distinguished Award for his contribution to the financial industry in Singapore.

**Mr. LEE Alex Wing Kwai**, aged 51, is the Chief Operating Officer of the Bank. He is also a Director of BOC-CC. Prior to joining the Bank, Mr. Lee was the Managing Director responsible for the operations and technology of the entire business of Citigroup in Hong Kong. Mr. Lee has held various leadership roles within Citigroup. He has strong experience in operation and technology with a leading financial institution for over 25 years. Mr. Lee graduated from the Arizona State University with a Bachelor's degree in General Business Administration in 1981 and a MBA Degree specialized in Accounting in 1983. Mr. Lee passed the uniform examination of the American Institute of Certified Public Accountants in 1984. He has been an Associate Member of the Institute of Internal Auditor and a Chartered Bank Auditor of the Bank Administration Institute of the United States of America since 1986.

**Mr. LI Jiuzhong**, aged 47, is the Deputy Chief Risk Officer of the Bank with the responsibility for assisting the Chief Risk Officer in overseeing the Group's various risk management functions. He is also a Director of BOC Life. Mr. Li has over 26 years' experience in the banking industry. Mr. Li joined BOC in 1983 and, since then, he has assumed various positions at BOC Head Office and overseas branch. He was Assistant General Manager and Deputy General Manager of BOC London Branch, respectively, from 1996 to 2002; and Deputy General Manager of Corporate Banking Department of BOC Head Office from 2002 to 2004; and then General Managers of Corporate Banking Department, Risk Management Department, and Global Markets Department of BOC Head Office, respectively, from 2004 to 2009. Mr. Li graduated from Daqing Petroleum Institute in 1983 with a Bachelor's degree in Science in Oilfield Development and Management and obtained a Master's degree in Science in International Banking and Financial Studies from Heriot-Watt University (UK) in 1993. Mr. Li will assume the position of Chief Risk Officer after Mr. Cheung Yau Shing ceases to act as the Chief Risk Officer with effect from March 1, 2010.

**Mr. YEUNG Jason Chi Wai**, aged 54, is the Board Secretary and Company Secretary of the Bank. Mr. Yeung has over 10 years' experience practicing corporate and commercial law. Prior to joining the Bank in 2001, Mr. Yeung was General Counsel and director of China Everbright Limited and a partner of Woo, Kwan, Lee & Lo. He has also served at the Securities and Futures Commission in Hong Kong. Mr. Yeung was educated at the University of Hong Kong where he obtained a Bachelor's degree in Social Sciences. Mr. Yeung later graduated from The College of Law, United Kingdom and further obtained a Bachelor's degree in Law from the University of Western Ontario, Canada and a Master's degree in Business Administration from the Richard Ivey School of Business of the University of Western Ontario, Canada.

## **BOARD PRACTICES**

The Board of Directors consists of 13 Directors, two of whom are Executive Directors, five of whom are Non-executive Directors and six of whom are Independent Non-executive Directors. Our shareholders may by ordinary resolution elect any person to be a Director, either to fill a casual vacancy or as an addition to the Board. In addition, the Directors have the power, under the Articles of Association, to appoint any other person as a Director, either to fill a casual vacancy or as an addition to the Board. The Chairman of the Board of Directors is elected by the Directors.

The Board is at the core of the Bank's corporate governance framework, and there is clear division of responsibilities between the Board and the Management. The Board is responsible for providing high-level guidance and effective oversight of the Management. Generally, the Board is responsible for:

- formulating the Group's medium- to long-term strategy and monitoring its implementation;
- reviewing and approving the annual business plan and financial budget;
- approving accounts and other public reports and financial disclosures;
- reviewing and monitoring risk management and internal control;
- ensuring good corporate governance and effective compliance; and
- monitoring the performance of the Management.

To enable the Board of Directors to discharge these responsibilities effectively, our senior management provides detailed reports on our performance to the Board of Directors on a regular basis.

The Board of Directors functions either as a full Board or through committees. The Board has established the Audit Committee, the Risk Committee, the Nomination and Remuneration Committee and the Strategy and Budget Committee to focus on specific issues. These Board committees meet regularly.

#### **AUDIT COMMITTEE**

The Audit Committee currently has seven members comprising one Non-executive Director and all six of the Independent Non-executive Directors. The Committee is chaired by Mr. Shan Weijian, an Independent Non-executive Director.

The Committee assists the Board in fulfilling its oversight role over the Bank and its subsidiaries in, among others, the following areas:

- integrity of financial statements and financial reporting process;
- internal control systems;
- effectiveness of internal audit function and performance appraisal of the Head of Internal Audit;
- appointment of external auditors and assessment of their qualifications, independence and performance and, with authorization of the Board, determination of their remuneration;
- periodic review and annual audit of the Bank's and the Group's financial statements and financial and business review;
- compliance with applicable accounting standards as well as legal and regulatory requirements on financial disclosures; and
- corporate governance framework of the Group and its implementation.

#### **NOMINATION AND REMUNERATION COMMITTEE**

The Nomination and Remuneration Committee currently has six members comprising two Non-executive Directors and four Independent Non-executive Directors. The Committee is chaired by Mr. Li Lihui, Vice Chairman of the Board.

The Committee assists the Board in fulfilling its oversight role over the Bank and its subsidiaries in the following areas among others:

- overall human resources and remuneration strategies of the Group;
- selection and nomination of Directors, Board Committee members and certain senior executives as designated by the Board from time to time;
- structure, size and composition (including skills, experience and knowledge) of Directors and Board Committee members;
- remuneration of Directors, Board Committee members and designated senior management; and
- effectiveness of the Board and Board Committees.

The Nomination and Remuneration Committee also has the delegated responsibility to determine the specific remuneration packages of the Executive Directors and designated senior executives, including share options, benefits in kind, pension rights, etc. Currently the principal components of the Bank's remuneration packages for the Executive Directors and designated senior executives include basic salary, discretionary bonus and other benefits in kind. A significant portion of the Executive Directors' or designated senior executives' discretionary bonus is based on the Group's and the individual's performance during the year. The Committee reviews and recommends to the Board the annual performance targets for the Executive Directors and designated senior executives by reference to the corporate goals and objectives approved by the Board from time to time. The Committee also reviews the performance of the Executive Directors and designated senior executives against the targets set on an ongoing basis and reviews and approves their specific performance-based remuneration.

## **RISK COMMITTEE**

The Risk Committee currently has four members. Two of them are Independent Non-executive Directors and the remaining two are Non-executive Directors. The Committee is chaired by Mr. Koh Beng Seng, an Independent Non-executive Director. Mdm. Yang Linda Tsao, an Independent Non-executive Director and the Chairlady of the Strategy and Budget Committee, attends the Risk Committee meetings from time to time as an observer.

The Committee assists the Board in fulfilling its oversight role over the Bank and its subsidiaries in, among others, the following areas:

- formulation of the risk appetite and risk management strategy of the Group and determination of the Group's risk profile;
- identification, assessment and management of material risks faced by the various business units of the Group;
- review and assessment of the adequacy and effectiveness of the Group's risk management policies, system and internal control;
- review and monitoring of the Group's capital management;
- review of the Group's targeted balance sheet;
- review and monitoring of the Group's compliance with the risk management policies, system and internal control, including the Group's compliance with prudential, legal and regulatory requirements governing the business of the Group;
- review and approval of high-level risk-related policies of the Group; and
- review of significant or high risk exposures and transactions.



## STRATEGY AND BUDGET COMMITTEE

The Strategy and Budget Committee comprises five members: two Independent Non-executive Directors, two Non-executive Directors and the Chief Executive, an Executive Director. The Committee is chaired by Mdm. Yang Linda Tsao, an Independent Non-executive Director.

The Committee assists the Board in fulfilling its oversight role over the Bank and its subsidiaries in, among others, the following areas:

- drafting, reviewing, motioning, and monitoring the Group's medium- to long-term strategy;
- drafting and reviewing the process for formulating the Group's medium- to long-term strategy to ensure that it is sufficiently robust to take into account a range of alternatives;
- monitoring implementation of the Group's medium- to long-term strategy through pre-determined metrics and providing guidance to Management;
- reviewing and monitoring the Group's regular/periodic (including annual) business plan and financial budget; and
- making recommendations to the Board on major capital expenditures, mergers and acquisitions and strategic commitments of the Group and monitoring implementation of the same.

## COMMITTEES UNDER OUR CHIEF EXECUTIVE

To assist our Chief Executive in the execution of his duties, we have established 11 committees that report directly to him or other members of senior management: the Management Committee, the Asset and Liability Management Committee, the Strategic Planning and Business Development Committee, the Investor Relations Committee, the Corporate Social Responsibility Committee (the “**CSR Committee**”), the Credit Risk Assessment Committee, the Anti-Money Laundering Committee, the Information Technology Committee (the “**IT Committee**”), the Procurement Committee, the Treasury Product Committee and the Operation Committee. Each of these committees consists primarily of the heads of our functional and business units.

The Management Committee's primary functions are to develop and monitor our business strategies, identify long-term business opportunities and ensure synergy among our business units. The Asset and Liability Management Committee's primary functions include managing our targeted balance sheet to maintain appropriate mix of asset and liability structure, managing adequate capital to support our business growth, developing appropriate liquidity and interest rate risk management policies and monitoring our liquidity risk and interest rate risk within our risk appetite. The Strategic Planning and Business Development Committee is primarily a forum for senior management and heads of business units within the Group to discuss the latest market situation and sector development, identify the potential business opportunities, and develop Group-wide strategies on key businesses. The Investor Relations Committee is responsible for the formulation of the Company's investor relations strategies and the overview of the investor relations programs. The CSR Committee's primary functions are stipulating social responsibility strategies and policies in view of the Group's current state of development, reviewing the annual CSR report and overseeing the execution of the Group's CSR strategies. The Credit Risk Assessment Committee has primary responsibility for independent risk assessment on material credit transactions. The Anti-Money Laundering Committee is responsible for managing our money laundering risk exposure and ensuring implementation of proper anti-money laundering policies and control procedures. The IT Committee is responsible for aligning the IT development strategy with the business strategy by overseeing the planning, coordination and management of the IT development strategy. The Procurement Committee is primarily responsible for review of the material transactions of procurement and asset disposal. The Treasury Product Committee is primarily responsible for overseeing the Group's overall development of treasury business. The Operation Committee is primarily responsible for studying,

establishing and implementing the optimal operation model of the Group, which strikes a balance among operation efficiency, cost-benefit efficiency, risk management and customer service.

## **SENIOR MANAGEMENT COMPENSATION SYSTEM**

Our compensation system links the financial interest of our senior management, including that of our executive Director, with our results of operations. Under this system, our senior management's compensation has three components: basic salary, allowances and performance bonus. The performance bonus component is linked to the attainment of business performance targets measured by, in particular, return on capital, return on equity, cost to income ratio and asset quality.

## **EMOLUMENTS OF DIRECTORS**

Our shareholders may determine from time to time by ordinary resolution the remuneration of the Directors for their services as Directors.

As disclosed in our Annual Reports for 2006, 2007 and 2008, the aggregate amount of emoluments (including directors' fees, basic salaries, allowances, bonuses, benefits in kind and contributions to pension schemes) that we paid to our then current Directors during 2006, 2007 and 2008 was approximately HK\$10 million, HK\$20 million and HK\$21 million, respectively.

## RELATED PARTY TRANSACTIONS

BOCHK enters into a number of transactions with related parties in its ordinary course of business. Please refer to the notes to the Audited Consolidated Financial Statements and Unaudited Condensed Consolidated Financial Information for the three financial years ended 2006, 2007 and 2008 and the nine months ended September 30, 2009 for the aggregate income and expenses arising from related party transactions with (i) immediate and intermediate holding companies, associates (as defined therein) and subsidiaries and associates (as defined therein) of BOC and (ii) key management personnel.

Information of some of these transactions with related parties is set out below.

### A. SUBORDINATED CREDIT FACILITIES BETWEEN BOC AND BOCHK

#### Euro Subordinated Loan

On June 25, 2008, BOC and BOCHK entered into a subordinated credit facility agreement, pursuant to which BOC has extended to BOCHK a subordinated credit facility of €660,000,000 (US\$451 million, based on a convenience translation of Euro amounts to U.S. dollar amounts made at a rate of €0.6835 to US\$1.00) (the “**Euro Subordinated Loan**”) for a term of 10 years from June 27, 2008. The Euro Subordinated Loan shall be due and repayable on June 27, 2018. BOCHK may elect to repay, subject to regulatory approval, the Euro Subordinated Loan at any time on or after June 28, 2013. Interest on the Euro Subordinated Loan shall be payable every six months at 0.85% + EURIBOR (Euro Interbank Offered Rate) for the initial period of five years and, if not repaid, at 1.35% + EURIBOR for the remaining period. As of September 30, 2009, the outstanding balance under the Euro Subordinated Loan was €660,000,000.

The Euro Subordinated Loan qualifies as Tier 2 Capital of BOCHK pursuant to the regulatory requirements of the HKMA and has improved the capital structure of BOCHK. It is used for general corporate purposes of BOCHK including to meet BOCHK’s business development needs. The terms of the Euro Subordinated Loan were negotiated on an arm’s length basis between the two parties.

#### USD Subordinated Loan

On December 16, 2008, BOC and BOCHK entered into a subordinated credit facility agreement, pursuant to which BOC has extended to BOCHK the BOC Loan for a term of 10 years from December 23, 2008. The BOC Loan shall be due and payable on December 23, 2018. BOCHK may elect to repay, subject to regulatory approval, the BOC Loan at any time on or after December 24, 2013. Interest on the BOC Loan shall be payable every six months at 2.00% + LIBOR (London Interbank Offered Rate) for the initial period of five years and, if not repaid, at 2.50% + LIBOR for the remaining period. As of September 30, 2009, the outstanding balance under the BOC Loan was US\$2,500,000,000.

The BOC Loan qualifies as Tier 2 Capital of BOCHK pursuant to the regulatory requirements of the HKMA and has improved the capital structure of BOCHK. The BOC Loan has provided BOCHK with greater operating flexibility to meet BOCHK’s business development needs. The terms of the BOC Loan were negotiated on an arm’s length basis between the two parties.

BOC and BOCHK have agreed that the BOC Loan will be partly or fully repaid using the proceeds derived from the issue of the Notes.

## **B. OTHER RELATED PARTY TRANSACTIONS WITH THE BOC GROUP**

BOCHK conducts various transactions with the BOC Group, including the subsidiaries of BOCHK, in the ordinary and usual course of business, which include general business support services provided to or received from related parties, cross-selling of product and services with related parties, investment services provided to or received from related parties as well as inter-bank transactions with related parties. The different categories of related party transactions are further described below:

### **Inter-bank Transactions**

#### ***Loans to Related Parties***

In the ordinary and usual course of its business, BOCHK extends loans and credit facilities to the BOC Group on normal commercial terms with reference to prevailing market rates, typically charging fees as well as interest on the amount drawn. The loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons of comparable standing and such loans did not involve more than the normal risk of collectability or present other unfavorable terms.

#### ***Deposits by Related Parties***

In the ordinary and usual course of its business, BOCHK accepts deposits from the BOC Group on normal commercial terms with reference to prevailing market rates.

#### ***Guarantees***

In the ordinary and usual course of its business, the Group has provided and received, and will continue to provide, guarantees for the obligations of the BOC Group, and will continue to receive the benefit of guarantees provided by the BOC Group for BOCHK's obligations, both on normal commercial terms, typically involving a fee payable for such guarantee. In addition, the Group provides guarantees to and receives guarantees from the BOC Group in respect of the obligations of the customers of the Group on normal commercial terms and in the ordinary and usual course of the Group's business.

#### ***Foreign Exchange Transactions***

In the ordinary course of its business, the Group enters into foreign exchange transactions with the BOC Group. These transactions are executed with reference to prevailing market rates. Foreign exchange transactions include spot, forward and outright transactions and exercised currency options. The Group also conducts foreign currency banknote exchange transactions with the BOC Group on normal commercial terms.

The Group provides, through the Margin Dealing System, foreign exchange transaction services to BOC Macau Branch and Tai Fung Bank, a subsidiary of BOC, as well as to an independent third party, on a principal to principal basis on normal commercial terms. BOCHK also conducts inter-bank foreign currency exchange transactions with its related parties on normal commercial terms.

#### ***Trading of Financial Assets***

The Group enters into various transactions with the BOC Group, in which the BOC Group buy or sell secondary interests in loans from and to BOCHK. Trading of account receivables, forfeiting and other similar types of financial assets are also included in this category. These transactions are conducted on normal commercial terms.

### ***Inter-bank Capital Markets***

The Group buys and sells debt securities from and to the BOC Group in the secondary market with reference to prevailing market rates. BOCHK may trade other securities with the BOC Group in the future.

### **Investment Transactions**

#### ***Securities Transactions***

BOCI Securities Limited, a subsidiary of BOC, provides securities brokerage services to the Group and its customers from time to time in the ordinary and usual course of its business and on normal commercial terms.

In consideration of the provision of securities brokerage services to the Group and its customers by BOCI Securities Limited, the Group pays a commission, net of a rebate based on a fixed portion of the gross commission, to BOCI Securities Limited. In addition, since 2004, the Group has distributed various securities products issued by BOCI Securities Limited such as equity linked instruments, structured notes, bonds and other financial products as their agent on the basis of a commission with reference to the prevailing market rates. Also, BOCI Financial Products Limited has OTC derivatives transactions with BOCHK.

#### ***Fund Distribution***

As one of the leading financial services providers in Hong Kong, the Group provides fund distribution services to fund houses, including BOCI Prudential Asset Management Limited (in which BOCI Asset Management Limited, a wholly owned subsidiary of BOCI, and Prudential Corporation Holdings Limited hold equity interests of 64% and 36%, respectively) and BOCI Prudential Trustee Limited (a company incorporated under the laws of Hong Kong, in which BOC Group Trustee Company Limited, a company incorporated under the laws of Hong Kong and a non-wholly owned subsidiary of BOCHK, and Prudential Corporation Holdings Limited hold equity interests of 64% and 36%, respectively), in its ordinary course of business.

The Group also promotes and distributes various fund products to its clients, including guaranteed fund and open-ended fund products and mandatory provident fund products, as an intermediary for BOCI Prudential Asset Management Limited and BOCI Prudential Trustee Limited. The Group receives a commission rebate on the basis of a certain percentage of fund sales from BOCI Prudential Asset Management Limited in relation to the guaranteed funds. In respect of open-ended fund products, the Group receives trailer fees from BOCI Prudential Asset Management Limited based on total fund under management.

In respect of mandatory provident fund products, the Group receives commissions based on the number of new members joining the mandatory provident fund schemes of BOCI Prudential Trustee Limited referred to it by the Group. All fees and commissions payable by the fund houses (including BOCI Prudential Asset Management Limited and BOCI Prudential Trustee Limited) are calculated with reference to the prevailing market rates and the underlying transaction volumes based on an agreed fee schedule.

#### ***Insurance Agency***

The Group provides to the BOC Group insurance agency services and receives commission payments in respect of the policies issued or renewed. These arrangements are conducted on normal commercial terms.

### **General Transactions**

#### ***Information Technology Services***

BOCHK provides various information technology services to the BOC Group in Hong Kong, Macau, the Asia Pacific region and Mainland China. These services include technical consultancy, specific computer

systems and software development, systems maintenance, operation, support, network installation, user training and support, control and supervision of system security and safety services. In return, BOCHK receives a fee on the basis of costs plus a margin of 5%. These services are provided on normal commercial terms.

### ***Bank-note Delivery***

BOCHK provides bank note delivery services to the BOC Group for fees based on market rates.

### ***Credit Card Services***

BOC acts as an agent bank for BOC-CC, a company incorporated under the laws of Hong Kong and a wholly owned subsidiary of BOCHK, in connection with BOC-CC's merchant acquiring business in Mainland China and promotes such business for a percentage of the transaction amount. BOC also provides training to its staff in its provincial branches throughout Mainland China in connection with BOC-CC's business.

Each of BOC Macau branch and Tai Fung Bank Limited, a subsidiary of BOC, promotes BOC-CC's Hong Kong dollar and Macau pataca settled credit cards bearing their respective names, to their customers in Macau and provides other services to BOC-CC such as processing and approving applications received and collecting payments for such credit cards. In addition to their card issuing services, BOC Macau branch and Tai Fung Bank Limited provide services for BOC-CC's merchant acquiring business in Macau.

BOC-CC provides operational, administrative and technical support services to BOC for BOC's Great Wall International Card and agency services for BOC's Great Wall Renminbi Card. It also provides back office settlement and other services to BOC Macau branch and BOC Zhuhai branch in connection with their Renminbi Cards. In addition, BOC-CC also provides business support services, such as business and product development, information technology services, customer support services and training services to BOC's overseas branches in relation to their credit card business.

BOC also cooperates with BOC-CC in Mainland China to provide back-office support services to credit card services of BOC and Mainland China business development of BOC-CC. All these arrangements and transactions are conducted on normal commercial terms.

Further, BOCHK and its subsidiaries promotes BOC-CC's credit cards and provides other services to BOC-CC such as processing and approving applications received and collecting payments for such credit cards.

### ***Other ATM Services***

Under the terms of a number of arrangements between BOCHK and the BOC Group, BOCHK's customers may use their ATM cards issued by us to make cash withdrawals from the ATMs of other members of the BOC Group. In particular, BOCHK has entered into an arrangement with BOC Guangdong branch, under which BOCHK's customers may use the ATM cards BOCHK issues to withdraw Hong Kong dollars from its ATMs. BOCHK is not required to pay a service fee for these withdrawals.

### ***Provision of Insurance Cover***

Bank of China Group Insurance Company Limited, a subsidiary of BOC and BOC Life, provide insurance cover to BOCHK and its subsidiaries, including, without limitation, cash and cash transit insurance, group medical insurance, group life insurance, employee compensation insurance, public liability insurance, accidental damage to property insurance, banker's bond insurance and directors' and officers' liability insurance. These arrangements are conducted on normal commercial terms.

## Intellectual Property Licenses

BOC is the owner of a number of registered and unregistered trademarks which BOCHK will need to use in conducting BOCHK's business. Under a trademark license agreement dated September 30, 2001, between BOCHK (Holdings), BOC and BOCHK (the "**Trademark License Agreement**"), BOC granted to BOCHK and BOCHK (Holdings) a royalty-free, non-exclusive and non-transferable (except as provided therein) license to use its registered and unregistered trademarks, including the use of the names "Bank of China," "Bank of China Group," "BOC" and its logos, in conducting BOCHK's businesses anywhere in the world, including the right to grant a sub-license to any associated company. The license is for an unlimited term until termination by any party if the other party: (i) commits a material breach which remains unremedied within 30 days after written notice is given or (ii) ceases to do business, becomes insolvent or bankrupt or is subject to liquidation or dissolution proceedings. The Group and Mainland China have given certain further customary undertakings to BOC regarding the use of the licensed marks and other matters.

## Property Transactions

### *(i) Leases and licenses*

The Group leases various premises from and to the BOC Group in Hong Kong and Mainland China pursuant to various leases and licenses agreements at prevailing market rates at the relevant times. These arrangements are conducted on normal commercial terms.

### *(ii) Property management and letting agency*

Sun Chung Property Management Company Limited, a company incorporated under the laws of Hong Kong and an indirect wholly owned subsidiary of BOC ("**Sun Chung**") provides property management and letting services to BOCHK at Bank of China Tower, Bank of China Building, Bank of China Center and other properties as required from time to time. In return, Sun Chung receives (i) a monthly management fee which is partially paid by the Group's tenants with the remainder paid by the Group in respect of the office space used by the Group; (ii) a commission payment based on the total rents collected for the buildings, which includes notional rents in respect of office space used by the Group; and (iii) commission payments, provided that either Sun Chung is able to find new tenants for the buildings or the existing tenants renew their leases with the Group. These arrangements are conducted on normal commercial terms.

## Mandatory Provident Fund and Occupational Retirement Schemes

As required by Hong Kong law, the Group has established a mandatory provident fund scheme for its employees. The Group participates in the BOC-Prudential Easy Choice Mandatory Provident Fund Scheme, the trustee of which is BOCI Prudential Trustee Limited and the investment manager of which is BOCI Prudential Asset Management Limited. The Group participates in this scheme on the same terms as independent third parties and by entering into the standard form participation agreement of BOCI Prudential Trustee Limited and BOCI Prudential Asset Management Limited, the Group has participated in the scheme with effect from December 1, 2000.

Prior to joining the Group's mandatory provident fund scheme, certain members of the Group had established occupational retirement schemes for the employees of the Group, with some of them participating in the pooling arrangements of the BOC Group Sister Banks Provident and Retirement Fund or the BOC Group Affiliated Banks Staff Provident and Retirement Fund (the "**Pooling Funds**"), in respect of their occupational retirement schemes. BOCI Prudential Trustee Limited provides trustee services for the occupational retirement schemes and the Pooling Funds, while BOCI Prudential Asset Management Limited acts as the investment manager and the guarantor. BOCI Prudential Asset Management Limited also acts as investment manager for certain other investment funds of the Group.



Under all of the occupational retirement schemes, including the Pooling Funds, the other investment funds of the Group and the mandatory provident fund scheme, the trustee and the investment manager charge their expenses to, and draw their fees from, the assets of the funds. All of the arrangements for the investment funds, the occupational retirement schemes and the mandatory provident fund scheme are on normal commercial terms and entered into on an arm's length basis.

#### **C. LOANS AND OTHER TRANSACTIONS WITH THE GROUP'S KEY MANAGEMENT PERSONNEL**

In the ordinary and usual course of the Group's business, the Group extends loan and credit facilities to, accepts deposits from, and issues credit cards to the directors and members of the senior management of the Group and also provides other services available to the Group's customers to such directors, close members of their families and enterprises in which such directors and members of the senior management have a substantial interest or over which they are able to exercise a significant control. The directors and members of the senior management of the Group who are employees of the Group are also entitled to certain benefits and preferences available to the staff of the Group generally, including staff housing loan scheme, deposits with preferential interest rate and certain benefits and preferences in relation to credit cards issued by BOC-CC. Save as aforesaid, all such loans, facilities and commercial banking services and products have been and will be offered on normal commercial terms and at market rates.

#### **D. RELATED PARTY TRANSACTION WITH BOCI ASIA LIMITED**

As further set out in the "Plans of Distribution" section, subject to the terms and conditions of the Purchase Agreement (defined below) entered into among us and the Initial Purchasers (including BOCI Asia Limited), BOCHK has agreed to sell to the Initial Purchasers and the Initial Purchasers have severally and not jointly agreed with BOCHK to purchase the principal amount of Notes, who propose to offer the Notes for resale in transactions not requiring registration under the Securities Act or applicable state securities laws, including sales pursuant to Rule 144A and Regulations S under the Securities Act. BOCHK will pay the Initial Purchasers' customary fees and commissions in connection with this offering and will reimburse the Initial Purchasers for certain expenses incurred in connection with the offering. As BOCI Asia Limited is a wholly owned subsidiary of BOC, BOCHK's holding company, the arrangements between BOCI Asia Limited and BOCHK under the Purchase Agreement constitute a related party transaction of BOCHK.

## OVERVIEW OF THE HONG KONG BANKING INDUSTRY

*Unless otherwise expressly stated, the information and statistics set out in this section are derived directly from publicly available information, including materials obtained from the HKMA or published in The Hong Kong Monthly Statistical Bulletin in relation to information as of December 31, 2009 and the HKMA Annual Report 2008, which is in turn based on returns submitted to the HKMA by reporting authorized institutions. We have not independently verified or checked such information and statistics and do not assume any responsibility for the accuracy or completeness thereof. Reporting authorized institutions as of December 31, 2009 comprised all the licensed banks, restricted license banks and deposit-taking companies in Hong Kong. References to assets, liabilities, loans, advances, deposits and negotiable certificates of deposit of banks or authorized institutions relate to assets, liabilities, loans, advances, deposits and negotiable certificates of deposit of only reporting licensed banks or other reporting authorized institutions.*

### INTRODUCTION

The banking industry in Hong Kong has a three-tier system of authorized institutions, comprising licensed banks, restricted licensed banks and deposit-taking companies. As of September 30, 2009, there were 146 licensed banks, 26 restricted license banks and 28 deposit-taking companies operating in Hong Kong; 23 of the licensed banks were incorporated in Hong Kong (including BOCHK), with the balance of 123 incorporated overseas. Furthermore, there were 72 representative offices of overseas banks established in Hong Kong.

Primary supervision of Hong Kong-incorporated authorized institutions is the responsibility of the HKMA, whereas overseas incorporated banks are subject to the supervision of both the HKMA (as to the banks' Hong Kong business) and home country regulator. The HKMA obtains regular returns from and sends examination teams to all authorized institutions. Off-site reviews, on-site examinations and prudential meetings are the methods usually adopted for the supervision of authorized institutions. Prudential meetings can also take the form of tripartite meetings between the management of an authorized institution, its auditors and the HKMA. In addition, all licensed banks in Hong Kong, whether incorporated overseas or locally, are required to be members of the Hong Kong Association of Banks, a statutory body, the purposes of which include representing the banking industry in banking-related matters and framing rules for the conduct of banking business in Hong Kong.

Since December 31, 1989, locally incorporated banks have been subject to capital adequacy standards similar to those set out in the Basel Accord, with a minimum risk adjusted capital adequacy ratio of 8.0%. As of September 30, 2009, our consolidated core capital ratio was 11.44% and consolidated capital adequacy ratio was 16.22%. The Banking (Amendment) Ordinance 2005, enacted on July 6, 2005, has put in place a legislative framework for the implementation in Hong Kong of Basel II proposed by the Basel Committee on Banking Supervision ("BCBS"). In line with the timetable set by BCBS for its members, the implementation of Basel II commenced in Hong Kong in January 2007 to further strengthen the soundness and stability of the banking system while maintaining sufficient consistency that capital adequacy regulation will not be a significant source of competitive inequality among active banks.

## **RECENT EVENTS AND PERFORMANCE**

### **Lehman Brothers Minibonds Incident**

The SFC, the HKMA and 16 distributing banks, including BOCHK, Nanyang and Chiyu, jointly announced on July 22, 2009 that they have reached an agreement in relation to the repurchase of Lehman Brothers Minibonds from eligible customers. Each of the banks will make an offer to repurchase from each eligible customer all outstanding Minibonds at a price equal to 60% of the nominal value of the original investment for customers below the age of 65 or at 70% of the nominal value for customers aged 65 or above as of July 1, 2009. Customers will be entitled to retain any coupon payments received to date. Each of the banks was required to implement enhanced complaints handling procedures to resolve, in a fair and reasonable manner, all complaints in relation to the sale and distribution of unlisted structured products.

### **CEPA**

The HKSAR Government and the Central People's Government agreed on further services liberalization and trade cooperation under the CEPA on May 9, 2009. Under Supplement VI, CEPA will make it easier for Hong Kong banks with existing branches to open up additional sub-branches in Guangdong province. CEPA itself may not significantly alter Hong Kong banks' China expansion plans, but it will be more positive to banks with stated expansion targets and the financial capability to do so by helping to accelerate the expansion process.

## **PERFORMANCE**

Pre-tax operating profit of retail banks dropped 9.7% in the first three quarters of 2009, compared with the same period in 2008. Net interest margin of retail banks narrowed to 1.5% in the first three quarters of 2009 compared to 1.8% in 2008.

### **Assets**

The total assets of all authorized institutions in Hong Kong decreased approximately 1.0% from HK\$10,754 billion as of December 31, 2008 to HK\$10,646 billion as of September 30, 2009.

### **Loans and Advances**

As of September 30, 2009, loans and advances to customers represented approximately 30.8% of the total assets of all authorized institutions in Hong Kong. The total Hong Kong dollar value of loans and advances to customers extended by all authorized institutions in Hong Kong has decreased approximately 0.3% from HK\$3,286 billion as of December 31, 2008 to HK\$3,278 billion as of September 30, 2009. Approximately 72.6% of loans and advances to customers extended by all authorized institutions in Hong Kong were denominated in Hong Kong dollars as of September 30, 2009, with the rest in foreign currencies. At the same date, of the total loans and advances to customers of HK\$3,278 billion extended by all authorized institutions, approximately 82.2% was classified as "Loans and Advances for use in Hong Kong plus trade finance" and approximately 17.8% was extended for use outside Hong Kong or where the place of use was not known. As of September 30, 2009, 77.1% of loans originated in Hong Kong, 17.8% from outside Hong Kong and the remaining 5.1% is in trade finance. Loan growth has been consistently driven by demand

from corporates as well as mortgages, as demonstrated by its steady growth of 8.1% compound annual growth rate (“CAGR”) from 2003 to the first half of 2009. The table below illustrates the breakdown of loans classified as “Loans and Advances for use in Hong Kong” by economic sector extended by all authorized institutions in Hong Kong as of September 30, 2009.

<u>Sector</u>	<u>Percentage of Total</u>
Manufacturing . . . . .	5.5%
Transport and transport equipment . . . . .	5.9%
Electricity and gas . . . . .	1.2%
Recreational activities . . . . .	0.1%
Information technology . . . . .	1.3%
Building, construction, property development and investment . . . . .	26.2%
Wholesale and retail trade . . . . .	6.0%
Professional & private individuals <sup>(1)</sup> . . . . .	35.5%
To purchase other residential property . . . . .	25.0%
Financial concerns <sup>(2)</sup> . . . . .	8.9%
All others <sup>(3)</sup> . . . . .	9.5%
Total . . . . .	<u>100.0%</u>

*Notes:*

- (1) Includes “to purchase flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme, for credit card advances and other business and private purposes.”
- (2) Investment companies, insurance companies, future brokers, finance companies and others.
- (3) Hotels, boarding houses, catering and stockbrokers.

## **Other Assets**

The other assets of authorized institutions in Hong Kong comprise predominantly inter-bank lending to both authorized institutions in Hong Kong and to banks overseas, as well as negotiable debt instruments, investments in shareholding and fixed assets. As of September 30, 2009, inter-bank lending represented approximately 35% of the total assets of all authorized institutions in Hong Kong, with approximately 30% of such lending being to banks outside Hong Kong.

## **Asset Quality and Capital Adequacy**

Asset quality among Hong Kong banks remains benign, with 1.42% NPL ratio as of September 30, 2009. The mortgage delinquency ratio is 0.05% as of September 30, 2009, with no change from December 31, 2008. The credit card charge off ratio stands at 4.1% as of September 30, 2009, compared to 2.72% in December 31, 2008. Although the financial crisis has resulted in higher delinquency ratios, credit quality is still under control and provisions have peaked. Classified loan ratio rose to 1.42% at September 30, 2009 from 1.24% at December 31, 2008 and a low of 0.81% at March 31, 2008. Capital adequacy ratio rose notably from 14.7% as of December 31, 2008 to 16.6% as of September 30, 2009.

## **FUNDING**

### **Deposits from Customers**

As of September 30, 2009, deposits from customers represented approximately 60.3% of the total liabilities of all authorized institutions in Hong Kong. Total deposits from customers of all authorized institutions increased approximately 6.0% from HK\$6,060 billion as of December 31, 2008 to HK\$6,424 billion as of September 30, 2009, of which approximately 52.8% of total customer deposits with authorized institutions were denominated in Hong Kong dollars. Hong Kong dollar deposits increased approximately 12% while deposits denominated in foreign currencies increased approximately 0.2%, in each case from December 31, 2008 to September 30, 2009. As of September 30, 2009, deposits from customers with licensed banks represented approximately 99.6% of deposits from customers with all authorized institutions in Hong Kong. As of September 30, 2009, time deposit accounts, savings accounts and demand accounts accounted for approximately 9%, 40.8% and 11.2%, respectively, of total deposits by customers with licensed banks in Hong Kong. As of September 30, 2009, there were 44 authorized institutions engaged in RMB banking business, which includes RMB deposit taking, currency exchange, remittances and cross-border trade settlement. RMB deposits was RMB58,174 million during the same time, of which 69.7% from demand and savings deposits and 30.3% from time deposits. The Hong Kong banking sector is awash with liquidity and deposits have exemplified steady growth even through the economic crisis by increasing its base by 9.2% CAGR from 2003 to the first half of 2009.

### **Interbank Funds**

Interbank transactions are significant in funding the Hong Kong banking system. As of September 30, 2009, inter-bank liabilities represented approximately 25% of the total liabilities of all authorized institutions in Hong Kong. A portion of the inter-bank funding for the Hong Kong banking system is sourced from banks outside Hong Kong and, as of September 30, 2009, approximately 20% of all inter-bank funding came from banks outside Hong Kong.

### **Negotiable Certificates of Deposit**

Some banks have adopted the practice of issuing medium-term negotiable certificates of deposit. As of October 31, 2009, the total outstanding value of negotiable certificates of deposit issued by authorized institutions in Hong Kong amounted to HK\$91,427 million, of which approximately 74.3% was denominated in Hong Kong dollars.

### **Deposit Protection Scheme**

On October 14, 2008, the Hong Kong Government announced the use of the Exchange Fund to guarantee repayment of all eligible customer deposits held with all authorized institutions in Hong Kong subject to the rules laid down in such Deposit Protection Scheme Ordinance (Cap.581 of the Laws of Hong Kong). The guarantee took immediate effect and is scheduled to remain in force until the end of 2010, whereupon the previous protection limit of HK\$100,000 of each eligible customer deposit held with a licensed bank (as opposed to with any authorized institution) will apply.

## SUPERVISION AND REGULATION

### SUPERVISION AND REGULATION IN HONG KONG

The banking industry in Hong Kong is regulated by and subject to the provisions of the Banking Ordinance and to the powers and functions ascribed by the Banking Ordinance to the HKMA. The Banking Ordinance provides that only banks (that is, a bank which has been granted a banking license (“**license**”) by the HKMA) may carry on banking business (as defined in the Banking Ordinance) in Hong Kong and contains controls and restrictions on such banks (“**licensed banks**”).

#### Supervision of Licensed Banks in Hong Kong

The provisions of the Banking Ordinance are implemented by the HKMA, the principal function of which is to promote the general stability and effectiveness of the banking system, especially in the area of supervising compliance with the provisions of the Banking Ordinance. The HKMA supervises licensed banks through, *inter alia*, a regular information gathering process, the main features of which are as follows:

- 1) each licensed bank must submit a monthly return to the HKMA setting out the assets and liabilities of its principal place of business in Hong Kong and all local branches and a further comprehensive quarterly return relating to its principal place of business in Hong Kong and all local branches, although the HKMA has the right to allow returns to be made at less frequent intervals;
- 2) the HKMA may order a licensed bank, any of its subsidiaries, its holding company or any subsidiaries of its holding company to provide such further information (either specifically or periodically) as it may reasonably require for the exercise of its functions under the Banking Ordinance or as it may consider necessary to be submitted in the interests of the depositors or potential depositors of the licensed bank concerned. Such information shall be submitted within such period and in such manner as the HKMA may require. The HKMA may in certain circumstances also require such information or any return submitted to it to be accompanied by a certificate of the licensed bank’s auditors (approved by the HKMA for the purpose of preparing the report) confirming compliance with the main provisions of the Banking Ordinance and certain other matters;
- 3) licensed banks may be required to provide information to the HKMA regarding companies in which they have an aggregate of 20% or more direct or indirect shareholding or with which they have common directors or managers (as defined in the Banking Ordinance), the same controller (as defined in the Banking Ordinance), with common features in their names or a concert party arrangement to promote the licensed bank’s business;
- 4) licensed banks are obliged to report to the HKMA immediately of their likelihood of becoming unable to meet their obligations or of the commencement of material civil proceedings applicable only to licensed banks incorporated in Hong Kong;
- 5) the HKMA may direct a licensed bank to appoint an auditor to report to the HKMA on the state of affairs and/or profit and loss of the licensed bank or the adequacy of the systems of control of the licensed bank or other matters as the HKMA may reasonably require;
- 6) the HKMA may, at any time, with or without prior notice, examine the books, accounts and transactions of any licensed bank, and in the case of a licensed bank incorporated in Hong Kong, any local branch, overseas branch, overseas representative office or subsidiary, whether local or overseas, of such licensed bank. Such inspections are carried out by the HKMA on a regular basis; and
- 7) licensed banks are required to give written notice to the HKMA immediately of any proposal to remove an auditor before the expiration of his term of office or replace an auditor at the expiration of his term of office.

## **Exercise of Powers over Licensed Banks**

The HKMA may, after consultation with the Financial Secretary, exercise certain powers over the conduct of licensed banks in any of the following circumstances:

- 1) when a licensed bank informs the HKMA that it is likely to become unable to meet its obligations, that it is insolvent, or that it is about to suspend payment;
- 2) when a licensed bank becomes unable to meet its obligations or suspends payment;
- 3) if, after an examination or investigation, the HKMA is of the opinion that a licensed bank:
  - (a) is carrying on its business in a manner detrimental to the interests of its depositors or potential depositors or of its creditors or of holders or potential holders of multi-purpose cards issued by it or the issue of which is facilitated by it;
  - (b) is insolvent or is likely to become unable to meet its obligations or is about to suspend payment;
  - (c) has contravened or failed to comply with any of the provisions of the Banking Ordinance; or
  - (d) has contravened or failed to comply with any condition attached to its license or certain conditions in the Banking Ordinance;
- 4) where the HKMA's power under section 22(1) of the Banking Ordinance to revoke the authorization of a licensed bank is exercisable (as discussed below); and
- 5) where the Financial Secretary advises the HKMA that he considers it in the public interest to do so.

In any of the circumstances described above, the HKMA may, after consultation with the Financial Secretary, exercise any of the following powers:

- 1) to require the licensed bank, by notice in writing served on it, forthwith to take any action or to do any act or thing whatsoever in relation to its affairs, business and property as the HKMA may consider necessary;
- 2) to direct the licensed bank to seek advice on the management of its affairs, business and property from an advisor approved by the HKMA;
- 3) to appoint a Manager (as defined in the Banking Ordinance) to assume control of and manage the affairs, business and property of the licensed bank; or
- 4) to report to the Chief Executive in Council in certain circumstances (in which case the Chief Executive in Council may exercise a number of powers, including directing the Financial Secretary to present a petition to the Court of First Instance for the winding-up of the licensed bank).

## **Revocation and Suspension of Banking License**

The HKMA also has powers to recommend the revocation or suspension of a license. Both powers are exercisable after consultation with the Financial Secretary and with a right of appeal of the licensed bank concerned except in the event of temporary suspension in urgent cases. The main grounds for suspension or revocation include the following:

- 1) the licensed bank no longer fulfills the criteria for authorization and the requirements for registration;
- 2) the licensed bank is likely to be unable to meet its obligations or proposes to make, or has made, any arrangement with its creditors or is insolvent;
- 3) the licensed bank has failed to provide material information required under the Banking Ordinance or has provided false information;



- 4) the licensed bank has breached a condition attached to its license;
- 5) a person has become or continues to be a controller or chief executive or director of the licensed bank after the HKMA has made an objection;
- 6) the interests of the depositors require that the license be revoked; or
- 7) the licensed bank is engaging in practices likely to prejudice Hong Kong as an international financial center or in practices (specified in the HKMA guidelines) that should not be engaged in.

Revocation or suspension of a license means that the licensed bank can no longer conduct banking business (for the specified period in the case of a suspension).

### **Principal Obligations of Licensed Banks**

The obligations of a licensed bank under the Banking Ordinance, which are enforced by the HKMA through the system described above, include, but are not limited to, the following:

#### ***Capital Adequacy***

A licensed bank incorporated in Hong Kong must at all times maintain a capital adequacy ratio of at least 8% and agreed by the HKMA, calculated as the ratio (expressed as a percentage) of its capital base to its risk-weighted exposure as more fully described below. In relation to a licensed bank with subsidiaries, the HKMA may require the ratio to be calculated (i) on a consolidated basis, (ii) on both a consolidated and an unconsolidated basis, or (iii) on a consolidated basis only in respect of such subsidiaries of the licensed bank as may be specified by the HKMA. The HKMA may, after consultation with the licensed bank concerned, increase the ratio for any particular licensed bank. A licensed bank is under a duty to inform the HKMA immediately of a failure to maintain the required capital adequacy ratio and to provide the HKMA with such particulars as it may require. It is an indictable offense not to do so, and the HKMA is entitled to prescribe remedial action.

The capital base of a licensed bank is, broadly speaking, but not limited to, and subject to certain exclusions, (i) all its paid-up capital and reserves, (ii) its profit and loss account, including its current year's profit or loss, (iii) perpetual and term subordinated debt meeting prescribed conditions, (iv) general provisions against doubtful debts subject to certain limitations and (v) a portion of its latent reserves arising from the revaluation of long-term holdings of specified equity securities or its reserves on the revaluation of real property. A licensed bank shall deduct from its capital base, *inter alia*, (a) investments in, advances to and guarantees of liabilities of certain connected companies, (b) shareholdings in subsidiaries or holding companies and in other companies in which more than 20% of voting power is held and (c) investments in other banks (except for those which are not subject to a cross-holding arrangement or not otherwise a strategic investment).

The risk-weighted exposure is determined by:

- 1) multiplying risk-weight factors to the book value of various categories of assets (including, but not limited to, notes and coins, Hong Kong government certificates of indebtedness and cash items in the course of collection);
- 2) multiplying the credit conversion factors to various off balance sheet items (including, but not limited to, direct credit substitutes, transaction-related contingencies, repurchase contracts, note issuance facilities and exchange rate contracts) to determine their credit equivalent amount;
- 3) aggregating the amounts determined pursuant to 1) and 2); and
- 4) subtracting from the amount determined pursuant to 3) the value of general provisions not included in the capital base of the licensed bank and the amount by which the book value of reserves on revaluation of real property exceeds the book value of such reserves as of the period-end.

Risk-weight factors are specified in the Banking Ordinance and the Banking (Capital) Rules (Cap.155L) in Hong Kong as being a percentage varying between 0% and 100% to reflect the extent to which an asset might be regarded as being at risk or the extent to which a liability might arise. Credit conversion factors are also specified in the Banking Ordinance and the Banking (Capital) Rules (Cap.155L) as being percentages varying between 0% to 100% to reflect the percentage of the relevant item to which the risk-weight factor should be applied.

The capital adequacy standards described above (commonly known as “**Basel I**”) were promulgated by the BCBS and have been applied in Hong Kong since 1989. The Banking (Amendment) Ordinance 2005, enacted on 6 July 2005, has put in place a legislative framework for the implementation in Hong Kong of Basel II. In line with the timetable set by BCBS for its members, implementation of Basel II commenced in Hong Kong in January 2007.

There are four approaches under Basel II to calculate credit risks, namely the basic approach, the standardized approach, foundation internal rating based approach and the advanced internal ratings based approach. Licensed banks in Hong Kong under Basel II are to adopt the standardized approach initially, under which expanded risk weights (0%, 20%, 35%, 75%, 100% and 150%) are used for assessing capital required.

A licensed bank, if approved by the HKMA, may adopt the basic approach in reporting its capital adequacy as a transitional measure before eventually adopting the internal ratings based approach. Under the internal ratings based approach, the capital required of a licensed bank relies on a bank’s internal ratings system (subject to supervisory validation and approval) and is based on three risk components – probability of default, loss given default and exposure at default.

Furthermore, in addition to credit risk and market risk, operational risk is also required to be included in the determination of the capital adequacy ratio. Even with the inclusion of operational risk in the calculation, the minimum capital adequacy ratio remains unchanged at 8%. For the calculation of operational risk, there are three approaches, namely, basic indicator approach, standardized approach and the alternative standardized approach.

### ***Liquidity***

Licensed banks must maintain at all times a liquidity ratio of not less than 25% in each calendar month, calculated as the ratio (expressed as a percentage) of the sum of the net weighted amount of its liquefiable assets to the sum of its qualifying liabilities for each working day of the calendar month concerned as calculated in accordance with the Fourth Schedule to the Banking Ordinance. In relation to a licensed bank with subsidiaries, the HKMA may require that ratio to be calculated (i) on a consolidated basis, (ii) both on a consolidated basis and an unconsolidated basis, or (iii) on a consolidated basis only in respect of such subsidiaries of the licensed bank as may be specified by the HKMA. The ratio may be varied by the HKMA. A licensed bank has a duty to inform the HKMA if the ratio requirement is not fulfilled and provide it with such particulars of that contravention as it may require, and it is an indictable offense not to do so; the HKMA is entitled to prescribe remedial action. For the purpose of the liquidity ratio, in the case of a licensed bank which has places of business in Hong Kong and elsewhere, its places of business in Hong Kong are collectively treated as a separate licensed bank to which the liquidity ratio provisions would apply.

Liquefiable assets are, broadly speaking, assets held in the form of currency notes and coins, gold, loans due within one month from other banks (after deducting amounts payable to other banks within one month), certain export bills payable within one month, certain kinds of marketable debt securities or prescribed instruments (in some cases subject to a discount) and certain types of loan repayments due on fixed dates within one month on performing loans (subject to a discount).

Qualifying liabilities are, broadly speaking, liabilities which will or could or, in the case of contingent liabilities, in the opinion of the HKMA, may, fall due within one month, except that liabilities to other banks are treated on a net basis.

### ***Financial Exposure to Any One Customer***

The financial exposure of a licensed bank incorporated in Hong Kong to any one person or group of connected persons must not (subject to certain exceptions) exceed 25% of the capital base of the licensed bank. Subject to certain exclusions, the licensed bank's financial exposure to any one person or group of connected persons is taken to be the aggregate of:

- 1) all advances, loans and credit facilities granted to that person or group;
- 2) the value of the licensed bank's holdings of shares, debentures and other debt securities issued by that person or group; and
- 3) the principal amount, multiplied by a factor to be specified by the HKMA, for off-balance sheet items resulting from transactions between the licensed bank and that person or group.

For these purposes, persons shall be treated as connected if one company is the subsidiary of another, they have a common holding company, they have a common controller (not being a company) or if one (not being a company) is a controller of another (being a company).

The calculation of financial exposure does not include, *inter alia*, financial exposure to the Hong Kong government or authorized institutions or financial exposure generally to the extent it is secured by a cash deposit, a guarantee, an undertaking, certain specified securities or a letter of comfort approved by the HKMA.

If a person or a company to whom a licensed bank is financially exposed is a trustee of more than one trust, the HKMA may by notice in writing extend the limit of the licensed bank's financial exposure to that person or company.

### ***Other Restrictions on Lending***

The Banking Ordinance also provides that:

- 1) licensed banks may not grant any loan, advance or credit facility (including letters of credit) or give any guarantee against the security of their own shares (or, except with the approval of the HKMA, that of their respective holding companies, subsidiaries or fellow subsidiaries of such holding companies);
- 2) the amount of the facilities which a Hong Kong-incorporated licensed bank may make available on an unsecured basis to its controllers, its directors, their relatives or certain of its employees and persons associated with any of them shall be subject to the restrictions set out therein; and
- 3) licensed banks may not, except with the written consent of the HKMA, provide to any one of their employees any unsecured facility of an amount in excess of that employee's salary for one year.

### ***Restrictions on Investments in Land***

A licensed bank incorporated in Hong Kong cannot purchase or hold any interest in land, whether situated in or outside Hong Kong, of a value or to an aggregate value in excess of 25% of its capital base. There are exceptions for land held that in the opinion of the HKMA is necessary for the operation of the business or for providing housing or amenities for staff.

### ***Shareholding in Other Companies***

A licensed bank incorporated in Hong Kong may not acquire or hold any part of the share capital of any other company or companies to an aggregate value which exceeds 25% of the licensed bank's capital base except for shares held by way of security for facilities granted by it or by virtue of acquisitions in satisfaction of debts due to it (which must, however, be disposed of at the earliest suitable opportunity and

not later than 18 months after their acquisition unless the HKMA agrees to a longer period). Shares held by virtue of underwriting and sub-underwriting commitments are, nevertheless, permitted, provided the relevant shares are disposed of within seven working days or such longer period as the HKMA may agree.

There are other exemptions for any holding of share capital approved by the HKMA in other banks and companies carrying on nominee, executor, trustee or other functions related to banking business, the business of deposit taking, insurance, investments or other financial services.

### ***Other Restrictions on Investment***

The aggregate of the outstanding amounts of all facilities granted to or on behalf of a licensed bank's controllers, directors, their relatives, certain of its employees and their associates; the value of all holdings of share capital in other companies; and the value of all holdings of interests in land (including land purchased or held which is necessary for the conduct of business or the provision of housing or amenities for the staff of the institution) must not exceed 80% of its capital base.

### ***Charges***

A licensed bank incorporated in Hong Kong is not permitted to create any charges over its assets if either the aggregate value of all charges existing over its total assets is 5% or more of the value of those total assets or creating that charge would cause the aggregate value of all charges over its total assets to be more than 5% of the value of those total assets.

### ***Restrictions on Overseas Activities***

A licensed bank which is incorporated in Hong Kong is subject to a condition that it shall not establish or maintain any overseas branch or overseas representative office without the approval of the HKMA. The HKMA is empowered by the Banking Ordinance to require financial and other information regarding any such overseas branch to be supplied to it.

Further, a licensed bank incorporated in Hong Kong or its Hong Kong-incorporated holding company may not without the consent of the HKMA own a company incorporated outside Hong Kong which may (whether or not in or outside Hong Kong) lawfully take deposits from the public. The HKMA may at any time attach in respect of any such approved overseas companies any conditions as the HKMA may think proper.

## **Shareholders, Chief Executives and Directors**

### ***Limitations on Shareholders***

The HKMA has the power to object, on certain specified grounds, to persons becoming or being "controllers" of licensed banks incorporated in Hong Kong. "**Controller**" in this context means:

- 1) a person who, either alone or with any associate(s), is entitled to exercise, or control the exercise of, 10% or more, but not more than 50%, of the voting power at any general meeting of the licensed bank or of another company of which it is a subsidiary;
- 2) a person who, either alone or with any associate(s), is entitled to exercise, or control the exercise of, more than 50% of the voting power at any general meeting of the licensed bank or of another company of which it is a subsidiary; or
- 3) a person in accordance with whose directions or instructions the directors of the licensed bank or of another company of which it is a subsidiary are accustomed to act (but does not include any professional advisors or managers appointed by the HKMA to manage the licensed bank).

A person may not become a controller of a licensed bank incorporated in Hong Kong unless he has served a written notice on the HKMA of his proposal to that effect and the HKMA consents to his becoming such a controller or does not object within three months.

Within the three-month period, the HKMA may object to the applicant's proposal, unless it is satisfied that the applicant is a fit and proper person to become a controller; that depositors' or potential depositors' interests will not be threatened by that person being such a controller; and having regard to the applicant's likely influence on that institution as a controller, the licensed bank is likely to continue to conduct its business prudently or that the applicant is likely to undertake adequate remedial action to ensure that the licensed bank will conduct its business prudently.

The HKMA may also object to the continuation of a person as a controller on similar grounds as in respect of new controllers.

Where a person becomes a controller (by virtue of being able to exercise or control the exercise of certain voting power in a licensed bank) after a notice of objection has been served on him or otherwise in the contravention of the procedure prescribed by the Banking Ordinance, the HKMA may notify the controller that until further notice any specified shares are subject to one or more of the following restrictions:

- 1) any transfer of the shares or, in the case of unissued shares, any transfer of the right to be issued with them, and any issue of such shares, shall be void;
- 2) voting rights in respect of those shares shall not be exercisable;
- 3) no further shares in right or pursuant to any offer made to the shareholder shall be issued; or
- 4) except in a liquidation, no payments of any sums due from the licensed bank on the shares shall be paid.

In addition, the HKMA may apply to court for an order that the shares be sold. Once the shares are sold, the proceeds (less the costs of sale) shall be paid into court and held for the benefit of the persons beneficially interested in them.

In the case of an indirect controller who does not have the approval of the HKMA, the person concerned is prohibited from giving directions or instructions to the directors of the licensed bank.

#### ***Limitations on Persons Becoming Chief Executives or Directors***

All licensed banks must have a chief executive ordinarily resident in Hong Kong. A person requires the consent of the HKMA before becoming a chief executive.

The consent of the HKMA is also required for a person to become a director of a Hong Kong-incorporated licensed bank.

#### **Supervision of Securities Business**

The Securities and Futures Ordinance (the "SFO"), which came into operation in April 2003, requires banks that engage in securities business to apply for registration with the SFC, which means they will have to meet the Fit and Proper Criteria set by the SFC. Likewise, staff engaged by banks in securities business will have to meet the Fit and Proper Criteria applicable to staff of securities firms. It is a statutory condition of registration for banks that each member of staff engaged by them in securities business is a fit and proper person and be entered on a register maintained by the HKMA as a relevant individual. Banks will also have to comply with the various regulatory requirements set by the SFC in relation to their securities business, including the subsidiary legislation and the business conduct codes. Under the SFO, banks and their securities staff will be subject to the same range of disciplinary actions that are applicable to SFC licensed intermediaries and their staff in case they are guilty of misconduct or otherwise not fit and proper.

With the introduction of the licensing regime under the SFO, corresponding changes have been made to the Banking Ordinance by way of the introduction of the Banking (Amendment) Ordinance 2002. Such ordinance came into operation simultaneously with the SFO and has enabled the HKMA to enhance their regulatory functions in relation to securities businesses of banks and other authorized institutions that are registered under the SFO.

## **SUPERVISION AND REGULATION IN THE PRC**

### **History and Development of Mainland China's Banking Industry**

Between 1949 and the late 1970s, Mainland China's banking industry functioned as part of the centrally planned economy and the PBOC was Mainland China's central bank as well as the primary commercial bank engaging in deposit-taking and lending activities. Since the late 1970s, as part of the economic reform, the banking industry underwent significant changes as some of the PBOC's commercial banking functions were separated from its central bank function. At that time, four commercial banks assumed the role of state-owned specialized banks, while the PBOC focused on acting as Mainland China's central bank and as the principal regulator and supervisor of Mainland China's banking system.

In the late 1980s, new commercial banks and non-bank financial institutions were established to provide commercial banking services. Since the mid-1990s, the PRC Government has taken a series of measures to reform the commercial banking sector. In 1995, the PRC Commercial Banking Law and PRC People's Bank of China Law were enacted to define more clearly the permitted scope of business of commercial banks and the functions and powers of the PBOC as Mainland China's central bank and banking regulator. In 2003, the CBRC was established to become the primary banking industry regulator and assumed the majority of the banking regulatory functions of the PBOC, the PBOC remains responsible for making and implementing monetary policies, safeguarding the overall financial stability and provision of financial services in Mainland China.

Foreign banks' presence in Mainland China has a history of over 100 years. The growth of foreign banks in the Mainland China market has continued to accelerate with the introduction of local incorporation of foreign banks marking a key stage in the development of Mainland China banking industry.

### **Licensing Requirements**

The Commercial Banking Law and the Measures of CBRC for the Implementation of Administrative Licensing Matters Concerning Chinese-funded Commercial Banks effective from February 1, 2006 set out the permitted scope of business, licensing standards and other requirements in respect of commercial banks. Commercial banks in Mainland China are permitted to engage in any or all of the following activities:

- taking deposits from the public;
- making short-term, medium-term and long-term loans;
- effecting domestic and overseas payment settlements;
- accepting and discounting instruments;
- issuing bonds;
- acting as agents to issue, honor and underwrite government bonds;
- trading government bonds and financial institution bonds;
- engaging in inter-bank lending;
- trading foreign exchange as principal or as agent;
- engaging in bank card business;
- providing letters of credit and guarantee services;
- collecting and making payment as agents and acting as insurance agents;



- providing safe deposit box service; and
- other businesses approved by the CBRC.

A commercial bank may undertake foreign exchange settlement and selling business with the approval of the PBOC.

A commercial bank must apply to the CBRC (or its local offices) for approval to establish a domestic branch. To obtain such business license and banking license, the branch must have sufficient operating funds commensurate with its scale and must meet other operating requirements.

## **Regulation of Principal Commercial Banking Activities**

### ***Lending***

To control credit risks relating to the extension of credit, Mainland China banking regulations require that commercial banks should, among other things: (1) establish a strict and unified credit risk management system; (2) establish standard operation procedures for each step in the extension of credit, including conducting due diligence investigations before granting credit facilities, monitoring borrowers' repayment ability and preparing credit assessment reports on a regular basis; and (3) make arrangements to appoint qualified risk control personnel. To control market risks relating to related party loans, the CBRC issued corresponding guidelines and measures. In addition, the CBRC issued regulations regulating loans and credit granted to certain specific industries and customers in an effort to control the credit risk of Mainland China commercial banks.

### ***Foreign Exchange Business***

Commercial banks are required to obtain approvals from the CBRC and the SAFE to conduct foreign exchange businesses. Under the Mainland China's anti-money laundering laws and regulations, Mainland China financial institutions are required to report to the Anti-Money Laundering Monitoring and Analyzing Center on a timely basis any large or suspicious foreign exchange transactions which they encounter.

### ***Securities and Asset Management Businesses***

Commercial banks in Mainland China are generally prohibited from trading and underwriting equity securities. Commercial banks in Mainland China are permitted to:

- underwrite and deal in Mainland China government bonds and financial institution bonds, and starting from May 2005, commercial bonds issued by qualified non-financial institutions;
- act as agents in transactions involving securities, including bonds issued by Mainland China government, financial institutions and other corporate entities;
- provide institutional and individual investors with comprehensive asset management advisory services;
- act as financial advisors in connection with large infrastructure projects, mergers and acquisitions transactions and bankruptcy reorganizations; and
- act as custodians for funds, including securities investment funds and corporate annuity funds.

Under the Administrative Measures on Qualifications for Securities Investment Fund Custodianship promulgated jointly by the China Securities Regulatory Commission ("CSRC") and the CBRC on November 29, 2004, a commercial bank is permitted to apply for the qualification to engage in fund custodian business of securities investment funds, if, among other requirements, such commercial bank



has net assets at the year-end totaling no less than RMB2 billion for each of the latest three fiscal years and its capital adequacy ratio fulfills the relevant regulatory requirement. The fund custodian must ensure the separation of its custodian business from its other businesses, as well as the independence of its fund assets. The CSRC and the CBRC are jointly responsible for examining and approving the qualifications and supervising the activities of fund custodians. In addition, the senior manager of a commercial bank's fund custody department must have certain qualifications and be approved by the CSRC.

### ***Insurance***

Commercial banks in Mainland China are not permitted to underwrite insurance policies, but are permitted to act as agents to sell insurance products through their distribution network. Commercial banks that conduct agency sales of insurance products are required to comply with applicable rules issued by the China Insurance Regulatory Commission ("CIRC"). Pursuant to the Interim Measures on the Administration of Ancillary Agency Insurance Business promulgated by the CIRC on August 4, 2000, commercial banks are required to obtain licenses from the CIRC before conducting agency insurance business. Pursuant to the Notice Regarding Standardization of Agency Insurance Business Conducted by Banks issued jointly by the CIRC and the CBRC on June 15, 2006, such licenses are required for all main branches of commercial banks conducting such business.

### ***Personal Wealth Management Services***

In September 2005, the CBRC issued the Provisional Administrative Measures on the Personal Wealth Management Business of Commercial Banks. Under these measures, commercial banks are required to obtain CBRC approval to provide certain wealth management services whereas in respect of certain other wealth management services, they are only required to submit a report to the CBRC. Commercial banks are also subject to certain restrictions on offering products under personal wealth management plans. In addition, under the Guidelines on Risk Management Regarding Personal Wealth Management Services of Commercial Banks issued by the CBRC in September 2005, commercial banks are required to establish an auditing and reporting system in respect of their wealth management services and to report to the relevant authorities any material risk management problems. Thereafter, the CBRC issued a series of documents, including the Notice on Issues Relating to Further Regulating Report Management of Personal Wealth Management Services Provided by Commercial Banks on April 28, 2009, in an effort to further improve the reporting mechanism and risk control for personal wealth management services provided by commercial banks.

### ***Electronic Banking***

In January 2006, the CBRC issued Administrative Measures Regulating Electronic Banking Business and Security Evaluation Guidelines on Electronic Banking in an effort to enhance risk management and security standards in this sector. All banking institutions applying to establish an e-banking business are required to have sound internal control and risk management systems and should not have had any major incidents relating to their primary information management and operations processing systems in the year immediately prior to the application. In addition, all banking institutions conducting e-banking business must adopt security measures to maintain information confidentiality and prevent the unauthorized use of e-banking accounts.

### ***Proprietary Investments***

In general, commercial banks in Mainland China are prohibited from making domestic investments other than in debt instruments issued by Mainland China government and financial institutions, short-term commercial paper and corporate bonds issued by qualified non-financial institutions, and certain derivative products. Unless approved by the Mainland China State Council, commercial banks are prohibited in Mainland China from engaging in trust investment and securities operation business, investing in real property (other than for their own use) and investing in non-banking financial institutions and enterprises.

## *Derivatives*

On February 4, 2004, the CBRC issued the Provisional Administrative Measures on Derivative Business of Financial Institutions, which set out, among other things, detailed regulations on market access and risk management of derivatives business conducted by financial institutions. In accordance with the provisional measures, commercial banks in Mainland China seeking to conduct derivatives business must meet relevant qualification requirements and obtain prior approval from the CBRC. On March 22, 2005, the CBRC issued the Circular on Risk Alert Regarding Trading of Derivative Products by Domestic Banks, and amended the Tentative Administrative Measures on the Management of the Dealings in Derivative Products of Financial Institutions on December 28, 2006 (effective from July 3, 2007), issued the Notice to Further Strengthen Risk Management of Derivative Product Transaction between Banking Financial Institutions and Institutional Customer on July 31, 2009 in an effort to further strengthen the risk management of derivatives business conducted by commercial banks in Mainland China.

## *Enhanced Regulation and Supervision*

In recent years, the CBRC and other Mainland China regulatory authorities have promulgated numerous rules and regulations in an effort to enhance supervision and promote orderly market competition in the banking industry, including:

*Enhancing supervision over capital adequacy.* In March 2004, the CBRC issued the Administrative Measures in Capital Adequacy Ratios of Commercial Bank (“**Capital Adequacy Measures**”) and implemented a set of capital adequacy guidelines that were to be complied with by January 1, 2007. On July 3, 2007, the CBRC amended the Capital Adequacy Measures issued in March 2004 to set forth a set of new and more stringent capital adequacy guidelines that were to be complied with from July 3, 2007;

*Establishing a general provision requirement for risk-bearing assets.* Starting from July 2005, commercial banks in Mainland China are required by the Ministry of Finance to set aside a regulatory general reserve of generally not less than 1% of the year-end balance of their risk-bearing assets;

*Raising the Renminbi reserve requirement ratio.* Between January 1, 2007 to January 18, 2010, the PBOC increased the Renminbi reserve requirement ratio 15 times, from 9.0% to 16%, in increments of 0.5% and 1%; and

*Enhancing supervision over information disclosure.* The Administrative Measures on Information Disclosure of Commercial Banks effective as of July 3, 2007 issued by CBRC required commercial banks to disclose financial and accounting reports, risk management status, corporate governance and substantial matters annually.

## *Interest Rate Deregulation*

Historically, interest rates on deposits and loans were set by and subject to restrictions established by the PBOC. In recent years, as part of the overall reform of the banking system, the PBOC has implemented a series of initiatives designed gradually to liberalize interest rates and move towards a more market-based interest rate regime. The ongoing interest rate liberalization will facilitate the ability of banks to develop and market innovative products and services and adopt risk-based pricing.

### ***Increasing Demand for Personal Banking Products and Services***

The rising income levels in Mainland China will continue to foster demand for personal banking products, including both personal loan products and fee-based and commission-based products and services. The following table sets forth key personal income data for Mainland China and their respective Compound Annual Growth Rates for the periods indicated.

	For the year ended 31 December,					Compound Annual Growth Rate (2005- 2009)
	2005	2006	2007	2008	2009	
	(in RMB, except percentages)					
GDP per capita. . . . .	14,053	16,165	19,524	22,698	N/A	17.3% <sup>(1)</sup>
Annual disposable income of urban households per capita .	10,493	11,759	13,786	15,781	17,175	13.1%
Annual net income of rural households per capita . . . . .	3,255	3,587	4,140	4,761	5,153	12.2%

Sources: National Bureau of Statistics of China, PBOC.

Note: (1) CAGR calculated from 2005 to 2008.

### ***Participation of Foreign Banks in Mainland China***

The opening up of the Mainland China banking sector to foreign banks is to encourage foreign investment by facilitating better financial services available to foreign investors. However, historically, operations of foreign banks in Mainland China were subject to significant restrictions, e.g. geographic restrictions and customer restrictions.

After Mainland China's accession to the WTO in December 2001, the Chinese government has opened up more business areas to the foreign-funded banks. Pursuant to its WTO accession commitments, Mainland China has progressively opened Renminbi-denominated banking activities to foreign banks. One of the key recent changes was the issuance of Regulations of the People's Republic of China on Administration of Foreign-funded Banks. Under such regulations, with effect from December 11, 2006, all restrictions on the geographic presence, customer base and operational licenses of foreign-invested banks were lifted on the condition that they are locally incorporated and have obtained regulatory approval. Foreign banks that are incorporated in Mainland China can now provide full-scope Renminbi individual banking services to local residents with a local currency business license, while previously, Renminbi business could only be provided to foreign individuals in Mainland China.

## DESCRIPTION OF THE NOTES

The following summary describes certain provisions of the Notes and the Indenture (as defined below). This summary is not complete and is subject to, and qualified in its entirety by reference to, the provisions of the Indenture and the Notes. Copies of the Indenture and specimen Notes may be obtained by prospective investors upon request to the Trustee at the address set forth at the back of this Offering Memorandum.

### GENERAL

The Issuer will issue the Notes under an Indenture dated as of February 11, 2010 (the “**Indenture**”) among the Issuer, the Trustee and Citibank, N.A., London Branch, as note registrar and paying agent.

The Notes will have the following basic terms:

- The Notes issued in this offering will be in an aggregate principal amount of US\$1,600,000,000. Except where the Issuer has redeemed the Notes in circumstances described in “– Redemption,” and “– Events of Default; Limited Rights of Acceleration,” the principal amount of the Notes will be payable in full in a single payment on February 11, 2020.
- The Notes will bear interest at a rate of 5.55% per annum from (and including) February 11, 2010 to (but excluding) the Interest Payment Date (as defined below) in February 11, 2020. Interest on the Notes will be paid semi-annually in arrears on February 11 and August 11 of each year, commencing on August 11, 2010, to the Noteholders (as defined below) registered as such as of the close of business, New York City time, on the 15th business day preceding the interest payment date.

For purposes of this Offering Memorandum:

“Interest Payment Date” . . . . . February 11 and August 11 in each year (the first such date being August 11, 2010 and the last such date being February 11, 2020).

“Noteholders” . . . . . an individual, partnership, corporation (including a business trust), limited liability company, joint stock company, trust, unincorporated association, joint venture or other entity, or a government or any political subdivision or agency thereof in whose name a Note is registered in the note register.

### PRESCRIPTION

Claims against the Issuer for payments under any Notes shall be prescribed unless made within a period of six years from the relevant date in respect of the payment.

### ADDITIONAL NOTES

The Indenture will provide that additional Notes may be issued upon satisfaction of the conditions set forth in the Indenture, to the extent permitted by applicable law. Any additional Notes may be issued on terms established pursuant to a resolution of the Board of Directors of the Issuer, which will also establish the aggregate principal amount of each tranche delivered to the Trustee and will be accompanied by an officers’ certificate, or pursuant to a supplemental indenture. Additional Notes issued will be consolidated with and form a single series with the previously outstanding Notes.

### RANKING AND SUBORDINATION

The Notes constitute direct, unsecured and subordinated obligations of the Issuer, ranking *pari passu* without any preference among themselves.

Upon the occurrence of a Subordination Event, the claims of the Noteholders will be subordinated in right of payment in the manner provided in the Indenture constituting the Notes to the claims of depositors and all other unsubordinated creditors of the Issuer and will rank at least *pari passu* in right of payment with all other Subordinated Indebtedness of the Issuer, present and future. Claims in respect of the Notes will rank in priority to the rights and claims of holders of subordinated liabilities which by their terms rank in right of payment junior to the Notes and all classes of equity securities of the Issuer, including holders of preference shares, if any.

A consolidation of the Issuer with, or the merger of the Issuer into, another person, or the liquidation or dissolution of the Issuer after the conveyance or transfer of our properties and assets substantially as an entirety to another person, as described under “– Certain Covenants – Consolidation, Merger, Conveyance or Transfer” will not be deemed a liquidation, dissolution or other winding-up of the Issuer for the purposes of the subordination provisions if the person formed by such consolidation or merger or that acquires those assets complies with the conditions described under “– Certain Covenants – Consolidation, Merger, Conveyance or Transfer.”

The Notes do not limit the amount of unsubordinated indebtedness or deposits or other liabilities, which rank senior to the Notes, that we may hereafter incur.

#### **SET-OFF; PAYMENT VOID**

No Noteholder may exercise, claim or plead any right of set-off, counter-claim or retention in respect of any amount owed to it by the Issuer arising under or in connection with the Notes. Each Noteholder shall be deemed to have waived all such rights of set-off, counter-claim or retention to the fullest extent permitted by law.

#### **LISTING**

The Issuer has made an application to list the Notes on the Hong Kong Stock Exchange.

#### **PAYMENTS OF PRINCIPAL AND INTEREST**

*Principal:* Payment of the principal of the Notes, together with accrued and unpaid interest thereon, will be made on the payment date therefor to the person in whose name the Note is registered as of the close of business, New York City time, on the fifteenth business day before that payment date. The Notes do not need to be surrendered to receive payment of principal, interest or other amounts, except in connection with a redemption or in connection with the final payment of principal on the maturity date.

*Interest:* Interest on the Notes for each Interest Period will be payable from (and including) the issue date of the Notes semi-annually in arrears, as described further below.

Interest shall accrue on the outstanding principal amount of each Note beginning on (and including) February 11, 2010 and to (but excluding) the Interest Payment Date in February 11, 2020 at the rate of 5.55% per annum, payable semi-annually in arrears on each Interest Payment Date, and will amount to \$2,775 per each \$100,000 in principal amount of the Notes.

The interest in respect of the first Interest Period and any interest required to be calculated for a period that is a portion of (and less than a full) Interest Period will be calculated on the basis of a 360-day year consisting of 12 months of 30 days each and, in the case of an incomplete month, the number of days elapsed and rounding the resulting figure to the nearest cent (half a cent being rounded upwards).

For purposes of the foregoing:

**“Interest Period”**. . . . . The period beginning on (and including) the issue date of the Notes and ending on (but excluding) the first Interest Payment Date thereafter and each successive period beginning on (and including) an Interest Payment Date and ending on (but excluding) the next succeeding Interest Payment Date up to (but excluding) February 11, 2020.

## **ADDITIONAL AMOUNTS**

The Issuer will make all payments of principal and interest on the Notes without withholding or deducting any present or future taxes, penalties, fines, duties, assessments or other governmental charges of any nature (which we refer to collectively as **“taxes”**) imposed by Hong Kong or any political subdivision or governmental authority thereof or therein having power to tax (each a **“Taxing Jurisdiction”**). If the Issuer is required by law to withhold or deduct any such taxes, except as provided below, the Issuer shall pay the Noteholders such additional amounts necessary to ensure that the Noteholders receive the same amount as they would have received without such withholding or deduction (**“Additional Amounts”**). The Issuer will not, however, pay any Additional Amounts in connection with any taxes imposed due to any of the following:

- the Noteholder or beneficial owner has some connection with the Taxing Jurisdiction other than merely holding the Notes or receiving principal or interest payments on the Notes (such as citizenship, nationality, residence, domicile, or existence of a business, a permanent establishment, a dependent agent, a place of business or a place of management present or deemed present within the Taxing Jurisdiction);
- the Noteholder fails to surrender (where surrender is required) its Note within 30 days after we have made available to the Noteholder a payment of principal or interest; provided that we will pay Additional Amounts to which a Noteholder would have been entitled had the Note owned by such Noteholder been surrendered on any day (including the last day) within such 30-day period;
- where any such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of ECOFIN Council meeting of November 26-27, 2000 on the taxation of savings income or any other law implementing or complying with, or introduced in order to conform to, such Directive; or
- where the Noteholder or beneficial owner could avoid withholding or deduction by requesting that a payment on the Notes be made by, or presenting the relevant Notes for payment to, another paying agent located in a member state of the European Union.

The Issuer will make any required withholding or deduction and remit the full amount withheld or deducted to the relevant taxing authority in accordance with applicable law. The Issuer will furnish to the Trustee, within 30 days after the date of payment of any such taxes, certified copies of tax receipts or other documentation reasonably satisfactory to the Trustee evidencing that payment. Upon request, copies of those receipts or other documentation, as the case may be, will be made available to the Noteholders.

The Issuer will pay any stamp, administrative, court, documentary, excise or property taxes arising in a Taxing Jurisdiction in connection with the Notes and will indemnify the Noteholders for any such taxes paid by Noteholders.

All references to principal, interest or other amounts payable on the Notes in this Offering Memorandum are deemed to include any Additional Amounts payable by the Issuer. These obligations will survive any termination or discharge of the Notes and the Indenture.

If the Issuer is required at any time to pay Additional Amounts to Noteholders pursuant to the terms of the Notes and the Indenture, the Issuer will use its reasonable efforts to obtain an exemption from the payment of (or otherwise avoid the obligation to pay) the taxes which have resulted in the requirement that the Issuer pay Additional Amounts.

## **CERTAIN COVENANTS**

For so long as any of the Notes are outstanding and any amount remains unpaid under the Indenture and the Notes, the Issuer will comply with the terms of the covenants described below, among others:

### **Performance of Obligations under the Notes and the Indenture**

The Issuer will pay all amounts owed by it under the terms of the Notes and the Indenture.

### **Maintenance of Approvals**

The Issuer will obtain and maintain in full force and effect all governmental approvals, consents or licenses of any governmental authority under the laws of Hong Kong or any other jurisdiction having jurisdiction over it, its business or the transactions contemplated herein, as well as of any third party under any agreement to which it may be subject, in connection with its execution, delivery and performance of the Notes and the Indenture or validity or enforceability thereof.

### **Maintenance of Office or Agency**

The Issuer will maintain an office or agency in the Borough of Manhattan, New York City, where Notes may be presented for payment or for exchange, transfer or redemption and where notices to and demands upon us in respect of the Indenture and the Notes may be served. Initially this office will be Citibank, N.A., London Branch, and the Issuer will agree not to change the designation of such office without prior notice to the Trustee and designation of a replacement office.

### **Use of Proceeds**

The Issuer will agree to use the proceeds from the offer and sale of the Notes for the partial repayment of the subordinated loan with BOC. See “Use of Proceeds.”

### **Notice of Certain Events**

The Issuer will give notice to the Trustee, promptly and in any event within 10 days after it becomes aware of the occurrence of any Event of Default under the Indenture or event that, with the giving of notice, lapse of time or other conditions, would become an Event of Default.

If the Trustee has actual knowledge of an Event of Default or an event that, with the giving of notice, lapse of time or other conditions, would become an Event of Default, the Trustee will give notice of that event to the Noteholders within 30 days after it is actually known to the Trustee.

The Issuer will provide, within 120 days after the end of each fiscal year, a compliance certificate stating that it has fulfilled its obligations under the Indenture and that no Event of Default or event that, with the giving of notice, lapse of time or other conditions, would become an Event of Default, has occurred during that period or, if one or more have actually occurred, specifying those events and what actions have been taken and will be taken with respect to each such event or events.



## **Further Actions**

The Issuer will, at its own cost and expense, satisfy any condition or take any action at any time required, as necessary or as requested by the Trustee, in accordance with applicable laws and regulations, to be taken in order:

- to enable it lawfully to enter into, exercise its rights and perform and comply with its obligations under the Notes and the Indenture;
- to ensure that its obligations under the Notes and the Indenture are legally binding and enforceable;
- to make the Notes and the Indenture admissible in evidence in the courts of the State of New York;
- to enable each of the Agents to exercise and enforce its rights under and to carry out the terms, provisions and purposes of the Indenture;
- to take any and all actions necessary to preserve the enforceability of, and maintain each of the Agents rights under, the Notes and the Indenture; and
- to assist each Agent, to the extent reasonably practicable, in the Agent's performance of its obligations, including by providing a copy of its most recent annual report and audited accounts in English and, solely (i) upon the occurrence of a Default or an Event of Default or (ii) in the event that the Trustee has reasonable grounds to believe that a Default or an Event of Default has occurred, access to the Issuer's accounts under the Notes and the Indenture, provided that such action will not result in a breach or violation by the Issuer of any applicable laws, regulations or Listing Rules.

## **Appointment to Fill a Vacancy in the Office of the Trustee**

Whenever necessary to avoid or fill a vacancy in the office of the Trustee, we will appoint a successor trustee so that there will at all times be a Trustee with respect to the Notes.

## **Maintenance of Existence**

Subject to the covenant described in “– Consolidation, Merger, Conveyance or Transfer,” we will do all things necessary to preserve and keep in full force and effect our corporate existence and rights; provided, however, that we will not be required to preserve any such right if our Board of Directors determines that the preservation thereof is no longer desirable in the conduct of our business and that the loss thereof is not disadvantageous in any material respect to the Noteholders.

## **Consolidation, Merger, Conveyance or Transfer**

The Issuer will not consolidate with or merge into any other person or convey or transfer substantially all of its properties and assets to any other person unless thereafter:

- the person formed by such consolidation or into which the Issuer is merged, or the person which acquires all or substantially all of the properties and assets of the Issuer, shall be a company organized and existing under the laws of Hong Kong and shall expressly assume the due and punctual payment of the principal of and interest on all the Notes and the performance or observance of every covenant of the Indenture on the Issuer's part to be performed or observed;
- immediately after giving effect to such transaction, no Event of Default or event that, with the giving of notice, lapse of time or other conditions, would become an Event of Default has occurred and is continuing and no covenant or agreement in the Indenture has been materially breached;
- the person formed by such consolidation or into which the Issuer is merged, or the person which acquires all or substantially all of the properties and assets of the Issuer delivers to the Trustee an officers' certificate and an opinion of counsel, each stating that the consolidation, merger,

conveyance or transfer and, if a supplemental indenture is required in connection with the transaction, such supplemental indenture comply with the Indenture and that all conditions precedent in the Indenture relating to the transaction have been complied with; and

- immediately after giving effect to such consolidation, merger, conveyance or transfer, no internationally recognized rating agency has in respect of the Notes, issued any notice downgrading its credit rating for such Notes or indicating that it intends to downgrade its credit rating for such Notes.

## **REDEMPTION**

### **Early Redemption for Tax Reasons**

Subject as described under “– Conditions for Redemption and Purchases,” the Issuer may redeem the Notes in whole, but not in part, at a redemption price equal to 100% of the principal amount thereof, together with accrued interest to the date fixed for redemption, upon giving not less than 30 nor more than 60 days’ notice to the Noteholders, if:

- it has become or will become obligated to pay Additional Amounts as a result of any generally applicable change in the laws or regulations of a Taxing Jurisdiction, or any generally applicable change in the application or official interpretation of those tax laws or regulations, in each case, which occurs after the date of the original issuance of any of the Notes;
- it cannot avoid its obligations to pay such Additional Amounts by taking reasonable measures available to it; and
- the HKMA or any successor thereto has given its prior written consent to such redemption.

No such notice of redemption may be given earlier than 60 days before the earliest date on which we would be obligated to pay Additional Amounts if a payment in respect of the Notes were then due. Prior to the giving of any notice of redemption as described above, we will deliver to the Trustee (1) a certificate stating that we are entitled to redeem the Notes in accordance with the terms in the Indenture and stating the facts relating to the redemption and (2) a written opinion of internationally recognized counsel to the effect that we have become obligated to pay such Additional Amounts as a result of a change or amendment described above, that we cannot avoid payment of such Additional Amounts by taking reasonable measures available to us and that all governmental approvals necessary for us to effect the redemption have been obtained and are in full force and effect or specifying any necessary approvals that have not been obtained.

### **No Other Optional Redemption**

The Notes will not be subject to optional redemption by the Issuer except as provided above under “– Early Redemption for Tax Reasons.”

### **Cancellation**

Any Notes redeemed by the Issuer will be immediately canceled and may not be reissued or resold.

### **Purchases of Notes by the Issuer**

The Issuer and each of its subsidiaries, subject to the prior written consent of the HKMA, may at any time purchase any Notes in the open market or otherwise at any price. In determining whether Noteholders holding any requisite principal amount of Notes have given any request, demand, authorization, direction, notice, consent or waiver under the Indenture, Notes owned by us or our affiliates will be deemed not outstanding for purposes thereof. The Issuer may at any time deliver to the Trustee for cancellation any Notes previously authenticated and delivered pursuant to the Indenture which the Issuer may have acquired in any manner whatsoever.

## **Conditions for Redemption and Purchase**

Notwithstanding any other provision in the Indenture, the Notes (subject as provided above) may not be redeemed (other than at maturity or as described under “– Events of Default; Limited Right of Acceleration”) or purchased by the Issuer or any of its subsidiaries without the prior written consent of the HKMA, provided, however, that if from time to time the consent of the HKMA is not a requirement of any such Notes to constitute Category II Supplementary Capital (or equivalent) of the Issuer for the purposes of, and as defined in, the Banking Ordinance (Chapter 155 of the Laws of Hong Kong), or any successor legislation, then the prior written consent of the HKMA is not so required. Accordingly, the Issuer shall not redeem any of the Notes (other than at maturity or as described under “– Events of Default; Limited Right of Acceleration”) and neither the Issuer nor any of its subsidiaries shall purchase any of the Notes unless the prior written consent of the HKMA thereto shall have been obtained. For the avoidance of doubt, this provision shall not apply to the Issuer or any of its subsidiaries holding the Notes in a purely nominee capacity.

## **EVENTS OF DEFAULT; LIMITED RIGHT OF ACCELERATION**

If default is made in the payment of principal or interest due in respect of the Notes or any of them and the default continues for a period of five business days in Hong Kong (in the case of principal) or 10 business days in Hong Kong (in the case of interest), then the Trustee, at its sole and absolute discretion may and with the consent of the Noteholders holding at least one-quarter in aggregate principal amount of the Notes then outstanding shall, subject in each case to being indemnified to its satisfaction, after giving the Issuer five days’ notice, institute proceedings for the winding-up of the Issuer in Hong Kong, but may take no further action in respect of such default (but without prejudice to the limited right of acceleration described below).

If any Subordination Event shall occur and be continuing, then the Trustee, at its sole and absolute discretion may and with the consent of the Noteholders holding at least one-quarter in aggregate principal amount of the notes then outstanding shall, subject in each case to being indemnified to its satisfaction, by written notice to us, declare the Notes to be forthwith due and repayable whereupon the same shall become forthwith due and repayable at their principal amount, together with accrued but unpaid interest (if any), as provided in the Indenture. Immediately upon delivery of such notice, the principal of and all interest accrued on the Notes shall become due and payable, subject to the subordination conditions described under “– Ranking and Subordination” above.

Neither the Trustee nor any Noteholder shall have any right to accelerate the repayment of any Notes upon a default in the payment of principal of or interest on the Notes or on the non-performance of any covenant of the Issuer in relation to the Notes or upon the happening of any other event in relation to the Notes other than a Subordination Event.

## **MODIFICATION OF THE INDENTURE**

The Issuer and the Trustee may, without the consent of the Noteholders, modify the Indenture for certain specific purposes, including, among other things, providing for the issuance of additional Notes as described under “– Additional Notes,” curing ambiguities, defects or inconsistencies or including any other provisions with respect to matters or questions arising under the Indenture, so long as that correction or added provision will not adversely affect the interests of the Noteholders in any material respect.

In addition, the Indenture may be modified by the Issuer and the Trustee with the consent of the holders of a majority in aggregate principal amount of the Notes then outstanding. However, no modification may, without the consent of the Noteholder of each outstanding Note affected thereby:

- change the maturity of any payment of principal of or any installment of interest on any Note;
- reduce the principal amount or the rate of interest, or change the method of computing the amount of principal or interest payable on any date;
- change any place of payment where the principal of or interest on Notes are payable;
- change the coin or currency in which the principal of or interest on the Notes are payable;
- impair the right of the Noteholders to institute suit for the enforcement of any payment on or after the date due;
- modify the subordination provisions of the Indenture in a manner adverse to the Noteholders;
- reduce the percentage in principal amount of the outstanding Notes, the consent of whose holders is required for any modification of or waiver of compliance with any provision of the Indenture or defaults under the Indenture and their consequences; or
- modify the provisions summarized in this paragraph or the provisions of the Indenture regarding waivers of past defaults, except to increase any percentage or to provide that other provisions of the Indenture cannot be modified or waived without the consent of each Noteholder affected thereby.

After an amendment described in the preceding paragraph, the Issuer is required to provide to the Noteholders a notice briefly describing the amendment. However, the failure to give that notice to all the Noteholders, or any defect in the notice, will not affect the validity of the amendment.

A meeting of the Noteholders may be called by the Trustee at any time. The Issuer or the holders of at least 10% in aggregate principal amount of the outstanding Notes may call a meeting if the Issuer or they have requested the Trustee in writing to call such a meeting and the Trustee has not given notice of such a meeting within 20 days of receiving the request. Notices of meetings must include the time and place of the meeting and a general description of the action proposed to be taken at the meeting and must be given not less than 30 days nor more than 60 days before the date of the meeting, except that notices of meetings reconvened after adjournment must be given not less than 10 days nor more than 60 days before the date of the meeting. As further described in the Indenture, at any meeting, the presence of Noteholders holding Notes in an aggregate principal amount sufficient to take the action for which the meeting was called will constitute a quorum. Any modifications to or waivers of the Indenture or the Notes will be conclusive and binding on all holders of Notes, whether or not they have given their consent (unless required under the Indenture) or were present at any duly held meeting.

Notes owned by the Issuer or its affiliates will not be considered outstanding for the purpose of determining whether the requisite aggregate principal amount of Notes has concurred in any request, demand, notice, consent or waiver under the Indenture.

It is not necessary for the Noteholders to approve the particular form of any proposed modification of the Indenture, but it is sufficient if that consent approves the substance of the proposed modification.

## **SATISFACTION AND DISCHARGE**

The Notes will be deemed to be paid for all purposes under the Indenture, and the Issuer's indebtedness under the Notes will be deemed to have been satisfied and discharged, if the following conditions are met, among others:

- either the Issuer has given a notice of redemption and all other conditions to redemption have been met or the Notes have otherwise become due and payable;
- the Issuer has irrevocably deposited money in trust with the Trustee that will be sufficient to pay when due all the principal of and interest on the Notes to maturity or redemption;
- no Event of Default or event that, with the giving of notice, lapse of time or other conditions, would become an Event of Default has occurred and is continuing on the date of the deposit, and the deposit will not breach any other instrument to which the Issuer is a party or by which the Issuer is bound; and
- the Trustee has received an opinion of counsel to the effect that the satisfaction and discharge of the Issuer's indebtedness under the Notes will not be deemed to be a taxable event for the Noteholders for United States income tax purposes, unless the Trustee has received documentary evidence that each Noteholder is either not subject to or is exempt from United States income taxation.

The Indenture will cease to be of further effect when:

- either (1) all the Notes have been delivered to the Trustee for cancellation (other than destroyed, lost or stolen Notes that have been replaced or paid in accordance with the Indenture, Notes that are deemed to have been paid as described in the preceding paragraph and Notes for whose payment money has been deposited in trust or held in trust by the Issuer and has thereafter been returned to the Issuer as described in the penultimate paragraph under “– Payments of Principal and Interest”) or (2) all Notes that have not been delivered to the Trustee for cancellation have been deemed to have been paid as described in the preceding paragraph;
- all other amounts due and payable under the Indenture have been paid; and
- the Issuer has delivered to the Trustee a certificate and an opinion of counsel stating that the conditions to satisfaction and discharge of the Indenture have been complied with.

Notwithstanding the satisfaction and discharge of the Notes and/or the Indenture, the Issuer's obligations under specified provisions of the Indenture relating to the transfer and exchange of Notes, payment of Additional Amounts, maintenance of a paying agent and a note registrar and certain other matters specified in the Indenture will survive.

## **REPLACEMENT OF NOTES**

If any Note becomes mutilated, destroyed, lost or stolen, the Issuer will execute and, upon the Issuer's request, the Trustee will authenticate and deliver a new Note of like tenor, interest rate and principal amount in exchange and substitution for that Note, so long as the Noteholder delivers to the Issuer, the note registrar and the Trustee satisfactory evidence of its ownership and of the destruction, loss or theft of the Note and provides such security or indemnity as they may require to hold them harmless. However, if a mutilated, destroyed, lost or stolen Note has become or is about to become due and payable, the Issuer may pay the outstanding amounts due under the Note instead of issuing a new Note. Mutilated or defaced Notes must be surrendered before replacements will be issued. The Issuer may require that the Noteholder pay any taxes or other expenses in connection with the replacement of the Note.

## **THE TRUSTEE**

Citicorp International Limited is the Trustee and Citibank N.A., London Branch has been appointed by the Issuer as note registrar and a paying agent under the Indenture with respect to the Notes. The Issuer may have normal banking relationships with Citicorp International Limited or its affiliates in the ordinary course of business. The address of the Trustee is 39th floor, ICBC Tower, Citibank Plaza, 3 Garden Road, Central, Hong Kong.

The Indenture contains provisions for the indemnification of the Trustee and for its relief from responsibility. The obligations of the Trustee to any Noteholder are subject to the immunities and rights set forth in the Indenture.

The Issuer and its affiliates may from time to time enter into normal banking and trustee relationships with the Trustee and its affiliates.

The Trustee and its affiliates may hold Notes in their own names.

## **PAYING AGENTS; TRANSFER AGENTS; REGISTRAR**

The Issuer has initially appointed Citibank N.A., London Branch as paying agent and note registrar. The note register, which provides for the registration of Notes and for the registration of transfers and exchanges of Notes, will be maintained in Hong Kong. The address of both the paying agent and note registrar is 21st Floor, Citigroup Centre, Canada Square, Canary Wharf London E14 5LB, United Kingdom. The Issuer may at any time appoint other paying agents, transfer agents and note registrars. However, the Issuer will at all times maintain a paying agent in New York City until the Notes are paid.

## **NOTICES**

Whenever the Indenture requires notice to the Noteholders, such notice will be given by the Trustee by (unless the Indenture specifies otherwise):

- first class mail, postage prepaid, to the address of each Noteholder as it appears in the note register; and
- publication in English on a business day in a leading newspaper having general circulation in the Borough of Manhattan, New York City.

Notice will be deemed to have been validly given on the date of mailing or publication, as the case may be.

## **GOVERNING LAW**

The Indenture and the Notes are governed by the laws of the State of New York (other than the provisions of the Indenture and the Notes relating to subordination, which shall be governed by Hong Kong law).

## **JURISDICTION**

The Issuer has consented to the non-exclusive jurisdiction of any court of the State of New York or any U.S. federal court sitting in the Borough of Manhattan, New York City, and any appellate court from any of those courts. Service of process in any such action or proceeding may be served upon us at CT Corporation. The Notes and the Indenture provide that, if CT Corporation no longer maintains an office in New York City, then the Issuer will appoint a new process agent in New York City.

## **CURRENCY RATE INDEMNITY**

U.S. dollars is the sole currency of account for the Notes and payment for all sums payable by the Issuer under the Notes, including damages. Any amount received or recovered in a currency other than U.S. dollars (whether as a result of, or of the enforcement of, a judgment or order of a court of any jurisdiction, in the Issuer's winding-up or dissolution or otherwise) by a Noteholder with respect to any amount due to it under the Notes will constitute a discharge to the Issuer only to the extent of the amount in U.S. dollars that the Noteholder is able to purchase with the amount it receives or recovers (or if it is not practicable to make a purchase of U.S. dollars on that date, on the first date on which it is practicable to do so). If the amount in U.S. dollars is less than the amount expressed to be due to the Noteholder, the Issuer will indemnify the Noteholder against any loss sustained as a result. In any event, the Issuer will indemnify the Noteholder against the cost of any such purchase.

For the purposes of the preceding paragraph, it will be sufficient for the Noteholder to certify in a satisfactory manner (indicating sources of information used) that it would have suffered a loss had it made an actual purchase of U.S. dollars with the amount it received or recovered in the other currency on the date it received or recovered that amount (or, if a purchase of U.S. dollars on that date had not been practicable, on the first date on which it would have been practicable, so long as the Noteholder certifies the need for the change of date).

These indemnities are a separate and independent obligation from the Issuer's other obligations, will give rise to a separate and independent cause of action, will apply regardless of any waiver or extension granted by the Noteholder and will continue in full force and effect in spite of any other judgment or order or the filing of any proof of claim in the winding-up of our company for a liquidated sum.



## FORM, DENOMINATION AND TRANSFER

The Notes will initially be represented by two or more Notes in global form that together will represent the aggregate principal amount of the Notes. Notes sold in reliance on Rule 144A under the Securities Act will be represented by global notes (the “**Rule 144A Global Notes**”). When issued, the Rule 144A Global Notes will be deposited with Citibank, N.A., London Branch, as custodian for DTC, and registered in the name of Cede & Co., as DTC’s nominee. Notes sold to non-U.S. persons in reliance on Regulation S will be represented by global notes (the “**Regulation S Global Notes**” and, together with the Rule 144A Global Notes, the “**Global Notes**”). When issued, the Regulation S Global Notes will be deposited with Citibank, N.A., London Branch, as custodian for DTC, and registered in the name of Cede & Co., as DTC’s nominee, for credit to Euroclear and Clearstream.

The Notes will be issued only in registered form and in minimum denominations of US\$100,000 and integral multiples of US\$1,000. The Notes will be issued on their Issue Date only against payment in immediately available funds.

Investors who are “qualified institutional buyers” (as defined in Rule 144A under the Securities Act) and who purchase Notes in reliance on Rule 144A under the Securities Act and investors who hold beneficial interests in the Regulation S Global Notes may hold their interests in the Rule 144A Global Notes and the Regulation S Global Notes, respectively, directly through DTC if they are DTC participants (the “**Participants**”) or indirectly through organizations that are DTC participants (“**Indirect Participants**”).

Regulation S prohibits purchasers of the Notes under Regulation S from offering, selling or delivering the Notes within the United States or to or for the account or benefit of U.S. persons until the expiration of the period ending 40 days after the later of the commencement of the offering of the Notes and the date the Notes were originally issued (the “**Distribution Compliance Period**”). Beneficial interests in the Rule 144A Global Notes may not be exchanged for beneficial interests in the Regulation S Global Notes at any time except in the circumstances described below. See “– Exchanges between the Global Notes.” In addition, transfers of beneficial interests in the Global Notes will be subject to the applicable rules and procedures of DTC and its Participants, which may change from time to time.

So long as Cede & Co., as the nominee of DTC, is the registered owner of a Global Note, Cede & Co. for all purposes will be considered the sole holder of the Global Note. Owners of beneficial interests in a Global Note will be entitled to have certificates registered in their names and to receive physical delivery of Notes only in the limited circumstances described below under “– Exchange of Global Notes for Definitive Notes.”

## DEPOSITORY PROCEDURES

The following description of the operations and procedures of DTC, Euroclear and Clearstream is provided solely as a matter of convenience. These operations and procedures are solely within the control of the respective settlement systems and are subject to changes by them from time to time. We do not take any responsibility for these operations and procedures and urge investors to contact the settlement systems or their participants directly to discuss these matters.

Upon deposit of the Global Notes, DTC will credit the accounts of Participants designated by the joint lead managers and bookrunners with portions of the principal amount of the Global Notes.

Payment of principal and other amounts, if any, on the Global Notes will be made to Cede & Co., the nominee for DTC, as registered owner of the Global Note, by wire transfer of immediately available funds on the applicable payment date. Neither we nor the Trustee, or any paying agent, or any agent of any of them, will have any responsibility or liability for any aspect of the records relating to or payments made on account of beneficial ownership interests in the Global Notes or for maintaining, supervising or reviewing any records relating to such beneficial ownership interest.

We have been informed by DTC that, with respect to any payment of principal, or premium, interest or other amounts, if any, on a Global Note, DTC's practice is to credit Participants' accounts on the applicable payment date, with payments in amounts proportionate to their respective beneficial interests in the Notes represented by the Global Notes as shown on the records of DTC, unless DTC has reason to believe that it will not receive payment on such payment date. Payments by Participants to owners of beneficial interests in the Notes represented by the Global Notes held through such Participants will be the responsibility of such Participants, as is now the case with securities held for the accounts of customers registered in "street name." In particular, payments to owners of beneficial interests in the Notes held through Euroclear and Clearstream will be made in accordance with the rules and operating procedures of Euroclear and Clearstream.

Transfers between Participants will be effected in the ordinary way in accordance with DTC's rules and will be settled in immediately available funds. Participants in Euroclear and Clearstream will effect transfers with other participants in the ordinary way in accordance with the rules and operating procedures of Euroclear and Clearstream, as applicable. The laws of some states require that certain persons take physical delivery in definitive form of securities that they own. Consequently, the ability to transfer beneficial interests in the Global Notes to such persons will be limited to that extent. Because DTC can act only on behalf of Participants, which in turn act on behalf of Indirect Participants and certain banks, the ability of a person having beneficial interests in the Global Notes to pledge such interests to persons or entities that do not participate in the DTC system, or otherwise take actions in respect of such interests, may be affected by the lack of a physical certificate evidencing such interests.

Subject to compliance with the transfer restrictions applicable to the Notes described in "Transfer Restrictions," cross-market transfers between Participants, on the one hand, and directly or indirectly through Euroclear or Clearstream participants, on the other, will be effected in DTC in accordance with DTC rules on behalf of Euroclear or Clearstream, as the case may be, by its respective depositary; however, these cross market transactions will require delivery of instructions to Euroclear or Clearstream, as the case may be, by the counterparty in the system in accordance with its rules and procedures and within its established deadlines (Brussels time). Euroclear or Clearstream, as the case may be, will, if the transaction meets its settlement requirements, deliver instructions to its depositary to take action to effect final settlement on its behalf by delivering or receiving interests in the relevant Global Note in DTC, and making or receiving payment in accordance with normal procedures for same day funds settlement applicable to DTC. Euroclear participants and Clearstream participants may not deliver instructions directly to the depositaries for Euroclear or Clearstream.

Neither we, the Trustee nor any Paying Agent, or any agent of any of them, will have responsibility for the performance of DTC, Euroclear, Clearstream or their respective participants of their respective obligations under the rules and procedures governing their operations. DTC has advised us that it will take any action permitted to be taken by a holder of the Notes (including, without limitation, the presentation of the Notes for exchange as described below) only at the direction of one or more Participants to whose accounts with DTC interests in a Global Note are credited, and only in respect of the Notes represented by the Global Note as to which such Participant or Participants has or have given such direction. However, if there are certain Events of Default under the Notes or any of the Notes has become immediately due and payable in accordance with the terms of the Indenture, DTC reserves the right to exchange the Global Notes for Notes in definitive form, which it will distribute to its Participants.

DTC has also advised us that DTC is a limited purpose trust company organized under the laws of the State of New York, a "**banking organization**" within the meaning of the New York Banking Law, a member of the U.S. Federal Reserve System, a "**clearing corporation**" within the meaning of the New York Uniform Commercial Code and a "**clearing agency**" registered pursuant to the provisions of Section 17A of the U.S. Exchange Act. DTC was created to hold securities for its Participants and to facilitate the clearance and settlement of securities transactions amongst its Participants through electronic book entry charges to

accounts of its Participants, thereby eliminating the need for physical movement of securities certificates. Participants include securities brokers and dealers, banks, trust companies and clearing corporations and may include certain other organizations such as the Initial Purchasers. Certain of such Participants (or their representatives), together with other entities, own DTC. Indirect access to the DTC system is available to others such as banks, brokers, dealers and trust companies that clear through, or maintain a custodial relationship with, a Participant, either directly or indirectly.

Euroclear and Clearstream have also advised us that Euroclear and Clearstream hold securities for participant organizations and facilitate the clearance and settlement of securities transactions between their respective participants through electronic book entry charges in accounts of such participants. Euroclear and Clearstream provide to their participants, among other things, services for safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Euroclear and Clearstream participants are financial institutions such as underwriters, securities brokers and dealers, banks, trust companies and certain other organizations. Indirect access to Euroclear or Clearstream is also available to others such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a Euroclear or Clearstream participant, either directly or indirectly.

Although we expect that DTC, Euroclear and Clearstream will agree to the foregoing procedures in order to facilitate transfers of interests in the Global Notes among their respective participants, DTC, Euroclear and Clearstream are under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time.

#### **EXCHANGE OF GLOBAL NOTES FOR DEFINITIVE NOTES**

The Global Notes are exchangeable for Definitive Notes if:

- (a) DTC notifies us in writing that it is unwilling or unable to continue as depositary for the Global Notes or has ceased to be a clearing agency registered under the Exchange Act and, in either case, we thereupon fail to appoint a successor depositary within 120 days after the date of such notice;
- (b) DTC so requests following notification of an Event of Default under the Notes or that any of the Notes has become immediately due and payable in accordance with the terms of the Indenture;
- (c) we, at our option, notify the Trustee in writing that we elect to exchange in whole but not in part, the Global Note for Definitive Notes; or
- (d) the owner of an interest in a Global Note requests such exchange in writing delivered through either DTC, Euroclear or Clearstream upon notification that any of the Notes has become immediately due and payable in accordance with the terms of the Indenture.

In all cases, Definitive Notes delivered in exchange for any Global Note or beneficial interests therein will be registered in the names, and issued in any approved denominations, requested by or on behalf of DTC (in accordance with its customary procedures), unless we determine otherwise in compliance with the requirements of the Indenture.

#### **TRANSFER OF DEFINITIVE NOTES FOR DEFINITIVE NOTES**

If issued, Definitive Notes may be transferred by presenting or surrendering such Definitive Notes at the office of the Trustee located in New York, New York with a written instrument of transfer in form satisfactory to the Trustee, duly executed by the holder of the Definitive Notes or by its attorney, duly authorized in writing.

## **EXCHANGES BETWEEN THE GLOBAL NOTES**

Until the expiration of the Distribution Compliance Period, beneficial interests in any of the Regulation S Global Notes may be exchanged for beneficial interests in the corresponding Rule 144A Global Notes only if such exchange occurs in connection with a transfer of the Notes pursuant to Rule 144A and the transferor first delivers to the Trustee a written certificate (in the form provided in the Indenture) to the effect that the Notes are being transferred to a person who the transferor reasonably believes to be a qualified institutional buyer within the meaning of Rule 144A, purchasing for its own account or the account of a qualified institutional buyer in a transaction meeting the requirements of Rule 144A and in accordance with all applicable securities laws of the United States and other jurisdictions. This certification requirement will not apply after the expiration of the Distribution Compliance Period.

Beneficial interests in any of the Rule 144A Global Notes may be transferred to a person who takes delivery in the form of an interest in one of the corresponding Regulation S Global Note, whether before or after the expiration of the Distribution Compliance Period, only if the transferor first delivers to the Trustee a written certificate (in the form provided in the Indenture) to the effect that such transfer is being made in accordance with Rule 903 or 904 of Regulation S and that, if such transfer is made to a person who takes delivery during the Distribution Compliance Period, the interest transferred will be held immediately thereafter through Euroclear or Clearstream.

Transfers involving an exchange of a beneficial interest in one of the Global Notes for a beneficial interest in another Global Note will be effected in DTC by means of an instruction originated by the Trustee through the DTC Deposit/Withdraw at Custodian system. Accordingly, in connection with any such transfer, appropriate adjustments will be made to reflect a decrease in the principal amount of the Global Note representing the beneficial interest that is transferred and a corresponding increase in the principal amount of the other Global Note. Any beneficial interest in one of the Global Notes that is transferred to a person who takes delivery in the form of an interest in the other Global Note will, upon transfer, cease to be an interest in such Global Note and will become an interest in the other Global Note and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to beneficial interests in such other Global Note for so long as it remains such an interest.

## **SAME DAY SETTLEMENT AND PAYMENT**

The Notes represented by the Global Notes will be eligible to trade in DTC's Same Day Funds Settlement System, and any permitted secondary market trading activity in such Notes will, therefore, be required by DTC to be settled in immediately available funds. We expect that secondary trading in any Definitive Notes would also be settled in immediately available funds.

Because of time zone differences, the securities account of a Euroclear or Clearstream participant purchasing an interest in a Global Note from a Participant will be credited, and any such crediting will be reported to the relevant Euroclear or Clearstream participant, during the securities settlement processing day (which must be a business day for Euroclear and Clearstream) immediately following the settlement date of DTC.

DTC has advised us that cash received in Euroclear or Clearstream as a result of sales of interests in a Global Note by or through a Euroclear or Clearstream participant to a Participant will be received with value on the settlement date of DTC but will be available in the relevant Euroclear or Clearstream cash account only as of the business day for Euroclear or Clearstream following DTC's settlement date.

## **TAXATION**

The following summary of certain Hong Kong, EU and U.S. Federal income tax consequences of the purchase, ownership and disposition of the Notes is based upon laws, regulations, rulings and decisions now in effect, all of which are subject to change (possibly with retroactive effect). The summary does not purport to be a comprehensive description of all the tax considerations that may be relevant to a decision to purchase, own or dispose of the Notes and does not purport to deal with the consequences applicable to all categories of investors, some of which may be subject to special rules. Persons considering the purchase of the Notes should consult their own tax advisors concerning the application of Hong Kong, EU and U.S. Federal income tax laws to their particular situations as well as any consequences of the purchase, ownership and disposition of the Notes arising under the laws of any other taxing jurisdiction.

### **HONG KONG TAXATION**

#### **Withholding Tax**

No withholding tax is payable in Hong Kong in respect of payments of principal or interest on the Notes or in respect of any capital gains arising from the sale of the Notes.

#### **Profits Tax**

Subject to the provisions of the Inland Revenue Ordinance (Cap.112) of Hong Kong (the “**IRO**”), Hong Kong profits tax is charged each year of assessment at the standard rate on every person (including a corporation, partnership, trustee, whether incorporated or unincorporated, or body of persons) carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong from such trade, profession or business (excluding profits arising from the sale of capital assets).

For the purpose of the IRO, interest on the Notes shall be deemed to be receipt arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong in the following circumstances (which are not exhaustive):

- (i) interest on the Notes is received by or accrued to a corporation carrying on a trade, profession or business in Hong Kong by way of interest derived from Hong Kong;
- (ii) interest on the Notes is received by or accrued to a person, other than a corporation, carrying on a trade, profession or business in Hong Kong by way of interest derived from Hong Kong which interest is in respect of the funds of that trade, profession or business;
- (iii) interest on the Notes is received by or accrues to a financial institution by way of interest which arises through or from the carrying on by the financial institution of its business in Hong Kong, notwithstanding that the moneys in respect of which the interest is received or accrues are made available outside Hong Kong.

Pursuant to the Exemption from Profits Tax (Interest Income) Order, interest income derived by a person other than a financial institution from any deposits (denominated in any currency and whether or not the deposit is evidenced by a certificate of deposit) placed with an authorized institution in Hong Kong (within the meaning of section 2 of the Banking Ordinance (Cap. 155) of Hong Kong) is exempt from the payment of Hong Kong profits tax. This exemption does not apply, however, to any deposits which is used to secure or guarantee a loan of money where the condition under section 16(2)(c), (d) or (e) of the IRO is satisfied.

Sums received by or accrued to a financial institution by way of gains or profits arising through or from the carrying on by the financial institution of its business in Hong Kong from the sale, disposal and redemption of the Notes will be subject to profits tax.

Sums derived from the sale, disposal or redemption of the Notes will be subject to Hong Kong profits tax where received by or accrued to a person, other than a financial institution, who carries on a trade, profession or business in Hong Kong and the sum which has a Hong Kong source is derived in carrying on of the trade, profession or business in Hong Kong. However, where the sum is considered to be profits arising from the sale of capital assets of the investor, such profits will not be subject to Hong Kong profits tax.

### **Stamp Duty**

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

### **EU Savings Directive**

Under EC Council Directive 2003/48/EC on the taxation of savings income, each Member State is required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in that other Member State; however, for a transitional period, Austria, Belgium and Luxembourg may instead apply a withholding system in relation to such payments, deducting tax at rates rising over time to 35%. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to the exchange of information relating to such payments. Belgium has replaced this withholding tax with a regime of exchange of information to the Member State of residence as from January 1, 2010.

A number of non-EU countries, and certain dependent or associated territories of certain Member States, have adopted similar measures (either provision of information or transitional withholding) in relation to payments made by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in a Member State. In addition, the Member States have entered into provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident or certain limited types of entity established in one of those territories.

On November 13, 2008 the European Commission published a proposal for amendments to the Directive, which included a number of suggested changes which, if implemented, would broaden the scope of the requirements described above. The European Parliament approved an amended version of this proposal on April 24, 2009. Investors who are in any doubt as to their position should consult their professional advisors.

## **UNITED STATES TAXATION**

### **U.S. Federal Income Tax Considerations**

**The discussion of U.S. tax matters set forth in this Offering Memorandum was written in connection with the promotion or marketing of this offering and was not intended or written to be used, and cannot be used, by any taxpayer for the purpose of avoiding tax-related penalties under U.S. federal, state or local tax law. Each taxpayer should seek advice based on its particular circumstances from an independent tax advisor.**

The following summary describes certain material U.S. federal income tax consequences of the acquisition, ownership and disposition of a Note by a U.S. Holder (as defined below) whose functional currency is the U.S. dollar, that acquires the Notes in this offering from the initial purchasers at a price equal to the issue price of the Notes (the first price at which a substantial amount of the Notes is sold for money to investors) and holds it as a capital asset. This summary does not address all aspects of U.S. federal income taxation that may be applicable to particular U.S. Holders subject to special U.S. federal



income tax rules, including, among others, tax-exempt organizations, financial institutions, dealers and traders in securities or currencies, U.S. Holders that will hold a Note as part of a “straddle,” hedging transaction, “conversion transaction” or other integrated transaction for U.S. federal income tax purposes, U.S. Holders that enter into “constructive sale” transactions with respect to the Notes, U.S. Holders that own (directly or through attribution) 10% or more of the stock, by vote or value, of the issuer or the guarantors, U.S. Holders liable for alternative minimum tax and certain U.S. expatriates. In addition this summary does not address consequences to U.S. Holders of the acquisition, ownership and disposition of a Note under any other U.S. federal tax laws (e.g., estate or gift tax laws) or under the tax laws of any state, locality or other political subdivision of the United States or other countries or jurisdictions.

The discussion below is based on the Internal Revenue Code of 1986, as amended (the “**Code**”), U.S. Treasury regulations thereunder, and judicial and administrative interpretations thereof, all as in effect as of the date of this Offering Memorandum and any of which may at any time be repealed, revoked or modified or subject to differing interpretations, potentially retroactively, so as to result in U.S. federal income tax consequences different from those discussed below. In addition, there can be no assurances that the U.S. Internal Revenue Service (the “**IRS**”) would not assert, or that a U.S. court would not uphold, positions concerning the U.S. federal income tax consequences of a U.S. Holder’s acquisition, ownership or disposition of a Note that are contrary to the discussion below.

As used herein, the term “U.S. Holder” means a beneficial owner of a Note that is for U.S. federal income tax purposes: (i) an individual who is a citizen or resident of the United States; (ii) a corporation or other entity treated as a corporation for U.S. federal income tax purposes created or organized in or under the laws of the United States or any political subdivision thereof or therein; (iii) an estate, the income of which is subject to U.S. federal income taxation regardless of its source; or (iv) a trust if a court within the United States is able to exercise primary jurisdiction over the administration of the trust and one or more U.S. persons have authority to control all substantial decisions of the trust.

If an entity or arrangement treated as a partnership for U.S. federal income tax purposes holds a Note, the U.S. federal income tax treatment of a partner will generally depend upon the status of the partner and the activities of the partnership. Therefore, a partnership holding a Note and its partners should consult their own tax advisors regarding the U.S. federal income tax consequences of the acquisition, ownership and disposition of a Note.

Prospective purchasers should consult their own tax advisers as to the particular tax considerations for them relating to the purchase, ownership and disposition of the Notes, including the applicability of any U.S. federal, state, or local tax laws, or non-U.S. tax laws, any changes in applicable tax laws, and any pending or proposed legislation or regulations.

### ***Taxation of interest***

In general, interest paid or payable on a Note will be taxable to a U.S. Holder as ordinary interest income as received or accrued, in accordance with the U.S. Holder’s method of accounting for U.S. federal income tax purposes and generally will be treated as non-U.S. source income.

### ***Sale, exchange, redemption, retirement at maturity or other taxable disposition of the Notes***

Upon the sale, exchange, redemption, retirement at maturity or other taxable disposition of a Note, a U.S. Holder generally will recognize taxable gain or loss equal to the difference between the amount realized (i.e., the amount of cash and the fair market value of any property received) on the disposition (except to the extent the cash or property received is attributable to accrued and unpaid interest, which is treated like a payment of interest) and the U.S. Holder’s tax basis in the Note. A U.S. Holder’s tax basis in a Note generally will equal the amount paid for the Note.



Any gain or loss that a U.S. Holder recognizes upon the sale, exchange, redemption, retirement or other disposition of a Note generally will be U.S. source capital gain or loss and will be long term capital gain or loss if, at the time of the disposition, the U.S. Holder's holding period for the Note is more than one year. The tax-rate for long-term capital gains of non-corporate taxpayers is scheduled to increase for taxable years beginning on or after January 1, 2011. The deductibility of capital losses by corporate and non-corporate U.S. Holders is subject to limitations.

***Backup withholding***

Information returns may be filed with the IRS in connection with payments of principal and interest in respect of, and the proceeds from certain sales of, Notes held by a U.S. Holder unless the U.S. Holder establishes that it is exempt from the information reporting rules, for example by properly establishing that it is a corporation. If a U.S. Holder does not establish that it is exempt from these rules, the U.S. Holder may be subject to backup withholding on these payments if it fails to provide its taxpayer identification number or otherwise comply with the backup withholding rules. The amount of any backup withholding from a payment to a U.S. Holder will be allowed as a credit against the U.S. Holder's U.S. federal income tax liability and may entitle the U.S. Holder to a refund, provided that the required information is timely furnished to the IRS.

## ERISA AND CERTAIN OTHER U.S. CONSIDERATIONS

The U.S. Employee Retirement Income Security Act of 1974, as amended (“**ERISA**”), imposes certain requirements on “employee benefit plans” (as defined in Section 3(3) of ERISA) subject to ERISA, including entities such as collective investment funds and separate accounts whose underlying assets include the assets of such plans (collectively, “**ERISA Plans**”) and on those persons who are fiduciaries with respect to ERISA Plans.

In considering an investment in the Notes of a portion of the assets of any Plan (as defined below), a fiduciary should determine whether the investment is in accordance with the documents and instruments governing the Plan and the applicable provisions of ERISA, the Code or any Similar Law (as defined below) relating to a fiduciary’s duties to the Plan including, without limitation, the prudence, diversification, delegation of control and prohibited transaction provisions of ERISA, the Code and any other applicable Similar Laws.

Section 406 of ERISA and Section 4975 of the U.S. Internal Revenue Code of 1986, as amended (the “**Code**”), which are among the ERISA and Code fiduciary provisions governing plans, prohibit certain transactions involving the assets of an ERISA Plan (as well as those plans that are not subject to ERISA but which are subject to Section 4975 of the Code, such as individual retirement accounts (together with ERISA Plans, “**Plans**”)) and certain persons (referred to as “**parties in interest**” or “**disqualified persons**”) having certain relationships to such Plans, unless a statutory or administrative exemption is applicable to the transaction. Prohibited transactions within the meaning of Section 406 of ERISA or Section 4975 of the Code may arise if any Notes are acquired by a Plan with respect to which any of the Issuer, the Group, or the BOCHK Holdings Group or any of their respective affiliates are a party in interest or a disqualified person. Certain exemptions from the prohibited transaction provisions of Section 406 of ERISA and Section 4975 of the Code may be applicable, however, depending in part on the type of Plan fiduciary making the decision to acquire Notes and the circumstances under which such decision is made. There can be no assurance that any exemption will be available with respect to any particular transaction involving the Notes, or that, if an exemption is available, it will cover all aspects of any particular transaction. No assurance is given regarding whether the purchase or holding of any Notes would be considered to involve an extension of credit to the Issuer for purposes of ERISA or Section 4975 of the Code. By its purchase of any Notes, whether in the case of the initial purchase or in the case of a subsequent transfer, the purchaser thereof will be deemed to have represented and agreed either that (i) it is not and for so long as it holds a Note (or any interest therein) will not be an ERISA Plan or other Plan, an entity whose underlying assets include the assets of any such ERISA Plan or other Plan, or a governmental or other employee benefit plan which is subject to any U.S. federal, state or local law, that is substantially similar to the provisions of Section 406 of ERISA or Section 4975 of the Code (“**Similar Law**”), or (ii) its purchase and holding of the Notes will not result in a prohibited transaction under Section 406 of ERISA or Section 4975 of the Code (or, in the case of such a governmental or other employee benefit plan, any such Similar Law) for which an exemption is not available.

Governmental plans and certain church and other U.S. plans, while not subject to the fiduciary responsibility provisions of ERISA or the provisions of Section 4975 of the Code, may nevertheless be subject to state or other federal laws that are substantially similar to ERISA and the Code. Fiduciaries of any such plans should consult with their counsel before purchasing any Notes.

The foregoing discussion is general in nature and not intended to be all-inclusive. Any Plan fiduciary who proposes to cause a Plan to purchase any Notes should consult with its counsel regarding the applicability of the fiduciary responsibility and prohibited transaction provisions of ERISA and Section 4975 of the Code to such an investment, and to confirm that such investment will not constitute or result in a prohibited transaction or any other violation of an applicable requirement of ERISA.

The sale of Notes to a Plan is in no respect a representation by the Issuer, the Group, or the BOCHK Holdings Group that such an investment meets all relevant requirements with respect to investments by Plans generally or any particular Plan, or that such an investment is appropriate for Plans generally or any particular Plan.

## PLAN OF DISTRIBUTION

### PLAN OF DISTRIBUTION

Subject to the terms and conditions of a purchase agreement dated February 4, 2010 (the “**Purchase Agreement**”) entered into among the Initial Purchasers and us, we have agreed to sell to the Initial Purchasers and the Initial Purchasers have severally and not jointly agreed with us to purchase the principal amount of Notes set forth opposite their names in the following table.

Initial purchasers	Notes
BOCI Asia Limited. . . . .	US\$533,333,000
Deutsche Bank Securities Inc. . . . .	US\$533,334,000
UBS AG . . . . .	US\$533,333,000
Total . . . . .	<u>US\$1,600,000,000</u>

We have agreed to indemnify the Initial Purchasers against certain liabilities, including, *inter alia*, liabilities under the Securities Act, and to make contributions in respect thereof.

The Initial Purchasers are offering the Notes in accordance with the terms of the Purchase Agreement and subject to certain conditions contained in the Purchase Agreement, including, *inter alia*, the receipt by the Initial Purchasers of documentation related to the issuance and sale of the Notes, officer’s certificates and legal opinions. The Purchase Agreement may be terminated by the Initial Purchasers in certain circumstances prior to payment of the Notes.

We will pay the Initial Purchasers’ customary fees and commissions in connection with this offering and will reimburse the Initial Purchasers for certain expenses incurred in connection with the offering.

The Initial Purchasers propose to offer the Notes for resale in transactions not requiring registration under the Securities Act or applicable state securities laws, including sales pursuant to Rule 144A and Regulations S under the Securities Act.

The Notes are a new issuance of securities with no established trading market. A liquid or active public trading market for the Notes may not develop. If an active trading market for the Notes does not develop, the market price and liquidity of the Notes may be adversely affected. If the Notes are traded, they may trade at a discount from their initial offering price, depending on prevailing interest rates, the market for similar securities, our performance and other factors.

The Initial Purchasers and their affiliates have engaged in, and may in the future engage in, investment banking and other commercial dealings in the ordinary course of business with us. They have received customary fees and commissions for these transactions. In addition, BOCI Asia Limited is a connected person of us under the Listing Rules of the Hong Kong Stock Exchange as both we and BOCI Asia Limited are commonly owned by Bank of China Limited.

### United States

The Notes have not been and will not be registered under the Securities Act, and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except in certain transactions exempt from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S.

The Notes will not be offered or sold (i) as part of their distribution at any time or (ii) otherwise until 40 days after the later of the commencement of the offering and the closing date, within the United States or to, or for the account or benefit of, U.S. persons. Terms used in this paragraph have the meanings given to them by Regulation S.

The Notes are being offered and sold outside of the United States to non-U.S. persons in reliance on Regulation S. The Purchase Agreement provides that the Initial Purchasers may directly or through their respective U.S. broker-dealer affiliates arrange for the offer and resales of Notes within the United States only to qualified institutional buyers in reliance on Rule 144A.

In addition, until 40 days after the commencement of the offering of the Notes, an offer or sale of Notes within the United States by a dealer that is not participating in the offering may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A.

### **United Kingdom**

No invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000 (the “**FSMA**”), received by any Initial Purchaser in connection with the issue or sale of any Notes may be or may cause to be communicated, other than such invitation in circumstances in which section 21(1) of the FSMA does not apply to us. All applicable provisions of the FSMA with respect to anything by the Initial Purchasers in relation to the Notes in, from or otherwise involving the United Kingdom have been or will be complied with.

### **Hong Kong**

It is prohibited from offering or selling in Hong Kong, by means of any document, any Notes other than (a) to “professional investors” as defined in the SFO and any rules made under the SFO; or (b) in other circumstances which do not result in the document being a “**prospectus**” as defined in the Companies Ordinance (Cap. 32) of Hong Kong (the “**Companies Ordinance**”) or which do not constitute an offer to the public within the meaning of the Companies Ordinance.

It is also prohibited to issue or hold in possession for the purpose of the issue, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to any Notes, which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to the Notes which are or are intended to be disposed of only to persons outside Hong Kong or only to “professional investors” as defined in the SFO and any rules made under the SFO.

### **Japan**

The Notes have not been and will not be registered under the Financial Instruments and Exchange Act of Japan (the “**Financial Instruments and Exchange Act**”). Accordingly, the Notes have not been, directly or indirectly, offered or sold and will not be, directly or indirectly, offered or sold in Japan or to, or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organized under the laws of Japan) or to others for reoffering or resale, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Financial Instruments and Exchange Act and other relevant laws and regulations of Japan.

### **Korea**

A registration statement for the offering and sale of the Notes has not been filed with the Financial Services Commission of Korea (the “**FSC**”). Accordingly, the Notes may not be offered, sold or delivered, directly or indirectly, in Korea or to, or for the account or benefit of, any Korean resident (as such term is defined in the Foreign Exchange Transaction Law of Korea, hereinafter the “**FETLK**”) for a period of one year from the date of issuance of the Notes, except as otherwise permitted by applicable Korean laws and regulations. A holder of the Notes shall be prohibited from offering, delivering or selling any Notes, directly or indirectly, in Korea or to any Korean resident (as such term is defined in the FETLK) for a period of one year from the date of issuance of the Notes, except as may be permitted by applicable Korean laws and regulations.

### **Singapore**

This Offering Memorandum has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, this Offering Memorandum or any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the Notes may not be circulated or distributed, nor may the Notes be offered or sold, whether directly or indirectly, to persons in Singapore

other than (i) to an institutional investor under Section 274 of the Securities and Futures Act, Chapter 289 of Singapore (the “SFA”), (ii) to a relevant person pursuant to Section 275(1), or any person pursuant to Section 275(1A), and in accordance with the conditions specified in Section 275, of the SFA or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. Where the Notes are subscribed or purchased under Section 275 of the SFA by a relevant person which is:

- (a) a corporation (which is not an accredited investor (as defined in Section 4A of the SFA)), the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or
- (b) a trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary of the trust is an individual who is an accredited investor, shares, debentures and units of shares and debentures of that corporation or the beneficiaries’ rights and interest (howsoever described) in that trust shall not be transferred within six months after that corporation or that trust has acquired the Notes pursuant to an offer made under Section 275 of the SFA except:
  - (i) to an institutional investor (for corporations, under Section 274 of the SFA) or to a relevant person defined in Section 275(2) of the SFA, or to any person pursuant to an offer that is made on terms that such shares, debentures and units of shares and debentures of that corporation or such rights and interest in that trust are acquired at a consideration of not less than S\$200,000 (or its equivalent in a foreign currency) for each transaction, whether such amount is to be paid for in cash or by exchange of securities or other assets, and further for corporations, in accordance with the conditions specified in Section 275 of the SFA;
  - (ii) where no consideration is or will be given for the transfer; or
  - (iii) where the transfer is by operation of law.

## **Switzerland**

Neither this Offering Memorandum nor any documents related to the Notes constitute a prospectus within the meaning of Articles 652a and 1156 of the Swiss Code of Obligations. The notes will not be listed on the SIX Swiss Exchange or any other regulated securities market in Switzerland and, consequently, the information presented in this Offering Memorandum does not necessarily comply with the information standards set out in the listing rules of SIX Swiss Exchange. Accordingly, the Notes have not been and may not be publicly offered or sold in Switzerland, as such term is defined or interpreted under the Swiss Code of Obligations. In addition, the Notes do not constitute a participation in a collective investment scheme in the meaning of the Swiss Collective Investment Schemes Act and they are subject to neither approval nor supervision by the Swiss Financial Market Supervisory Authority. Therefore, investors in the Notes do not benefit from protection under the Swiss Collective Investment Schemes Act or supervision by the Swiss Financial Market Supervisory Authority or any other regulatory authority in Switzerland.

## **General**

The distribution of this Offering Memorandum and the offering and sales of the Notes in other jurisdictions are subject to restrictions and may not be made except as permitted under the applicable securities laws of such jurisdictions pursuant to registration with or authorization by the relevant securities regulatory authorities or an exemption therefrom.

No action has been or will be taken in any jurisdiction by us or the Initial Purchasers that would, or is intended to, permit a public offering of the Notes, or possession or distribution of this Offering Memorandum or any other offering material, in any country or jurisdiction where action for that purpose is required. Persons into whose hands this Offering Memorandum comes are required by us and the Initial Purchasers to comply with all applicable laws and regulations in each country or jurisdiction in which they purchase, offer, sell or deliver Notes or have in their possession, distribute or publish this Offering Memorandum or any other offering material relating to the Notes, in all cases at their own expense.

## TRANSFER RESTRICTIONS

Because the following restrictions will apply to the Notes, investors should consult legal counsel prior to making any offer, resale, pledge or transfer of the Notes.

The Notes have not been and will not be registered under the Securities Act and may not be offered or sold within the United States except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Accordingly, the Notes are being offered and sold only:

- to “qualified institutional buyers” in compliance with Rule 144A; and
- outside the United States to persons other than U.S. persons, in reliance upon Regulation S.

It is expected that delivery of the Notes will be made against payment therefore on or about the closing date, which will be the fifth business day following the date of pricing of the Notes. Pursuant to Rule 15c6-1 under the Exchange Act, trades in the secondary market generally are required to settle in three business days, unless the parties to any such trade expressly agree otherwise. Accordingly, purchasers who wish to trade the Notes on the date of pricing or the next succeeding business day will be required, by virtue of the fact that the Notes initially will settle five business days following the pricing date (T+5), to specify an alternate settlement cycle at the time of any such trade to prevent a failed settlement. Purchasers of the Notes who wish to trade the Notes on the date of pricing or the next succeeding business day should consult their own advisor.

### Rule 144A Notes

Each purchaser of the Notes within the United States pursuant to Rule 144A, by accepting delivery of this Offering Memorandum, will be deemed to have represented, agreed and acknowledged that:

1. It is (a) a qualified institutional buyer within the meaning of Rule 144A (a “**QIB**”), (b) acquiring such Notes for its own account or for the account of a QIB and (c) aware, and each beneficial owner of such Notes has been advised, that the sale of such Notes to it is being made in reliance on Rule 144A.
2. It understands that such Notes have not been and will not be registered under the Securities Act and may not be offered, sold, pledged or otherwise transferred except (a) in accordance with Rule 144A to a person that it and any person acting on its behalf reasonably believe is a QIB purchasing for its own account or for the account of a QIB, (b) in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S or (c) pursuant to an exemption from registration under the Securities Act provided by Rule 144 thereunder (if available), in each case, in accordance with any applicable securities laws of any State of the United States.
3. It understands that such Notes, unless otherwise agreed between us and the Trustee in accordance with applicable law, will bear a legend to the following effect:

“THIS NOTE HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE “**SECURITIES ACT**”), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND, MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) IN ACCORDANCE WITH RULE 144A UNDER THE SECURITIES ACT (“**RULE 144A**”) TO A PERSON THAT THE HOLDER AND ANY PERSON ACTING ON ITS BEHALF REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER, (2) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 903 OR RULE 904 OF REGULATION S UNDER THE SECURITIES ACT OR (3) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER (IF AVAILABLE), IN EACH CASE



IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES. THE HOLDER WILL, AND EACH SUBSEQUENT HOLDER IS REQUIRED TO, NOTIFY ANY SUBSEQUENT PURCHASER OF THIS NOTE FROM IT OF THE RESALE RESTRICTIONS REFERRED TO ABOVE. NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT FOR RESALES OF THIS NOTE.”

4. We, the Registrar, the Initial Purchasers and their affiliates, and others will rely upon the truth and accuracy of the foregoing acknowledgments, representations and agreements and, if any such acknowledgments, representations or agreements deemed to have been made by virtue of its purchase of the Notes are no longer accurate, it agrees to promptly notify us. If it is acquiring any Notes for the account of one or more QIBs, it represents that it has sole investment discretion with respect to each such account and it has full power to make the foregoing acknowledgments, representations and agreements on behalf of each such account.
5. It understands that the Notes offered in reliance on Rule 144A will be represented by the Rule 144A Global Notes. Before any interest in the Rule 144A Global Notes may be offered, sold, pledged or otherwise transferred to a person who takes delivery in the form of an interest in the Regulation S Global Notes, it will be required to provide the Registrar with a written certification (in the form provided in the Indenture) as to compliance with applicable securities laws.

**Prospective purchasers are hereby notified that sellers of the Notes may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A.**

#### **Regulation S Notes**

Each purchaser of the Notes outside the United States pursuant to Regulation S and each subsequent purchaser of such Notes in resales prior to the expiration of the Distribution Compliance Period by accepting delivery of this Offering Memorandum and the Notes, will be deemed to have represented, agreed and acknowledged that:

1. It is, or at the time the Notes are purchased will be, the beneficial owner of such Notes and (a) it is not a U.S. person and it is located outside the United States (within the meaning of Regulation S) and (b) it is not an affiliate of us or a person acting on behalf of such an affiliate.
2. It understands that such Notes have not been and will not be registered under the Securities Act and that, prior to the expiration of the Distribution Compliance Period, it will not offer, sell, pledge or otherwise transfer such Notes except (a) in accordance with Rule 144A under the Securities Act to a person that it and any person acting on its behalf reasonably believe is a QIB purchasing for its own account or the account of a QIB or (b) in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S, in each case, in accordance with any applicable securities laws of any State of the United States.
3. We, the Registrar, the Initial Purchasers and their affiliates, and others will rely upon the truth and accuracy of the foregoing acknowledgments, representations and agreements and, if any such acknowledgments, representations or agreements deemed to have been made by virtue of its purchase of the Notes are no longer accurate, it agrees to promptly notify us.



4. It understands that the Notes offered in reliance on Regulation S will be represented by the Regulation S Global Notes, which will, unless otherwise agreed by us in accordance with applicable law, bear a legend substantially to the following effect:

THIS NOTE HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE “**SECURITIES ACT**”), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND, PRIOR TO THE EXPIRATION OF 40 DAYS AFTER THE LATER OF THE COMMENCEMENT OF THE OFFERING OF THE NOTES AND THE LATEST ISSUE DATE (“**DISTRIBUTION COMPLIANCE PERIOD**”), MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) IN ACCORDANCE WITH RULE 144A UNDER THE SECURITIES ACT (“**RULE 144A**”) TO A PERSON THAT THE HOLDER AND ANY PERSON ACTING ON ITS BEHALF REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER, (2) IN AN OFFSHORE TRANSACTION COMPLYING WITH RULE 903 OR 904 OF REGULATION S UNDER THE SECURITIES ACT OR (3) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER (IF AVAILABLE), IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES. DURING THE DISTRIBUTION COMPLIANCE PERIOD, THE HOLDER WILL, AND EACH SUBSEQUENT HOLDER IS REQUIRED TO, NOTIFY ANY SUBSEQUENT PURCHASER OF THIS NOTE FROM IT OF THE RESALE RESTRICTIONS REFERRED TO ABOVE. NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144A UNDER THE SECURITIES ACT FOR RESALES OF THIS NOTE.

Prior to the expiration of the Distribution Compliance Period, before any interest in the Regulation S Global Notes may be offered, sold, pledged or otherwise transferred to a person who takes delivery in the form of an interest in the Rule 144A Global Notes, it will be required to provide the Registrar with a written certification (in the form provided in the Indenture) as to compliance with the applicable securities laws.

## **LEGAL MATTERS**

Certain legal matters with respect to the issue and sale of the Notes as to New York State and United States federal law and Hong Kong law will be passed upon for us by Clifford Chance. Certain legal matters with respect to the issue and sale of the Notes as to New York State and United States federal law and Hong Kong law will be passed upon for the Initial Purchasers by Linklaters.

## **INDEPENDENT AUDITOR**

The consolidated financial statements as of and for the years ended December 31, 2006, 2007 and 2008 included (or incorporated by reference) in this Offering Memorandum have been audited by PwC, Certified Public Accountants, our independent auditors, as indicated in their unqualified audit reports appearing herein. The unaudited condensed consolidated financial information as of and for the nine months ended September 30, 2009 included in this Offering Memorandum have been reviewed by PwC in accordance with Hong Kong Standard on Review Engagements 2410, “Review of interim financial information performed by the independent auditor of the entity,” issued by the Hong Kong Institute of Certified Public Accountants.

For the sole purpose of the proposed listing of the Notes on the HKSE, PwC has given and not withdrawn its written consent to the inclusion of its reports included herein (including those incorporated by reference herein) and the references to its name and in the form and context in which they are included. Such written consent is different from a consent filed with the SEC under Section 7 of the Securities Act, which is applicable only to transactions involving securities registered under the Securities Act. PwC has not filed a consent under Section 7 of the Securities Act.

For the purpose of the offers and sales outside the United States in reliance on Regulation S and within the United States to “qualified institutional buyers” in reliance on Rule 144A under the Securities Act, PwC has acknowledged the references to its name and the inclusion of its reports in the form and context in which they are respectively included in this Offering Memorandum.

## GENERAL INFORMATION

1. The creation and issue of the Notes have been authorized by resolutions of the Board of Directors passed on January 22, 2010.
2. All consents, approvals, authorizations or other orders as may be required by the Issuer have been given for the creation and issue of the Notes and for the Issuer to undertake and perform its obligations under the Notes and the Indenture.
3. Except as otherwise publicly disclosed, there has been no material adverse change in our financial or trading position since December 31, 2008.
4. None of the Issuer or its subsidiaries is involved in any litigation or claims which are material in the context of the offering of the Notes or the outcome of which would have a material adverse effect on the operations of the Issuer or the operations of any of its subsidiaries, and the Issuer is not aware of any pending or threatened litigation which is material in a similar manner.
5. The Notes have been accepted for clearance through the facilities of Euroclear, Clearstream and DTC. Certain trading information with respect to the Notes is set forth below:

	CUSIP	ISIN
Rule 144A Notes . . . . .	061199 AA3	US061199AA35
Regulations S Notes . . . . .	Y1391C AJ0	USY1391CAJ00

Only Notes evidenced by a Global Note have been accepted for clearance through Euroclear, Clearstream and DTC.

6. Application has been made to HKSE to the listing of, and permission to deal in, the Notes by way of selectively marketed securities and such permission is expected to become effective on or about February 12, 2010.
7. For as long as the Notes are listed on the HKSE, copies of the Indenture will be available for inspection during usual business hours on any weekday (except public holidays) at the offices of the Trustee and in the registered office of the Issuer.

For as long as the Notes are listed on the HKSE, copies of the latest annual report, the audited consolidated financial statements as of and for the years ended December 31, 2006, 2007 and 2008, and unaudited condensed consolidated financial information as of and for the nine months ended September 30, 2009 of the Issuer will be available for inspection during usual business hours on any weekday (except public holidays) at the registered office of the Issuer.

## **SUMMARY OF CERTAIN DIFFERENCES BETWEEN HKFRS AND U.S. GAAP**

The financial information included herein is prepared and presented in accordance with HKFRS. Certain differences exist between HKFRS and U.S. GAAP which might be material to the financial information herein. The matters described below summarize certain differences between HKFRS and U.S. GAAP that may be material. The Group is responsible for preparing the summary below. The Group has not prepared a complete reconciliation of its consolidated financial statement and related footnote disclosures between HKFRS and U.S. GAAP and has not quantified such differences. Accordingly, no assurance is provided that the following summary of differences between HKFRS and U.S. GAAP is complete. In addition, no attempt has been made to identify future differences between HKFRS and U.S. GAAP as the result of future changes in accounting standards or as a result of events or transactions that may occur in the future. Regulatory and standard-setting bodies that promulgate HKFRS and U.S. GAAP have significant projects ongoing that could affect future comparisons. In making an investment decision, investors must rely upon their own examination of the Group's affairs, the terms of the offering and the Group's financial information. Potential investors should consult their own professional advisors for an understanding of the differences between HKFRS and U.S. GAAP, and how those differences might affect the financial information herein.

### **Impairment for available-for-sale and held-to-maturity debt securities**

Under HKFRS, a financial asset is impaired and impairment losses are incurred only if there is objective evidence of impairment as the result of one or more events that occurred after initial recognition and if that loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be estimated reliably. Once impairment of a debt instrument is determined to be triggered, the related unrealized loss is recorded in the income statement.

Under U.S. GAAP, if an entity intends to sell an impaired debt security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the impairment is other than temporary and the related unrealized loss is recorded in the income statement.

If a portion of the unrealized loss related to an impaired debt security is related to a credit loss, but an entity does not intend to sell the impaired debt security and is not more likely than not to be required to sell before recovery, the impairment is other than temporary and should be separated into (i) the estimated amount relating to the credit loss, and (ii) the amount relating to all other factors. Only the estimated amount related to the credit loss amount is recognized in the income statement and the remainder of the loss amount recognized in other comprehensive income.

### **Certain debt securities classified as loans and receivables**

Under HKFRS, certain debt securities that are not quoted in an active market, which the Group has neither the intention to sell immediately or in the short term, are classified as loans and receivables. After initial recognition, these securities are carried at amortized cost using the effective interest method, less allowance for impairment losses.

Under U.S. GAAP, debt securities are classified as held-to-maturity, available-for-sale or trading based on the characteristics of the security and, where appropriate, management's intent. Under U.S. GAAP, held-to-maturity securities are carried at amortized cost while available-for-sale and trading securities are carried at fair value, with changes in the fair value recognized in other comprehensive income and the income statement, respectively.

## **Reversal of impairment on debt securities**

Under HKFRS, when objective evidence that an impairment loss on financial assets classified as loans and receivables, held-to-maturity or available-for-sale has been identified and an impairment loss has been incurred, the amount of the loss shall be recognized in the income statement. If, in a subsequent period, the estimated future cash flows of loans and receivables/held-to-maturity security or the fair value of an available-for-sale security increases, and the increase can be objectively related to an event occurring after the impairment loss was recognized in the income statement, the impairment loss shall be reversed, with the amount of the reversal recognized in the income statement.

Under U.S. GAAP, reversals of impairment losses which have been recognized in the income statement on such securities are not permitted.

## **Investment properties**

Under HKFRS, the Group's investment properties are carried at fair value, representing open market value determined periodically by independent appraisers. Changes in fair values are recorded in the consolidated income statements as part of other operating income. Investment properties are not depreciated.

Under U.S. GAAP, property revaluations are not permitted. Realized gains or losses are recognized in the consolidated income statement only upon impairment or disposal of the property. Depreciation is charged on all properties based on cost.

## **Consolidation of special purpose entities and variable interest entities**

Under HKFRS, the Group is required to consolidate all entities over which it has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. In applying this principle to special purpose entities ("SPEs"), an entity created to accomplish a narrow and well-defined objective, consideration is made of control indicators related to (i) whether the substance of an SPE's activities are being conducted for the benefit of the Group, (ii) the Group's ability to exercise decision-making power over the SPE, (iii) the extent of the Group's rights to the benefits of the SPE and (iv) its obligation to absorb the SPE's losses.

Under U.S. GAAP, a variable interest entity ("VIE") is an entity that does not have sufficient equity at risk to finance its activities without additional subordinated financial support from other parties or, as a group, the holders of the equity investment at risk lack any one of the following characteristics:

- direct or indirect ability to make decisions about the entity's activities through voting rights;
- obligation to absorb the expected losses of the special purpose entity if they occur; or
- the right to receive the residual returns of the entity if there are any.

Variable interests can be contractual, ownership or other pecuniary interests in an entity that change with changes in the fair value of that entity's net assets.

U.S. GAAP requires consolidation of variable interest entities ("VIE"s) in which an entity is the primary beneficiary. An entity is the primary beneficiary if it is exposed to the majority of the financial risk, rewards, or both of the VIE.

### **Recognition of interest income on impaired financial assets**

Under HKFRS, when there is objective evidence that a financial asset has been impaired, an allowance for impairment loss is recognized based on the estimated discounted cash flows to be received in the future. From this point, interest income is recognized at the original effective interest rate used to discount the estimated future cash flows for the purpose of measuring the impairment loss.

Under U.S. GAAP, from the point a financial asset is identified as being impaired, the recognition of interest income may be suspended. In this case, the change in the present value of estimated future cash flows, if below cost, is recognized as a change in the allowance for impairment loss in the respective reporting period.

### **Foreign exchange gains and losses on monetary assets classified as available for sale**

Under HKFRS, amortized cost of monetary assets classified as available-for-sale, denominated in foreign currencies are translated at the rate of exchange at the balance sheet date and the resulting differences arising from translation is recognized in the income statement. Translation difference related to other changes in the carrying amount are recognized in other comprehensive income.

Under U.S. GAAP, changes in the value of foreign currency denominated available-for-sale securities resulting from movements in foreign exchange rates should be recognized as a separate component of shareholders' equity until realized.

### **Derecognition of financial assets**

Under HKFRS, derecognition of financial assets is based on an evaluation of whether, and to what extent, the Group has retained the risks and rewards of ownership of a financial asset that has been transferred to an unrelated entity. Full derecognition is permitted when the Group has transferred substantially all of the risks and rewards of ownership of the financial asset. Where the Group has not transferred substantially all risks and rewards related to a financial asset and/or retains control over the financial asset, derecognition may be inappropriate or the financial asset may continue to be recognized to the extent of the Group's continuing involvement.

Under U.S. GAAP, the derecognition of financial assets is based on whether control over a financial asset has been transferred. The transfer of control is determined through consideration of the legal isolation of the transferred asset from the transferor; the ability of the transferee to pledge or exchange the asset; and right or obligation of the transferor to repurchase the financial asset.

### **Uncertain tax positions**

Under HKFRS, uncertain income tax positions should be measured at the amount expected to be paid to/(recovered from) the taxation authorities. The amount of provision for uncertain tax positions is measured as the most likely outcome from a range of possible outcomes or using weighted average probability. These provisions are generally classified as current liabilities and presented as non current if the Group has an unconditional right to defer payment for more than 12 months.

U.S. GAAP requires that a tax benefit from an uncertain tax position be recognized only if it is "more likely than not" that the tax position is sustainable based on its technical merits. The uncertain tax position is measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement. The provisions are measured using cumulative probability of the range of possible outcomes. Under U.S. GAAP, provisions for uncertain tax positions are classified as a long term liability except for those amounts management expects to require actual cash payment within the next 12 months.

## **Offsetting financial assets and financial liabilities**

Under HKFRS, to offset a financial asset and a financial liability, an entity must currently have a legally enforceable right to set-off the recognized amounts and intend to settle the financial asset and liability on a net (or simultaneous) basis. Master netting arrangements do not provide a basis for offsetting collateral posted or received for derivatives against the related carrying value of the derivative contract unless both criteria are met.

Under U.S. GAAP, financial assets and financial liabilities may not be offset unless each of two parties owes the other determinable amounts, the reporting entity has the legally enforceable right to set off the amounts and it intends to set off the amounts. Specific U.S. GAAP guidance, however, permits offsetting for derivatives contracts under a master netting arrangement. Further, other U.S. GAAP guidance permits the offsetting of repurchase and reverse repurchase agreements executed with the same counterparty, having the same settlement date and subject to a master netting arrangement.

## **Acceptances**

In the case of a bank, under HKFRS, acceptances are accounted for as off-balance sheet transactions and disclosed in the related credit commitments.

Under U.S. GAAP, assets and liabilities related to acceptances are recognized on the balance sheet.



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*Note:*

1. The Independent Auditor's Reports on the consolidated financial statements of the Issuer set out herein are reproduced from the Issuer's annual reports for the years ended December 31, 2007 and 2008, and page references included in the respective Independent Auditor's Reports refer to pages set out in such annual reports. In addition, the Independent Review Report set out herein is reproduced from the original Independent Review Report and page references contained therein refer to the original unaudited condensed consolidated financial information for the nine months ended September 30, 2009.

## INDEPENDENT AUDITOR'S REPORT

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

We have audited the consolidated financial statements of Bank of China (Hong Kong) Limited (the "Bank") and its subsidiaries (together, the "Group") set out on pages 27 to 311, 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.

### **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, 24 March 2009

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#### *Note:*

1. The Independent Auditor's Report on the consolidated financial statements of the Issuer set out herein are reproduced from the Issuer's annual report for the year ended December 31, 2008, and page references included in the Independent Auditor's Report refer to pages set out in such annual report.

# **CONSOLIDATED INCOME STATEMENT**

*For the year ended 31 December*

	Notes	2008 HK\$'m	2007 HK\$'m
Interest income . . . . .		<b>34,185</b>	45,309
Interest expense . . . . .		<b>(15,186)</b>	(26,769)
<b>Net interest income</b> . . . . .	5	<b>18,999</b>	18,540
Fees and commission income . . . . .		<b>7,475</b>	8,480
Fees and commission expenses . . . . .		<b>(2,011)</b>	(1,897)
<b>Net fees and commission income</b> . . . . .	6	<b>5,464</b>	6,583
Net trading income . . . . .	7	<b>1,914</b>	1,013
Net loss on financial instruments designated at fair value through profit or loss . . . . .		<b>(316)</b>	(25)
Net loss on investment in securities . . . . .	8	<b>(15)</b>	(53)
Other operating income . . . . .	9	<b>434</b>	756
<b>Net operating income before impairment allowances</b> . . . . .		<b>26,480</b>	26,814
Net charge of impairment allowances . . . . .	10	<b>(9,843)</b>	(1,448)
<b>Net operating income</b> . . . . .		<b>16,637</b>	25,366
Operating expenses . . . . .	11	<b>(8,636)</b>	(7,659)
<b>Operating profit</b> . . . . .		<b>8,001</b>	17,707
Net (loss)/gain from disposal of/fair value adjustments on investment properties . . . . .	12	<b>(118)</b>	1,064
Net gain from disposal/revaluation of properties, plant and equipment . . . . .	13	<b>18</b>	28
Share of profits less losses of associates . . . . .	27	<b>7</b>	3
<b>Profit before taxation</b> . . . . .		<b>7,908</b>	18,802
Taxation . . . . .	14	<b>(1,170)</b>	(3,255)
<b>Profit for the year</b> . . . . .		<b>6,738</b>	15,547
<b>Attributable to:</b>			
Equity holders of the Bank . . . . .		<b>6,517</b>	15,277
Minority interests . . . . .		<b>221</b>	270
		<b>6,738</b>	15,547
<b>Dividends</b> . . . . .	16	<b>3,960</b>	14,376

The notes on pages 35 to 311 are an integral part of these financial statements.

**CONSOLIDATED BALANCE SHEET***As at 31 December*

	<u>Notes</u>	<u>2008</u> HK\$'m	<u>2007</u> HK\$'m
<b>ASSETS</b>			
Cash and balances with banks and other financial institutions . . . . .	20	<b>153,268</b>	159,052
Placements with banks and other financial institutions maturing between one and twelve months . . . . .		<b>89,718</b>	53,154
Financial assets at fair value through profit or loss . . . . .	21	<b>16,404</b>	10,302
Derivative financial instruments . . . . .	22	<b>19,628</b>	14,477
Hong Kong SAR Government certificates of indebtedness . .		<b>34,200</b>	32,770
Advances and other accounts . . . . .	23	<b>470,220</b>	420,212
Investment in securities . . . . .	25	<b>289,353</b>	297,048
Interests in associates . . . . .	27	<b>88</b>	83
Investment properties . . . . .	28	<b>7,727</b>	8,058
Properties, plant and equipment . . . . .	29	<b>22,788</b>	23,288
Deferred tax assets . . . . .	36	<b>47</b>	10
Other assets . . . . .	30	<b>14,555</b>	20,776
Total assets . . . . .		<b><u>1,117,996</u></b>	<b><u>1,039,230</u></b>
<b>LIABILITIES</b>			
Hong Kong SAR currency notes in circulation . . . . .	31	<b>34,200</b>	32,770
Deposits and balances of banks and other financial institutions . . . . .		<b>88,779</b>	60,599
Financial liabilities at fair value through profit or loss . . .	32	<b>21,938</b>	11,405
Derivative financial instruments . . . . .	22	<b>20,450</b>	11,082
Deposits from customers . . . . .	33	<b>805,866</b>	794,247
Debt securities in issue at amortised cost . . . . .		<b>1,042</b>	2,089
Other accounts and provisions . . . . .	34	<b>33,662</b>	38,569
Current tax liabilities . . . . .		<b>441</b>	1,210
Deferred tax liabilities . . . . .	36	<b>2,799</b>	3,967
Subordinated liabilities . . . . .	37	<b>26,604</b>	–
Total liabilities . . . . .		<b><u>1,035,781</u></b>	<b><u>955,938</u></b>
<b>EQUITY</b>			
Share capital . . . . .	38	<b>43,043</b>	43,043
Reserves . . . . .	39	<b>37,714</b>	38,700
Capital and reserves attributable to the equity holders of the Bank . . . . .		<b><u>80,757</u></b>	<b><u>81,743</u></b>
Minority interests . . . . .		<b><u>1,458</u></b>	<b><u>1,549</u></b>
Total equity . . . . .		<b><u>82,215</u></b>	<b><u>83,292</u></b>
Total liabilities and equity . . . . .		<b><u>1,117,996</u></b>	<b><u>1,039,230</u></b>

The notes on pages 35 to 311 are an integral part of these financial statements

Approved by the Board of Directors on 24 March 2009 and signed on behalf of the Board by:

**XIAO Gang**

*Director*

**HE Guangbei**

*Director*

**SUN Changji**

*Director*

**LEE Wing Hung**

*Chief Financial Officer*

**BALANCE SHEET***As at 31 December*

	<u>Notes</u>	<u>2008</u> HK\$'m	<u>2007</u> HK\$'m
<b>ASSETS</b>			
Cash and balances with banks and other financial institutions . . . . .	20	<b>133,433</b>	134,020
Placements with banks and other financial institutions maturing between one and twelve months . . . . .		<b>67,900</b>	31,887
Financial assets at fair value through profit or loss . . . . .	21	<b>13,036</b>	6,369
Derivative financial instruments . . . . .	22	<b>18,633</b>	13,972
Hong Kong SAR Government certificates of indebtedness . .		<b>34,200</b>	32,770
Advances and other accounts . . . . .	23	<b>385,860</b>	341,896
Investment in securities . . . . .	25	<b>264,953</b>	271,049
Interests in subsidiaries . . . . .	26	<b>12,401</b>	12,866
Interests in associates . . . . .	27	<b>12</b>	12
Investment properties . . . . .	28	<b>7,279</b>	7,595
Properties, plant and equipment . . . . .	29	<b>17,549</b>	18,261
Deferred tax assets . . . . .	36	<b>3</b>	–
Other assets . . . . .	30	<b>13,625</b>	18,560
Total assets . . . . .		<b><u>968,884</u></b>	<b><u>889,257</u></b>
<b>LIABILITIES</b>			
Hong Kong SAR currency notes in circulation . . . . .	31	<b>34,200</b>	32,770
Deposits and balances of banks and other financial institutions . . . . .		<b>87,843</b>	56,207
Financial liabilities at fair value through profit or loss . . .	32	<b>20,469</b>	8,116
Derivative financial instruments . . . . .	22	<b>19,566</b>	10,788
Deposits from customers . . . . .	33	<b>679,251</b>	673,580
Other accounts and provisions . . . . .	34	<b>27,868</b>	31,378
Current tax liabilities . . . . .		<b>296</b>	855
Deferred tax liabilities . . . . .	36	<b>2,230</b>	3,352
Subordinated liabilities . . . . .	37	<b>26,604</b>	–
Total liabilities . . . . .		<b><u>898,327</u></b>	<b><u>817,046</u></b>
<b>EQUITY</b>			
Share capital . . . . .	38	<b>43,043</b>	43,043
Reserves . . . . .	39	<b>27,514</b>	29,168
Capital and reserves attributable to the equity holders of the Bank . . . . .		<b>70,557</b>	72,211
Total liabilities and equity . . . . .		<b><u>968,884</u></b>	<b><u>889,257</u></b>

The notes on pages 35 to 311 are an integral part of these financial statements

Approved by the Board of Directors on 24 March 2009 and signed on behalf of the Board by:

**XIAO Gang**

*Director*

**HE Guangbei**

*Director*

**SUN Changji**

*Director*

**LEE Wing Hung**

*Chief Financial Officer*

# CONSOLIDATED 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*	Translation reserve	Retained earnings	Total	Minority interests	Total equity
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
At 1 January 2007 . . . . .	43,043	6,154	(115)	3,621	–	26,298	79,001	1,419	80,420
Net profit for the year . . . . .	–	–	–	–	–	15,277	15,277	270	15,547
Currency translation difference . . . . .	–	–	–	–	14	–	14	–	14
2006 dividend paid . . . . .	–	–	–	–	–	–	–	(79)	(79)
2007 interim dividend . . . . .	–	–	–	–	–	(14,376)	(14,376)	(78)	(14,454)
Revaluation of premises . . . . .	–	2,908	–	–	–	–	2,908	17	2,925
Release upon disposal of premises . . . . .	–	(23)	–	–	–	23	–	–	–
Change in fair value of available-for-sale securities taken to equity . . . . .	–	–	(917)	–	–	–	(917)	3	(914)
Amortisation with respect to available-for-sale securities transferred to held-to-maturity securities . . . . .	–	–	12	–	–	(115)	(103)	–	(103)
Net impairment charges transferred to income statement . . . . .	–	–	289	–	–	–	289	–	289
Release of reserve upon disposal of available-for-sale securities . . . . .	–	–	17	–	–	–	17	–	17
Release of deferred tax . . . . .	–	(476)	109	–	–	–	(367)	(3)	(370)
Transfer from retained earnings . . . . .	–	–	–	509	–	(509)	–	–	–
At 31 December 2007 . . . . .	<u>43,043</u>	<u>8,563</u>	<u>(605)</u>	<u>4,130</u>	<u>14</u>	<u>26,598</u>	<u>81,743</u>	<u>1,549</u>	<u>83,292</u>
Bank and subsidiaries . . . . .	43,043	8,563	(605)	4,130	14	26,553	81,698		
Associates . . . . .	–	–	–	–	–	45	45		
	<u>43,043</u>	<u>8,563</u>	<u>(605)</u>	<u>4,130</u>	<u>14</u>	<u>26,598</u>	<u>81,743</u>		
At 1 January 2008 . . . . .	<b>43,043</b>	<b>8,563</b>	<b>(605)</b>	<b>4,130</b>	<b>14</b>	<b>26,598</b>	<b>81,743</b>	<b>1,549</b>	<b>83,292</b>
Net profit for the year . . . . .	–	–	–	–	–	6,517	6,517	221	6,738
Currency translation difference . . . . .	–	–	–	–	212	–	212	–	212
2007 dividend paid . . . . .	–	–	–	–	–	–	–	(107)	(107)
2008 interim dividend . . . . .	–	–	–	–	–	(3,960)	(3,960)	(217)	(4,177)
Revaluation of premises . . . . .	–	(261)	–	–	–	–	(261)	9	(252)
Release upon disposal of premises . . . . .	–	(103)	–	–	–	103	–	–	–
Change in fair value of available-for-sale securities taken to equity . . . . .	–	–	(9,372)	–	–	–	(9,372)	4	(9,368)
Amortisation with respect to available-for-sale securities transferred to held-to-maturity securities . . . . .	–	–	1	–	–	(88)	(87)	–	(87)
Net impairment charges transferred to income statement . . . . .	–	–	5,109	–	–	–	5,109	–	5,109
Release of reserve upon disposal of available-for-sale securities . . . . .	–	–	15	–	–	–	15	–	15
Release of deferred tax . . . . .	–	114	727	–	–	–	841	(1)	840
Transfer from retained earnings . . . . .	–	–	–	373	–	(373)	–	–	–
At 31 December 2008 . . . . .	<u>43,043</u>	<u>8,313</u>	<u>(4,125)</u>	<u>4,503</u>	<u>226</u>	<u>28,797</u>	<u>80,757</u>	<u>1,458</u>	<u>82,215</u>
Bank and subsidiaries . . . . .	43,043	8,313	(4,125)	4,503	226	28,747	80,707		
Associates . . . . .	–	–	–	–	–	50	50		
	<u>43,043</u>	<u>8,313</u>	<u>(4,125)</u>	<u>4,503</u>	<u>226</u>	<u>28,797</u>	<u>80,757</u>		

\* 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 35 to 311 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*	Translation reserve	Retained earnings	Total equity
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
At 1 January 2007 . . . . .	43,043	4,663	(110)	3,058	–	21,866	72,520
Net profit for the year . . . . .	–	–	–	–	–	12,701	12,701
Currency translation difference . . . . .	–	–	–	–	4	–	4
2007 interim dividend . . . . .	–	–	–	–	–	(14,376)	(14,376)
Revaluation of premises . . . . .	–	2,336	–	–	–	–	2,336
Release upon disposal of premises . . . . .	–	(10)	–	–	–	10	–
Change in fair value of available-for-sale securities taken to equity . . . . .	–	–	(917)	–	–	–	(917)
Amortisation with respect to available-for-sale securities transferred to held-to-maturity securities . . . . .	–	–	6	–	–	(91)	(85)
Net impairment charges transferred to income statement . . . . .	–	–	289	–	–	–	289
Release of reserve upon disposal of available-for-sale securities . . . . .	–	–	19	–	–	–	19
Release of deferred tax . . . . .	–	(390)	110	–	–	–	(280)
Transfer from retained earnings . . . . .	–	–	–	367	–	(367)	–
At 31 December 2007 . . . . .	<u>43,043</u>	<u>6,599</u>	<u>(603)</u>	<u>3,425</u>	<u>4</u>	<u>19,743</u>	<u>72,211</u>
At 1 January 2008 . . . . .	<b>43,043</b>	<b>6,599</b>	<b>(603)</b>	<b>3,425</b>	<b>4</b>	<b>19,743</b>	<b>72,211</b>
Net profit for the year . . . . .	–	–	–	–	–	6,123	6,123
Currency translation difference . . . . .	–	–	–	–	10	–	10
2008 interim dividend . . . . .	–	–	–	–	–	(3,960)	(3,960)
Revaluation of premises . . . . .	–	(385)	–	–	–	–	(385)
Release upon disposal of premises . . . . .	–	(100)	–	–	–	100	–
Change in fair value of available-for-sale securities taken to equity . . . . .	–	–	(9,353)	–	–	–	(9,353)
Amortisation with respect to available-for-sale securities transferred to held-to-maturity securities . . . . .	–	–	(5)	–	–	(65)	(70)
Net impairment charges transferred to income statement . . . . .	–	–	5,109	–	–	–	5,109
Release of reserve upon disposal of available-for-sale securities . . . . .	–	–	15	–	–	–	15
Release of deferred tax . . . . .	–	154	703	–	–	–	857
Transfer from retained earnings . . . . .	–	–	–	331	–	(331)	–
At 31 December 2008 . . . . .	<u><b>43,043</b></u>	<u><b>6,268</b></u>	<u><b>(4,134)</b></u>	<u><b>3,756</b></u>	<u><b>14</b></u>	<u><b>21,610</b></u>	<u><b>70,557</b></u>

\* 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 35 to 311 are an integral part of these financial statements.



# CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December

	Notes	2008 HK\$'m	2007 HK\$'m
<b>Cash flows from operating activities</b>			
Operating cash inflow before taxation . . . . .	40(a)	2,663	42,157
Hong Kong profits tax paid . . . . .		(2,173)	(2,822)
Overseas profits tax paid . . . . .		(131)	(85)
<b>Net cash inflow from operating activities . . . . .</b>		<b>359</b>	<b>39,250</b>
<b>Cash flows from investing activities</b>			
Purchase of properties, plant and equipment . . . . .	29	(814)	(1,145)
Acquisition of an associate . . . . .	27	–	(24)
Proceeds from disposal of properties, plant and equipment . . . . .		104	40
Proceeds from disposal of investment properties . . . . .		200	208
Proceeds from dissolution of an associate . . . . .	27	–	1
Dividends received from associates . . . . .	27	2	3
<b>Net cash outflow from investing activities . . . . .</b>		<b>(508)</b>	<b>(917)</b>
<b>Cash flows from financing activities</b>			
Dividends paid to equity holders of the Bank . . . . .		(3,960)	(14,376)
Dividends paid to minority shareholders . . . . .		(324)	(157)
Proceeds from subordinated liabilities . . . . .		27,519	–
Interest paid for subordinated loans . . . . .		(218)	–
<b>Net cash inflow/(outflow) from financing activities . . . . .</b>		<b>23,017</b>	<b>(14,533)</b>
Increase in cash and cash equivalents . . . . .		22,868	23,800
Cash and cash equivalents at 1 January . . . . .		152,057	128,257
<b>Cash and cash equivalents at 31 December . . . . .</b>	40(b)	<b>174,925</b>	<b>152,057</b>

The notes on pages 35 to 311 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 14/F, Bank of China Tower, 1 Garden Road, 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.

#### *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).

***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.
- 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.
- 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 a 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)

***Standards, amendments 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 (Revised) ‘Borrowing Costs’ (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)
- HK(IFRIC)-Int 17, 'Distributions of non-cash assets to owners' (effective from 1 July 2009)
- HK(IFRIC)-Int 18, 'Transfers of assets from customers' (effective from 1 July 2009)

## **2.2 Consolidation**

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

### ***(1) Subsidiaries***

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

For acquisition of a company under common control, the merger accounting method will be applied. The principle of merger accounting is a way to combine companies under common control as though the business of the acquired company had always been carried out by the acquirer. The Group's consolidated financial statements represent the consolidated results, consolidated cash flows and consolidated financial position of the Group as if any such combination had occurred from the date when the Bank and the acquired company first came under common control (i.e. no fair value adjustment on the date of combination is required). The difference between the consideration and carrying amount at the time of combination is treated as a merger reserve in equity. The effects of all transactions between the Group and the acquired company, whether occurring before or after the combination, are eliminated in preparing the consolidated financial statements of the Group. The transaction costs for the combination will be expensed in the income statement.

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

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

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

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

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

## **(2) Associates**

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The Group's investment in associates includes goodwill, net of accumulated impairment loss and any related accumulated foreign currency translation difference.

The Group's share of the post-acquisition profits or losses of associates is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the cost of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognise further losses unless the Group has incurred obligations or made payments on behalf of the associates.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred.

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

## **2.3 Segmental reporting**

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

## **2.4 Foreign currency translation**

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

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

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

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

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

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

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

## **2.5 Derivative financial instruments and hedge accounting**

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

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

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



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

The Group designates certain derivatives as hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedge). Hedge accounting is used for derivatives designated in this way.

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

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

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

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

## **2.6 Offsetting financial instruments**

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

## **2.7 Interest income and expense and fees and commission income and expense**

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

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

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

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
- 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.

### **(4) *Available-for-sale***

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

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

## **2.9 Financial liabilities**

The Group classifies its financial liabilities under the following categories: trading liabilities, financial liabilities designated at fair value through profit or loss, deposits, debt securities in issue, subordinated liabilities, 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:

- 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, debt securities in issue, subordinated liabilities and other liabilities***

Deposits and debt securities in issue other than those classified as trading liabilities or designated at fair value through profit or loss, together with subordinated liabilities 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.

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 Precious metals**

Precious metals comprise gold, silver and other precious metals. Precious metals are initially recognised at fair value and subsequently re-measured at their respective market prices as of the balance sheet date. Mark-to-market gains or losses on precious metals are included in net trading income.

## 2.13 Impairment of financial assets

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

- (i) significant financial difficulty of the issuer or obligor;
- (ii) a breach of contract, such as a default or delinquency in interest or principal payment;
- (iii) the Group granting to the borrower, for economic or legal reasons relating to the borrower’s financial difficulty, a concession that the lender would not otherwise consider;
- (iv) it becoming probable that the borrower will enter into bankruptcy or other financial reorganisation;
- (v) the disappearance of an active market or downgrading below investment grade level for that financial asset because of financial difficulties; or
- (vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
  - adverse changes in the payment status of borrowers in the group; or
  - national or local economic conditions that correlate with defaults on the assets in the group.

### *(1) Assets carried at amortised cost*

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

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

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral.

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.

## **(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.

## **2.14 Impairment of investment in subsidiaries and associates 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.

## **2.15 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.

## **2.16 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.

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

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



## **(2) *Property under development***

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

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

### **2.17 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.

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.

## **2.18 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.

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

### ***(2) Finance leases on properties***

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

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

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

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

## **2.19 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.

## **2.20 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.

## **2.21 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.

### ***(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.

## **2.22 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 and associates 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.

### **2.23 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'.

### **2.24 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.

### **2.25 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.

### **2.26 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.

### **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.

For asset/mortgage backed securities (“ABS/MBS”), the Group adopts a comprehensive methodology in determining whether a particular security is impaired. Under the methodology, the Group will not only take into consideration the mark-to-market (MTM) price of the issue and its external credit rating, but also other factors including the FICO score, vintage, location, adjustable rate mortgage (“ARM”) status, delinquencies, level of collateral protection, loan to value ratio and prepayment speed of the underlying assets. Having considered these factors, the ABS/MBS issue has to further pass the required credit enhancement coverage ratio set by the Group. This ratio is determined by applying assumptions regarding the default rates based on the available delinquency, foreclosure and real estate owned (“REO”) data of the ABS/MBS issue.

The methodology and assumptions used for the assessments are reviewed regularly. In evaluating impairment of ABS/MBS during the year, the Group continued to consider significant decline in market prices of ABS/MBS to be a key indicator of impairment. In addition, due to reduced market liquidity and wider dispersion in indicative prices of certain ABS/MBS held by the Group, the Group also ensured that there was additional objective evidence of credit impairment by considering whether there has been a significant adverse change in the credit enhancement coverage ratio, taking into account the reported delinquencies and credit losses incurred in the underlying mortgage portfolio for each security held by the Group.

Many of the ABS/MBS held by the Group are complex, and involve cashflows over many years. These future cashflows depend on economic factors such as US residential real estate prices and the performance of the US economy. The recoverable amounts of the securities therefore cannot be predicted with certainty at the current balance sheet date, and additional impairment charges – or releases of impairment charges – may be required in future accounting periods.

### **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.

## **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 Risk Committee, 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 Risk 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 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 Chief Risk Officer (“CRO”) assists the CE in fulfilling his responsibilities for the day-to-day management of risks. The CRO 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 CRO 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.

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 the department of strategic development shall ensure the plans are aligned with the Bank’s overall strategies. Departments that are responsible for risk management, legal and compliance and finance 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 obligations under a contract. It arises principally from lending, trade finance and treasury businesses 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 conditions and business strategies.

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

The Chief Credit Officer (“CCO”) reports directly to the CRO and 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. The Risk Management Department (“RMD”) has the primary responsibility for drafting, reviewing and updating credit risk management policies and procedures. The Group’s principal banking subsidiaries, Nanyang, Nanyang (China) and Chiyu, have also formulated their own credit risk policies that are consistent with those of the Group. These subsidiaries execute their risk management strategies independently and report to the Group’s management on a regular basis.

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 business nature, rating, the level of transaction risk, and the extent 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.

### ***Loans and advances***

Different credit approval and control procedures are adopted according to the level of risk associated with the customer, counterparty or transaction. Corporate and financial institution credit applications are independently reviewed, 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, personal loans and credit cards while a bank scorecard is used to assist the risk assessment of financial institutions’ credit risk. The Credit Risk Assessment Committee comprising experts from the Group’s credit and other functions is responsible for making an independent assessment of all credit facilities which require the approval of Deputy Chief Executives or above.

RMD provides regular credit management information reports and ad hoc reports to the Management Committee (“MC”), RC and Board of Directors to facilitate their continuous monitoring of credit risk.

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

The Group’s internal loan grading system divides credit assets 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 investments in debt securities and securitisation assets, 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 procedures are established.

The Group adopts a comprehensive methodology in determining whether a particular asset/mortgage backed security (“ABS/MBS”) is impaired. Under the methodology, the Group will not only take into consideration the mark-to-market (MTM) price of the issue and its external credit rating, but also other factors including the FICO score, vintage, location, adjustable rate mortgage (“ARM”) status, delinquencies, level of collateral protection, loan to value ratio and prepayment speed of the underlying assets. Having considered these factors, the ABS/MBS issue has to further pass the required credit enhancement coverage ratio set by the Group. This ratio is determined by applying assumptions regarding the default rates based on the available delinquency, foreclosure and real estate owned (“REO”) data of the ABS/MBS issue.

Settlement risk arises mainly from foreign exchange transactions with counterparties 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.

### *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 are summarised as follows:

	The Group	
	2008	2007
	HK\$'m	HK\$'m
Credit risk exposures relating to on-balance sheet assets are as follows:		
Cash and balances with banks and other financial institutions .	153,268	159,052
Placements with banks and other financial institutions maturing between 1 and 12 months . . . . .	89,718	53,154
Financial assets at fair value through profit or loss		
– debt securities . . . . .	16,322	9,881
Derivative financial instruments . . . . .	19,628	14,477
Hong Kong SAR Government certificates of indebtedness . . . .	34,200	32,770
Advances and other accounts . . . . .	470,220	420,212
Investment in securities		
– debt securities – available-for-sale . . . . .	170,935	100,073
– debt securities – held-to-maturity . . . . .	105,393	165,428
– debt securities – loans and receivables . . . . .	12,595	31,102
Other assets . . . . .	13,208	20,776
Credit risk exposures relating to off-balance sheet items are as follows:		
Letters of guarantee issued . . . . .	11,838	9,407
Loan commitment and other credit related liabilities . . . . .	241,556	221,901
	<u>1,338,881</u>	<u>1,238,233</u>

	The Bank	
	2008	2007
	HK\$'m	HK\$'m
Credit risk exposures relating to on-balance sheet assets are as follows:		
Cash and balances with banks and other financial institutions .	133,433	134,020
Placements with banks and other financial institutions maturing between 1 and 12 months . . . . .	67,900	31,887
Financial assets at fair value through profit or loss		
– debt securities . . . . .	13,016	6,042
Derivative financial instruments . . . . .	18,633	13,972
Hong Kong SAR Government certificates of indebtedness . . . .	34,200	32,770
Advances and other accounts . . . . .	385,860	341,896
Investment in securities		
– debt securities – available-for-sale . . . . .	166,593	97,330
– debt securities – held-to-maturity . . . . .	89,817	150,873
– debt securities – loans and receivables . . . . .	8,444	22,784
Other assets . . . . .	12,278	18,560
Credit risk exposures relating to off-balance sheet items are as follows:		
Letters of guarantee issued . . . . .	11,819	10,669
Loan commitment and other credit related liabilities . . . . .	159,928	145,926
	<u>1,101,921</u>	<u>1,006,729</u>

### *Gross loans and advances*

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

	<b>The Group</b>	
	<b>2008</b>	<b>2007</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Advances to customers		
Personal		
– Mortgages . . . . .	<b>130,980</b>	121,663
– Credit cards . . . . .	<b>6,445</b>	5,641
– Others . . . . .	<b>14,321</b>	14,382
Corporate		
– Commercial loans . . . . .	<b>284,873</b>	247,079
– Trade finance . . . . .	<b>24,555</b>	24,275
	<b>461,174</b>	413,040
Trade bills . . . . .	<b>7,609</b>	5,334
Advances to banks and other financial institutions . . . . .	<b>3,738</b>	3,223
Total . . . . .	<b><u>472,521</u></b>	<b><u>421,597</u></b>

	<b>The Bank</b>	
	<b>2008</b>	<b>2007</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Advances to customers		
Personal		
– Mortgages . . . . .	<b>115,282</b>	105,275
– Others . . . . .	<b>8,674</b>	9,541
Corporate		
– Commercial loans . . . . .	<b>231,710</b>	199,665
– Trade finance . . . . .	<b>21,578</b>	20,726
	<b>377,244</b>	335,207
Trade bills . . . . .	<b>6,422</b>	4,421
Advances to banks and other financial institutions . . . . .	<b>3,738</b>	3,222
Total . . . . .	<b><u>387,404</u></b>	<b><u>342,850</u></b>

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.

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:

	The Group			
	2008			
	Pass	Special mention	Substandard or below	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers				
Personal				
– Mortgages . . . . .	128,545	155	88	128,788
– Credit cards . . . . .	6,179	–	–	6,179
– Others . . . . .	13,801	75	10	13,886
Corporate				
– Commercial loans . . . . .	276,609	6,349	274	283,232
– Trade finance . . . . .	23,381	538	5	23,924
	448,515	7,117	377	456,009
Trade bills . . . . .	7,084	523	2	7,609
Advances to banks and other financial institutions . . . . .	3,738	–	–	3,738
Total . . . . .	459,337	7,640	379	467,356

	The Group			
	2007			
	Pass	Special mention	Substandard or below	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers				
Personal				
– Mortgages . . . . .	118,583	229	112	118,924
– Credit cards . . . . .	5,397	–	–	5,397
– Others . . . . .	13,715	78	20	13,813
Corporate				
– Commercial loans . . . . .	243,140	908	349	244,397
– Trade finance . . . . .	23,052	795	4	23,851
	403,887	2,010	485	406,382
Trade bills . . . . .	5,255	74	1	5,330
Advances to banks and other financial institutions . . . . .	3,223	–	–	3,223
Total . . . . .	412,365	2,084	486	414,935

The Bank				
2008				
	Pass	Special mention	Substandard or below	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers				
Personal				
– Mortgages . . . . .	113,189	130	77	113,396
– Others . . . . .	8,308	32	10	8,350
Corporate				
– Commercial loans . . . . .	225,900	4,388	224	230,512
– Trade finance . . . . .	20,834	280	5	21,119
	368,231	4,830	316	373,377
Trade bills . . . . .	6,408	13	1	6,422
Advances to banks and other financial institutions . . . . .	3,738	–	–	3,738
Total . . . . .	378,377	4,843	317	383,537

The Bank				
2007				
	Pass	Special mention	Substandard or below	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers				
Personal				
– Mortgages . . . . .	102,647	193	106	102,946
– Others . . . . .	9,011	54	19	9,084
Corporate				
– Commercial loans . . . . .	196,344	713	290	197,347
– Trade finance . . . . .	19,698	680	4	20,382
	327,700	1,640	419	329,759
Trade bills . . . . .	4,344	72	1	4,417
Advances to banks and other financial institutions . . . . .	3,222	–	–	3,222
Total . . . . .	335,266	1,712	420	337,398

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:

The Group						
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\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers						
Personal						
– Mortgages . . . . .	2,065	34	12	30	2,141	4,870
– Credit cards . . . . .	237	–	–	–	237	–
– Others . . . . .	318	3	3	32	356	731
Corporate						
– Commercial loans . . .	832	8	9	156	1,005	2,437
– Trade finance . . . . .	81	4	–	15	100	178
Total . . . . .	<u>3,533</u>	<u>49</u>	<u>24</u>	<u>233</u>	<u>3,839</u>	<u>8,216</u>

The Group						
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\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers						
Personal						
– Mortgages . . . . .	2,465	77	45	48	2,635	5,634
– Credit cards . . . . .	221	–	–	–	221	–
– Others . . . . .	428	3	12	31	474	875
Corporate						
– Commercial loans . . .	1,997	54	42	203	2,296	4,509
– Trade finance . . . . .	315	7	2	11	335	410
	5,426	141	101	293	5,961	11,428
Trade bills . . . . .	4	–	–	–	4	–
Total . . . . .	<u>5,430</u>	<u>141</u>	<u>101</u>	<u>293</u>	<u>5,965</u>	<u>11,428</u>

The Bank						
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\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers						
Personal						
– Mortgages . . . . .	1,772	32	12	28	1,844	4,135
– Others . . . . .	215	3	3	32	253	626
Corporate						
– Commercial loans . . .	588	2	8	154	752	1,969
– Trade finance . . . . .	57	4	–	15	76	163
Total . . . . .	<u>2,632</u>	<u>41</u>	<u>23</u>	<u>229</u>	<u>2,925</u>	<u>6,893</u>

The Bank						
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\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers						
Personal						
– Mortgages . . . . .	2,076	73	44	47	2,240	4,786
– Others . . . . .	324	3	12	31	370	731
Corporate						
– Commercial loans . . .	1,700	45	35	200	1,980	3,843
– Trade finance . . . . .	288	6	1	11	306	382
	4,388	127	92	289	4,896	9,742
Trade bills . . . . .	4	–	–	–	4	–
Total . . . . .	<u>4,392</u>	<u>127</u>	<u>92</u>	<u>289</u>	<u>4,900</u>	<u>9,742</u>

The Group		
	2008	2007
	HK\$'m	HK\$'m
Current market value of collateral held against the covered portion of advances to customers . . . . .	<u>8,216</u>	<u>11,428</u>
Covered portion of advances to customers . . . . .	<u>3,341</u>	<u>4,929</u>
Uncovered portion of advances to customers . . . . .	<u>498</u>	<u>1,032</u>

	The Bank	
	2008	2007
	HK\$'m	HK\$'m
Current market value of collateral held against the covered portion of advances to customers . . . . .	<u>6,893</u>	<u>9,742</u>
Covered portion of advances to customers . . . . .	<u>2,795</u>	<u>4,225</u>
Uncovered portion of advances to customers . . . . .	<u>130</u>	<u>671</u>

(c) *Impaired advances*

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

	The Group			
	2008		2007	
	Gross advances	Market value of collateral	Gross advances	Market value of collateral
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers				
Personal				
– Mortgages . . . . .	51	50	104	95
– Credit cards . . . . .	29	–	23	–
– Others . . . . .	79	21	95	54
Corporate				
– Commercial loans . . . . .	636	434	386	392
– Trade finance . . . . .	<u>531</u>	<u>205</u>	<u>89</u>	<u>18</u>
Total . . . . .	<u>1,326</u>	<u>710</u>	<u>697</u>	<u>559</u>
Loan impairment allowances made in respect of such advances . . . . .	<u>829</u>		<u>403</u>	

	The Bank			
	2008		2007	
	Gross advances	Market value of collateral	Gross advances	Market value of collateral
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers				
Personal				
– Mortgages . . . . .	42	41	89	81
– Others . . . . .	71	20	87	53
Corporate				
– Commercial loans . . . . .	446	396	338	355
– Trade finance . . . . .	<u>383</u>	<u>167</u>	<u>38</u>	<u>17</u>
Total . . . . .	<u>942</u>	<u>624</u>	<u>552</u>	<u>506</u>
Loan impairment allowances made in respect of such advances . . . . .	<u>531</u>		<u>306</u>	

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

	<b>The Group</b>	
	<b>2008</b>	2007
	<b>HK\$'m</b>	HK\$'m
Current market value of collateral held against the covered portion of advances to customers . . . . .	<b><u>710</u></b>	<u>559</u>
Covered portion of advances to customers . . . . .	<b><u>628</u></b>	<u>410</u>
Uncovered portion of advances to customers . . . . .	<b><u>698</u></b>	<u>287</u>

	<b>The Bank</b>	
	<b>2008</b>	2007
	<b>HK\$'m</b>	HK\$'m
Current market value of collateral held against the covered portion of advances to customers . . . . .	<b><u>624</u></b>	<u>506</u>
Covered portion of advances to customers . . . . .	<b><u>548</u></b>	<u>364</u>
Uncovered portion of advances to customers . . . . .	<b><u>394</u></b>	<u>188</u>

Classified or impaired advances to customers are analysed as follows:

	<b>The Group</b>	
	<b>2008</b>	2007
	<b>HK\$'m</b>	HK\$'m
Gross classified or impaired advances to customers . . . . .	<b><u>2,138</u></b>	<u>1,803</u>
Gross classified or impaired advances to customers as a percentage of gross advances to customers . . . . .	<b><u>0.46%</u></b>	<u>0.44%</u>
Individually assessed loan impairment allowances made in respect of such advances . . . . .	<b><u>800</u></b>	<u>381</u>

	<b>The Bank</b>	
	<b>2008</b>	2007
	<b>HK\$'m</b>	HK\$'m
Gross classified or impaired advances to customers . . . . .	<b><u>1,660</u></b>	<u>1,551</u>
Gross classified or impaired advances to customers as a percentage of gross advances to customers . . . . .	<b><u>0.44%</u></b>	<u>0.46%</u>
Individually assessed loan impairment allowances made in respect of such advances . . . . .	<b><u>531</u></b>	<u>306</u>

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

(d) *Advances overdue for more than 3 months*

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

The Group				
2008			2007	
Amount	% of gross advances to customers	Amount	% of gross advances to customers	
HK\$'m		HK\$'m		
Gross advances to customers which have been overdue for:				
– six months or less but over three months . . . . .	339	0.07%	242	0.06%
– one year or less but over six months . .	66	0.02%	163	0.04%
– over one year . . . . .	<u>571</u>	<u>0.12%</u>	<u>652</u>	<u>0.16%</u>
Advances overdue for over three months . .	<u>976</u>	<u>0.21%</u>	<u>1,057</u>	<u>0.26%</u>
Individually assessed loan impairment allowances made in respect of such advances . . . . .				
	<u>439</u>		<u>305</u>	

The Bank				
2008			2007	
Amount	% of gross advances to customers	Amount	% of gross advances to customers	
HK\$'m		HK\$'m		
Gross advances to customers which have been overdue for:				
– six months or less but over three months . . . . .	132	0.04%	188	0.06%
– one year or less but over six months . .	56	0.01%	136	0.04%
– over one year . . . . .	<u>536</u>	<u>0.14%</u>	<u>625</u>	<u>0.18%</u>
Advances overdue for over three months . .	<u>724</u>	<u>0.19%</u>	<u>949</u>	<u>0.28%</u>
Individually assessed loan impairment allowances made in respect of such advances . . . . .				
	<u>254</u>		<u>276</u>	

	<b>The Group</b>	
	<b>2008</b>	<b>2007</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Current market value of collateral held against the covered portion of advances to customers . . . . .	<u><b>1,436</b></u>	<u><b>1,970</b></u>
Covered portion of advances to customers . . . . .	<u><b>604</b></u>	<u><b>847</b></u>
Uncovered portion of advances to customers . . . . .	<u><b>372</b></u>	<u><b>210</b></u>

	<b>The Bank</b>	
	<b>2008</b>	<b>2007</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Current market value of collateral held against the covered portion of advances to customers . . . . .	<u><b>1,330</b></u>	<u><b>1,884</b></u>
Covered portion of advances to customers . . . . .	<u><b>571</b></u>	<u><b>796</b></u>
Uncovered portion of advances to customers . . . . .	<u><b>153</b></u>	<u><b>153</b></u>

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 for the Group and the Bank.

*(e) Rescheduled advances*

	<b>The Group</b>			
	<b>2008</b>		<b>2007</b>	
	<b>Amount</b>	<b>% of gross advances to customers</b>	<b>Amount</b>	<b>% of gross advances to customers</b>
	<b>HK\$'m</b>		<b>HK\$'m</b>	
Rescheduled advances to customers net of amounts included in advances overdue for more than 3 months . . . . .	<u><b>127</b></u>	<u><b>0.03%</b></u>	<u><b>186</b></u>	<u><b>0.05%</b></u>

The Bank			
2008		2007	
Amount	% of gross advances to customers	Amount	% of gross advances to customers
HK\$m		HK\$m	
Rescheduled advances to customers net of amounts included in advances overdue for more than 3 months . . . . .	<u>72</u> <u>0.02%</u>	<u>121</u> <u>0.04%</u>	

As at 31 December 2008, the total rescheduled advances to customers during the year amounted to HK\$54 million (2007: HK\$88 million) and HK\$45 million (2007: HK\$80 million) for the Group and the Bank respectively.

As at 31 December 2008 and 2007, there were no rescheduled advances to banks and other financial institutions for the Group and the Bank.

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.



(f) *Concentration of advances to customers*

(i) Sectoral analysis of gross advances to customers

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

	The Group					
	2008					
		% Covered by collateral or other security	Classified or impaired	Overdue*	Individually assessed impairment allowances	Collectively assessed impairment allowances
	Gross advances					
	HK\$'m		HK\$'m	HK\$'m	HK\$'m	HK\$'m
Loans for use in Hong Kong						
Industrial, commercial and financial						
– Property development . . .	19,856	40.49%	2	14	1	66
– Property investment . . . .	71,374	88.00%	294	585	30	312
– Financial concerns . . . . .	12,312	8.14%	–	–	1	56
– Stockbrokers . . . . .	124	10.33%	–	–	–	–
– Wholesale and retail trade . . . . .	18,156	52.85%	218	300	71	98
– Manufacturing . . . . .	16,410	53.67%	234	298	138	80
– Transport and transport equipment . . . . .	21,590	13.82%	2	9	1	81
– Recreational activities . .	139	46.87%	–	–	–	–
– Information technology . .	6,049	2.21%	–	3	–	19
– Others . . . . .	23,529	26.91%	68	213	13	83
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme . . . . .	13,477	99.91%	98	510	4	12
– Loans for purchase of other residential properties . . . . .	116,303	99.97%	153	1,650	7	74
– Credit card advances . . .	6,553	–	30	273	–	71
– Others . . . . .	11,452	77.84%	107	333	57	20
Total loans for use in						
Hong Kong . . . . .	337,324	70.68%	1,206	4,188	323	972
Trade finance . . . . .	24,555	30.36%	560	494	355	108
Loans for use outside						
Hong Kong . . . . .	99,295	22.38%	372	235	122	421
Gross advances to customers .	461,174	58.14%	2,138	4,917	800	1,501

The Group						
2007						
	Gross advances	% Covered by collateral or other security	Classified or impaired	Overdue*	Individually assessed impairment allowances	Collectively assessed impairment allowances
	HK\$'m		HK\$'m	HK\$'m	HK\$'m	HK\$'m
Loans for use in Hong Kong						
Industrial, commercial and financial						
– Property development . . .	17,979	33.97%	16	18	3	52
– Property investment . . . .	65,963	86.50%	343	961	14	187
– Financial concerns . . . . .	12,346	6.05%	–	14	–	43
– Stockbrokers . . . . .	242	12.10%	–	–	–	–
– Wholesale and retail trade . . . . .	13,572	65.05%	238	382	85	41
– Manufacturing . . . . .	14,468	58.08%	138	550	37	48
– Transport and transport equipment . . . . .	21,001	21.11%	3	25	1	60
– Recreational activities . .	30	93.53%	–	–	–	–
– Information technology . .	2,009	37.39%	–	2	–	6
– Others . . . . .	21,046	41.70%	90	584	16	65
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme . . . . .	13,969	99.78%	129	599	8	13
– Loans for purchase of other residential properties . . . . .	106,583	99.87%	284	2,078	18	81
– Credit card advances . . .	5,761	–	23	245	–	63
– Others . . . . .	<u>10,686</u>	<u>79.57%</u>	<u>119</u>	<u>314</u>	<u>50</u>	<u>14</u>
Total loans for use in						
Hong Kong . . . . .	305,655	73.30%	1,383	5,772	232	673
Trade finance . . . . .	24,275	40.71%	105	399	73	77
Loans for use outside						
Hong Kong . . . . .	<u>83,110</u>	<u>39.76%</u>	<u>315</u>	<u>375</u>	<u>76</u>	<u>254</u>
Gross advances to customers .	<u>413,040</u>	<u>64.64%</u>	<u>1,803</u>	<u>6,546</u>	<u>381</u>	<u>1,004</u>

The Bank						
2008						
	Gross advances	% Covered by collateral or other security	Classified or impaired	Overdue*	Individually assessed impairment allowances	Collectively assessed impairment allowances
	HK\$'m		HK\$'m	HK\$'m	HK\$'m	HK\$'m
Loans for use in Hong Kong						
Industrial, commercial and financial						
– Property development . . .	17,134	38.58%	2	14	1	51
– Property investment . . . .	59,644	88.41%	287	503	30	237
– Financial concerns . . . . .	16,297	5.21%	–	–	–	51
– Stockbrokers . . . . .	123	9.97%	–	–	–	–
– Wholesale and retail trade . . . . .	16,142	50.04%	204	254	68	85
– Manufacturing . . . . .	12,515	57.83%	141	197	52	57
– Transport and transport equipment . . . . .	17,641	14.80%	2	5	1	54
– Recreational activities . .	128	50.04%	–	–	–	–
– Information technology . .	5,620	2.02%	–	–	–	17
– Others . . . . .	19,568	20.92%	65	160	11	58
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme . . . . .	11,964	99.92%	88	429	4	12
– Loans for purchase of other residential properties . . . . .	102,674	99.97%	135	1,436	7	67
– Credit card advances . . .	–	–	–	–	–	–
– Others . . . . .	6,828	93.86%	97	224	55	5
Total loans for use in						
Hong Kong . . . . .	286,278	71.05%	1,021	3,222	229	694
Trade finance . . . . .	21,578	27.56%	412	339	244	90
Loans for use outside						
Hong Kong . . . . .	69,388	17.69%	227	88	58	229
Gross advances to customers .	<u>377,244</u>	<u>58.75%</u>	<u>1,660</u>	<u>3,649</u>	<u>531</u>	<u>1,013</u>

The Bank						
2007						
	Gross advances	% Covered by collateral or other security	Classified or impaired	Overdue*	Individually assessed impairment allowances	Collectively assessed impairment allowances
	HK\$'m		HK\$'m	HK\$'m	HK\$'m	HK\$'m
Loans for use in Hong Kong						
Industrial, commercial and financial						
– Property development . . .	15,104	33.54%	16	17	3	36
– Property investment . . . .	55,430	86.84%	329	844	14	136
– Financial concerns . . . . .	13,986	3.52%	–	5	–	33
– Stockbrokers . . . . .	234	9.34%	–	–	–	–
– Wholesale and retail trade . . . . .	11,639	63.13%	215	315	79	31
– Manufacturing . . . . .	11,061	62.01%	115	470	33	31
– Transport and transport equipment . . . . .	17,374	23.34%	3	15	1	42
– Recreational activities . .	29	93.30%	–	–	–	–
– Information technology . .	1,550	47.87%	–	1	–	4
– Others . . . . .	15,323	35.00%	85	521	13	38
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme . . . . .	12,224	99.85%	119	502	8	12
– Loans for purchase of other residential properties . . . . .	92,284	99.91%	257	1,782	15	72
– Credit card advances . . .	–	–	–	–	–	–
– Others . . . . .	<u>7,470</u>	<u>87.81%</u>	<u>109</u>	<u>241</u>	<u>48</u>	<u>6</u>
Total loans for use in						
Hong Kong . . . . .	253,708	74.52%	1,248	4,713	214	441
Trade finance . . . . .	20,726	38.55%	54	337	23	59
Loans for use outside						
Hong Kong . . . . .	<u>60,773</u>	<u>35.13%</u>	<u>249</u>	<u>315</u>	<u>69</u>	<u>148</u>
Gross advances to customers .	<u>335,207</u>	<u>65.16%</u>	<u>1,551</u>	<u>5,365</u>	<u>306</u>	<u>648</u>

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

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

	The Group			
	2008		2007	
	New impairment allowances	Classified or impaired loans written off	New impairment allowances	Classified or impaired loans written off
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Loans for use in Hong Kong				
Industrial, commercial and financial				
– Property development . . . . .	28	–	25	–
– Property investment . . . . .	139	5	99	9
– Financial concerns . . . . .	24	–	22	–
– Stockbrokers . . . . .	–	–	–	–
– Wholesale and retail trade. . . . .	120	103	149	98
– Manufacturing . . . . .	249	125	58	18
– Transport and transport equipment. . . . .	34	–	31	–
– Recreational activities. . . . .	–	–	–	–
– Information technology. . . . .	9	–	3	–
– Others . . . . .	34	8	77	5
Individuals				
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme . . . . .	1	1	13	4
– Loans for purchase of other residential properties. . . . .	8	–	79	1
– Credit card advances . . . . .	157	141	124	126
– Others . . . . .	61	47	50	50
Total loans for use in Hong Kong . . . . .	864	430	730	311
Trade finance . . . . .	374	26	76	15
Loans for use outside Hong Kong . . . . .	266	19	149	1
Gross advances to customers. . . . .	<u>1,504</u>	<u>475</u>	<u>955</u>	<u>327</u>

The Bank				
	2008		2007	
	New	Classified or	New	Classified or
	impairment	impaired	impairment	impaired
	allowances	loans written	allowances	loans written
	off	off		
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Loans for use in Hong Kong				
Industrial, commercial and financial				
– Property development . . . . .	26	–	18	–
– Property investment . . . . .	116	5	73	7
– Financial concerns . . . . .	24	–	17	–
– Stockbrokers . . . . .	–	–	–	–
– Wholesale and retail trade . . . . .	114	100	134	97
– Manufacturing . . . . .	151	114	47	14
– Transport and transport equipment . . . . .	27	–	21	–
– Recreational activities . . . . .	–	–	–	–
– Information technology . . . . .	8	–	2	–
– Others . . . . .	34	7	24	5
Individuals				
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme . . . . .	1	1	12	4
– Loans for purchase of other residential properties . . . . .	8	–	69	–
– Credit card advances . . . . .	–	–	–	–
– Others . . . . .	27	12	19	21
Total loans for use in Hong Kong . . . . .	536	239	436	148
Trade finance . . . . .	278	–	43	–
Loans for use outside Hong Kong . . . . .	128	18	88	–
Gross advances to customers . . . . .	942	257	567	148

(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**

	<b>The Group</b>	
	<b>2008</b>	<b>2007</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Hong Kong . . . . .	<b>375,233</b>	351,080
Mainland China . . . . .	<b>55,318</b>	39,050
Others . . . . .	<b>30,623</b>	22,910
	<b><u>461,174</u></b>	<b><u>413,040</u></b>

	<b>The Bank</b>	
	<b>2008</b>	<b>2007</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Hong Kong . . . . .	<b>315,572</b>	291,521
Mainland China . . . . .	<b>35,809</b>	25,260
Others . . . . .	<b>25,863</b>	18,426
	<b><u>377,244</u></b>	<b><u>335,207</u></b>

*Collectively assessed loan impairment allowances in respect of the gross advances to customers*

	<b>The Group</b>	
	<b>2008</b>	<b>2007</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Hong Kong . . . . .	<b>1,172</b>	827
Mainland China . . . . .	<b>221</b>	124
Others . . . . .	<b>108</b>	53
	<b><u>1,501</u></b>	<b><u>1,004</u></b>

	<b>The Bank</b>	
	<b>2008</b>	<b>2007</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Hong Kong . . . . .	<b>818</b>	555
Mainland China . . . . .	<b>112</b>	58
Others . . . . .	<b>83</b>	35
	<b><u>1,013</u></b>	<b><u>648</u></b>



## Overdue advances

	The Group	
	2008	2007
	HK\$m	HK\$m
Hong Kong . . . . .	4,622	6,221
Mainland China . . . . .	266	278
Others . . . . .	29	47
	<u>4,917</u>	<u>6,546</u>

	The Bank	
	2008	2007
	HK\$m	HK\$m
Hong Kong . . . . .	3,569	5,149
Mainland China . . . . .	73	174
Others . . . . .	7	42
	<u>3,649</u>	<u>5,365</u>

## *Individually assessed loan impairment allowances in respect of the overdue advances*

	The Group	
	2008	2007
	HK\$m	HK\$m
Hong Kong . . . . .	554	284
Mainland China . . . . .	99	46
Others . . . . .	21	2
	<u>674</u>	<u>332</u>

	The Bank	
	2008	2007
	HK\$m	HK\$m
Hong Kong . . . . .	378	241
Mainland China . . . . .	42	35
Others . . . . .	—	2
	<u>420</u>	<u>278</u>

*Collectively assessed loan impairment allowances in respect of the overdue advances*

	<b>The Group</b>	
	<b>2008</b>	2007
	HK\$'m	HK\$'m
Hong Kong . . . . .	<b>50</b>	60
Mainland China . . . . .	<u><b>6</b></u>	<u>10</u>
	<u><b>56</b></u>	<u><b>70</b></u>

	<b>The Bank</b>	
	<b>2008</b>	2007
	HK\$'m	HK\$'m
Hong Kong . . . . .	<b>23</b>	26
Mainland China . . . . .	<u><b>–</b></u>	<u>1</u>
	<u><b>23</b></u>	<u><b>27</b></u>

**Classified or impaired advances**

	<b>The Group</b>	
	<b>2008</b>	2007
	HK\$'m	HK\$'m
Hong Kong . . . . .	<b>1,792</b>	1,572
Mainland China . . . . .	<b>323</b>	223
Others . . . . .	<u><b>23</b></u>	<u>8</u>
	<u><b>2,138</b></u>	<u><b>1,803</b></u>

	<b>The Bank</b>	
	<b>2008</b>	2007
	HK\$'m	HK\$'m
Hong Kong . . . . .	<b>1,461</b>	1,342
Mainland China . . . . .	<b>198</b>	201
Others . . . . .	<u><b>1</b></u>	<u>8</u>
	<u><b>1,660</b></u>	<u><b>1,551</b></u>

*Individually assessed loan impairment allowances in respect of the classified or impaired advances*

	<b>The Group</b>	
	<b>2008</b>	<b>2007</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Hong Kong . . . . .	<b>677</b>	333
Mainland China . . . . .	<b>100</b>	46
Others . . . . .	<b>23</b>	2
	<b><u>800</u></b>	<b><u>381</u></b>

	<b>The Bank</b>	
	<b>2008</b>	<b>2007</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Hong Kong . . . . .	<b>487</b>	269
Mainland China . . . . .	<b>43</b>	35
Others . . . . .	<b>1</b>	2
	<b><u>531</u></b>	<b><u>306</u></b>

*Collectively assessed loan impairment allowances in respect of the classified or impaired advances*

	<b>The Group</b>	
	<b>2008</b>	<b>2007</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Hong Kong . . . . .	<b>26</b>	19
Mainland China . . . . .	<b>7</b>	6
	<b><u>33</u></b>	<b><u>25</u></b>

	<b>The Bank</b>	
	<b>2008</b>	<b>2007</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Hong Kong . . . . .	<b>2</b>	2
Mainland China . . . . .	<b>1</b>	1
	<b><u>3</u></b>	<b><u>3</u></b>

### ***Reposessed 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:

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$m	HK\$m	HK\$m	HK\$m
Commercial properties . . . . .	<b>18</b>	10	<b>12</b>	6
Residential properties . . . . .	<u><b>85</b></u>	<u>43</u>	<u><b>84</b></u>	<u>40</u>
	<u><b>103</b></u>	<u>53</u>	<u><b>96</b></u>	<u>46</u>

The estimated market value of reposessed assets held by the Group and the Bank as at 31 December 2008 amounted to HK\$173 million (2007: HK\$116 million) and HK\$165 million (2007: HK\$91 million) respectively. They comprise properties in respect of which the Group and the Bank have 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 reposessed 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

### ***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.

	The Group			
	2008			
	Aaa to A3	Lower than A3	Unrated	Total
	HK\$m	HK\$m	HK\$m	HK\$m
Central banks . . . . .	<b>66,158</b>	–	–	<b>66,158</b>
Banks and other financial institutions . . . .	<u><b>168,456</b></u>	<u>585</u>	<u>3,555</u>	<u><b>172,596</b></u>
	<u><b>234,614</b></u>	<u>585</u>	<u>3,555</u>	<u><b>238,754</b></u>

<b>The Group</b>				
<b>2007</b>				
	<b>Aaa to A3</b>	<b>Lower than A3</b>	<b>Unrated</b>	<b>Total</b>
	<b>HK\$m</b>	<b>HK\$m</b>	<b>HK\$m</b>	<b>HK\$m</b>
Central banks . . . . .	30,627	–	–	30,627
Banks and other financial institutions . . . .	<u>173,236</u>	<u>2,046</u>	<u>2,963</u>	<u>178,245</u>
	<u>203,863</u>	<u>2,046</u>	<u>2,963</u>	<u>208,872</u>
<b>The Bank</b>				
<b>2008</b>				
	<b>Aaa to A3</b>	<b>Lower than A3</b>	<b>Unrated</b>	<b>Total</b>
	<b>HK\$m</b>	<b>HK\$m</b>	<b>HK\$m</b>	<b>HK\$m</b>
Central banks . . . . .	<b>64,407</b>	–	–	<b>64,407</b>
Banks and other financial institutions . . . .	<u>129,000</u>	<u>459</u>	<u>3,726</u>	<u>133,185</u>
	<u>193,407</u>	<u>459</u>	<u>3,726</u>	<u>197,592</u>
<b>The Bank</b>				
<b>2007</b>				
	<b>Aaa to A3</b>	<b>Lower than A3</b>	<b>Unrated</b>	<b>Total</b>
	<b>HK\$m</b>	<b>HK\$m</b>	<b>HK\$m</b>	<b>HK\$m</b>
Central banks . . . . .	29,814	–	–	29,814
Banks and other financial institutions . . . .	<u>128,521</u>	<u>1,416</u>	<u>3,304</u>	<u>133,241</u>
	<u>158,335</u>	<u>1,416</u>	<u>3,304</u>	<u>163,055</u>

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

## Debt securities

The table below represents an analysis of the carrying value of debt securities by credit rating and credit risk characteristic, based on Moody's ratings or their equivalent to the respective issues of the debt securities.

The Group							
2008							
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated		Other
					Hong Kong government and government bodies	Other governments and government agencies	
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
<b>Investment in securities</b>							
US non-agency residential							
mortgage-backed							
– Subprime . . . . .	913	–	30	104	–	–	1,047
– Alt-A . . . . .	1,245	383	274	432	–	–	2,334
– Prime . . . . .	9,549	1,558	2,878	1,950	–	–	15,935
Fannie Mae							
– issued debt securities . . . . .	1,504	–	–	–	–	–	1,504
– mortgage-backed securities . . . . .	–	–	–	–	–	88	88
Freddie Mac							
– issued debt securities . . . . .	864	162	–	–	–	–	1,026
– mortgage-backed securities . . . . .	–	–	–	–	–	1,633	1,633
Other MBS/ABS . . . . .	6,874	24	63	–	–	3,807	10,768
Other debt securities . . . . .	40,537	83,827	26,437	4,371	12,175	51,368	254,588
Subtotal . . . . .	61,486	85,954	29,682	6,857	12,175	56,896	288,923
<b>Financial assets at fair value through</b>							
<b>profit or loss</b>							
Other MBS/ABS . . . . .	27	–	–	–	–	–	27
Other debt securities . . . . .	243	1,814	1,800	729	11,358	–	16,295
Subtotal . . . . .	270	1,814	1,800	729	11,358	–	16,322
Total . . . . .	61,756	87,768	31,482	7,586	23,533	56,896	305,245

*Note:* In 2007, securities issued by Ginnie Mae of HK\$3,365 million were disclosed as Aaa rating, whereas for the current year such securities of HK\$3,807 million have been included in above as “Unrated – Other governments and government agencies”.

The Group							
2007							
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated		Other
					Hong Kong government and government bodies	Other governments and government agencies	
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
<b>Investment in securities</b>							
US non-agency residential							
mortgage-backed							
– Subprime . . . . .	4,118	–	–	–	–	–	4,118
– Alt-A . . . . .	6,567	–	–	–	–	–	6,567
– Prime . . . . .	29,014	–	–	–	–	–	29,014
Fannie Mae							
– issued debt securities. . . . .	4,243	–	–	–	–	–	4,243
– mortgage-backed securities . . . . .	–	–	–	–	–	104	104
Freddie Mac							
– issued debt securities. . . . .	2,753	165	–	–	–	–	2,918
– mortgage-backed securities . . . . .	–	–	–	–	–	1,683	1,683
Other MBS/ABS . . . . .	14,105	78	–	–	–	–	14,322
Other debt securities . . . . .	33,572	88,709	27,062	2,772	6,946	–	233,634
Subtotal . . . . .	94,372	88,952	27,062	2,772	6,946	1,787	296,603
<b>Financial assets at fair value through profit or loss</b>							
Other MBS/ABS . . . . .	40	–	–	–	–	–	40
Other debt securities . . . . .	693	2,108	1,647	1,136	3,518	–	9,841
Subtotal . . . . .	733	2,108	1,647	1,136	3,518	–	9,881
Total . . . . .	95,105	91,060	28,709	3,908	10,464	1,787	306,484

The total amount of unrated issues of the Group amounted to HK\$116,653 million (2007: HK\$87,702 million) as at 31 December 2008, of which only HK\$8,971 million (2007: HK\$10,672 million) were without issuer ratings. For details, please refer to page 137.

The Bank

	2008							
					Unrated			
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Hong Kong government and government bodies	Other governments and government agencies	Other	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>Investment in securities</b>								
US non-agency residential								
mortgage-backed								
– Subprime . . . . .	913	–	30	104	–	–	–	1,047
– Alt-A . . . . .	1,245	383	274	432	–	–	–	2,334
– Prime . . . . .	9,549	1,558	2,878	1,950	–	–	–	15,935
Fannie Mae								
– issued debt securities. . . . .	1,504	–	–	–	–	–	–	1,504
– mortgage-backed securities . . . . .	–	–	–	–	–	88	–	88
Freddie Mac								
– issued debt securities. . . . .	864	162	–	–	–	–	–	1,026
– mortgage-backed securities . . . . .	–	–	–	–	–	1,633	–	1,633
Other MBS/ABS . . . . .	6,630	9	63	–	–	3,807	–	10,509
Other debt securities . . . . .	39,837	75,702	23,148	2,713	11,234	51,368	26,776	230,778
Subtotal . . . . .	60,542	77,814	26,393	5,199	11,234	56,896	26,776	264,854
<b>Financial assets at fair value through profit or loss</b>								
Other debt securities . . . . .	–	1,460	969	134	10,451	–	2	13,016
Subtotal . . . . .	–	1,460	969	134	10,451	–	2	13,016
Total . . . . .	60,542	79,274	27,362	5,333	21,685	56,896	26,778	277,870

*Note:* In 2007, securities issued by Ginnie Mae of HK\$3,365 million were disclosed as Aaa rating, whereas for the current year such securities of HK\$3,807 million have been included in above as “Unrated – Other governments and government agencies”.



	The Bank							
	2007							
					Unrated			
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Hong Kong government and government bodies	Other governments and government agencies	Other	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Investment insecurities								
US non-agency residential								
mortgage-backed								
– Subprime . . . . .	4,118	–	–	–	–	–	–	4,118
– Alt-A . . . . .	6,567	–	–	–	–	–	–	6,567
– Prime . . . . .	29,014	–	–	–	–	–	–	29,014
Fannie Mae								
– issued debt securities. . . . .	4,243	–	–	–	–	–	–	4,243
– mortgage-backed securities . . . . .	–	–	–	–	–	104	–	104
Freddie Mac								
– issued debt securities. . . . .	2,753	165	–	–	–	–	–	2,918
– mortgage-backed securities . . . . .	–	–	–	–	–	1,683	–	1,683
Other MBS/ABS . . . . .	13,844	28	–	–	–	–	79	13,951
Other debt securities . . . . .	32,527	81,660	25,231	1,762	6,057	–	61,152	208,389
Subtotal . . . . .	93,066	81,853	25,231	1,762	6,057	1,787	61,231	270,987
Financial assets at fair value through profit or loss								
Other debt securities . . . . .	76	1,381	1,010	181	3,066	–	328	6,042
Subtotal . . . . .	76	1,381	1,010	181	3,066	–	328	6,042
Total . . . . .	93,142	83,234	26,241	1,943	9,123	1,787	61,559	277,029

The total amount of unrated issues of the Bank amounted to HK\$105,359 million (2007: HK\$72,469 million) as at 31 December 2008, of which only HK\$7,788 million (2007: HK\$8,650 million) were without issuer ratings. For details, please refer to page 138.

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

The Group						
2008						
Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total	
HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	
Available-for-sale securities . . . . .	18,180	49,408	3,293	35	5,481	76,397
Held-to-maturity securities . . . . .	624	10,140	2,037	–	3,151	15,952
Loans and receivables . . .	3,386	8,768	397	–	44	12,595
Financial assets at fair value through profit or loss . . . . .	1	11,413	–	–	295	11,709
Total . . . . .	<u>22,191</u>	<u>79,729</u>	<u>5,727</u>	<u>35</u>	<u>8,971</u>	<u>116,653</u>

The Group						
2007						
Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total	
HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	
Available-for-sale securities . . . . .	2,486	8,166	3,818	440	1,708	16,618
Held-to-maturity securities . . . . .	5,859	20,467	3,765	50	5,584	35,725
Loans and receivables . . .	8,572	19,365	80	–	3,085	31,102
Financial assets at fair value through profit or loss . . . . .	29	3,843	20	70	295	4,257
Total . . . . .	<u>16,946</u>	<u>51,841</u>	<u>7,683</u>	<u>560</u>	<u>10,672</u>	<u>87,702</u>

The Bank						
2008						
Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total	
HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	
Available-for-sale securities . . . . .	18,180	48,062	3,228	35	4,838	74,343
Held-to-maturity securities . . . . .	624	6,664	1,881	–	2,950	12,119
Loans and receivables . . .	2,329	6,115	–	–	–	8,444
Financial assets at fair value through profit or loss . . . . .	–	10,453	–	–	–	10,453
Total . . . . .	<u>21,133</u>	<u>71,294</u>	<u>5,109</u>	<u>35</u>	<u>7,788</u>	<u>105,359</u>

The Bank						
2007						
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Available-for-sale securities . . . . .	2,486	6,984	3,694	440	687	14,291
Held-to-maturity securities . . . . .	5,519	17,720	3,755	50	4,956	32,000
Loans and receivables . . .	7,810	11,967	–	–	3,007	22,784
Financial assets at fair value through profit or loss . . . . .	–	3,304	20	70	–	3,394
Total . . . . .	<u>15,815</u>	<u>39,975</u>	<u>7,469</u>	<u>560</u>	<u>8,650</u>	<u>72,469</u>

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.

The Group						
2008						
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Available-for-sale securities . . . . .	<b>32,231</b>	<b>41,722</b>	<b>12,752</b>	<b>1,839</b>	<b>76,362</b>	<b>164,906</b>
Held-to-maturity securities . . . . .	<b>22,667</b>	<b>42,554</b>	<b>15,129</b>	<b>2,067</b>	<b>15,952</b>	<b>98,369</b>
Loans and receivables . . .	–	–	–	–	<b>12,595</b>	<b>12,595</b>
Financial assets at fair value through profit or loss . . . . .	<b>270</b>	<b>1,814</b>	<b>1,800</b>	<b>729</b>	<b>11,709</b>	<b>16,322</b>
Total . . . . .	<u><b>55,168</b></u>	<u><b>86,090</b></u>	<u><b>29,681</b></u>	<u><b>4,635</b></u>	<u><b>116,618</b></u>	<u><b>292,192</b></u>

The Group						
2007						
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
Available-for-sale securities . . . . .	42,166	28,588	10,686	1,459	16,618	99,517
Held-to-maturity securities . . . . .	47,912	60,364	16,376	1,313	35,725	161,690
Loans and receivables . . .	–	–	–	–	31,102	31,102
Financial assets at fair value through profit or loss . . . . .	733	2,108	1,647	1,136	4,257	9,881
Total . . . . .	<u>90,811</u>	<u>91,060</u>	<u>28,709</u>	<u>3,908</u>	<u>87,702</u>	<u>302,190</u>

The Bank						
2008						
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
Available-for-sale securities . . . . .	32,231	41,205	11,707	1,113	74,308	160,564
Held-to-maturity securities . . . . .	21,723	34,931	12,885	1,135	12,119	82,793
Loans and receivables . . .	–	–	–	–	8,444	8,444
Financial assets at fair value through profit or loss . . . . .	–	1,460	969	134	10,453	13,016
Total . . . . .	<u>53,954</u>	<u>77,596</u>	<u>25,561</u>	<u>2,382</u>	<u>105,324</u>	<u>264,817</u>

The Bank						
2007						
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
Available-for-sale securities . . . . .	42,165	28,588	10,429	1,301	14,291	96,774
Held-to-maturity securities . . . . .	46,607	53,265	14,802	461	32,000	147,135
Loans and receivables . . .	–	–	–	–	22,784	22,784
Financial assets at fair value through profit or loss . . . . .	76	1,381	1,010	181	3,394	6,042
Total . . . . .	<u>88,848</u>	<u>83,234</u>	<u>26,241</u>	<u>1,943</u>	<u>72,469</u>	<u>272,735</u>

The carrying values of impaired debt securities by credit rating are analysed as follows:

	The Group and the Bank						
	2008						
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total	Of which impairment allowances
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Available-for-sale securities . . . . .	3,451	814	542	1,187	35	6,029	4,561
Held-to-maturity securities . . . . .	3,137	864	1,259	1,764	–	7,024	4,440
Total . . . . .	<u>6,588</u>	<u>1,678</u>	<u>1,801</u>	<u>2,951</u>	<u>35</u>	<u>13,053</u>	<u>9,001</u>
Of which impairment allowances . . .	4,195	1,400	976	2,078	352	9,001	

	The Group and the Bank						
	2007						
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total	Of which impairment allowances
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Available-for-sale securities . . . . .	556	—	—	—	—	556	190
Held-to-maturity securities . . . . .	<u>3,738</u>	—	—	—	—	<u>3,738</u>	<u>1,682</u>
Total . . . . .	<u>4,294</u>	—	—	—	—	<u>4,294</u>	<u>1,872</u>
Of which impairment allowances . . .	<u>1,872</u>	—	—	—	—	<u>1,872</u>	

As at 31 December 2008 and 2007, there were no overdue but not impaired debt securities for the Group and the Bank.

Debt securities overdue for more than 3 months are analysed as follows:

The Group and the Bank	
Overdue for 6 months or less but over 3 months	
2008	2007
HK\$'m	HK\$'m
Available-for-sale securities . . . . .	<u>35</u>

*MBS/ABS*

The table below represents an analysis of the Group's and the Bank's exposure to MBS/ABS by geographical location.

	The Group		
	2008		
	Carrying values	Of which	Of which
	HK\$m	impaired	impairment
		HK\$m	allowances
			HK\$m
<b>US MBS/ABS</b>			
Non-agency residential mortgage-backed			
– Subprime . . . . .	1,047	829	339
– Alt-A. . . . .	2,334	1,750	1,302
– Prime . . . . .	15,935	9,594	6,479
Ginnie Mae . . . . .	3,807	–	–
Fannie Mae . . . . .	88	–	–
Freddie Mac . . . . .	1,633	–	–
Commercial mortgage-backed . . . . .	929	–	–
Others . . . . .	2,806	–	–
	<u>28,579</u>	<u>12,173</u>	<u>8,120</u>
<b>Other countries MBS/ABS</b>			
Residential mortgage-backed . . . . .	2,649	69	27
Commercial mortgage-backed . . . . .	454	–	–
Others . . . . .	150	–	–
	<u>3,253</u>	<u>69</u>	<u>27</u>
Total MBS/ABS . . . . .	<u>31,832</u>	<u>12,242</u>	<u>8,147</u>

The Group			
2007			
	Carrying values	Of which impaired	Of which impairment allowances
	HK\$'m	HK\$'m	HK\$'m
<b>US MBS/ABS</b>			
Non-agency residential mortgage-backed			
– Subprime . . . . .	4,118	2,856	1,253
– Alt-A. . . . .	6,567	1,380	573
– Prime . . . . .	29,014	58	46
Ginnie Mae . . . . .	3,365	–	–
Fannie Mae . . . . .	104	–	–
Freddie Mac . . . . .	1,683	–	–
Commercial mortgage-backed . . . . .	997	–	–
Others . . . . .	3,692	–	–
	<u>49,540</u>	<u>4,294</u>	<u>1,872</u>
<b>Other countries MBS/ABS</b>			
Residential mortgage-backed . . . . .	5,189	–	–
Commercial mortgage-backed . . . . .	561	–	–
Others . . . . .	558	–	–
	<u>6,308</u>	<u>–</u>	<u>–</u>
Total MBS/ABS . . . . .	<u>55,848</u>	<u>4,294</u>	<u>1,872</u>

The Bank			
2008			
	Carrying values	Of which impaired	Of which impairment allowances
	HK\$'m	HK\$'m	HK\$'m
<b>US MBS/ABS</b>			
Non-agency residential mortgage-backed			
– Subprime . . . . .	1,047	829	339
– Alt-A. . . . .	2,334	1,750	1,302
– Prime . . . . .	15,935	9,594	6,479
Ginnie Mae . . . . .	3,807	–	–
Fannie Mae . . . . .	88	–	–
Freddie Mac . . . . .	1,633	–	–
Commercial mortgage-backed . . . . .	929	–	–
Others . . . . .	2,806	–	–
	<u>28,579</u>	<u>12,173</u>	<u>8,120</u>
<b>Other countries MBS/ABS</b>			
Residential mortgage-backed . . . . .	2,405	69	27
Commercial mortgage-backed . . . . .	427	–	–
Others . . . . .	135	–	–
	<u>2,967</u>	<u>69</u>	<u>27</u>
Total MBS/ABS . . . . .	<u>31,546</u>	<u>12,242</u>	<u>8,147</u>

The Bank			
2007			
	Carrying values	Of which	Of which
	HK\$m	impaired	impairment
		HK\$m	allowances
			HK\$m
<b>US MBS/ABS</b>			
Non-agency residential mortgage-backed			
– Subprime . . . . .	4,118	2,856	1,253
– Alt-A . . . . .	6,567	1,380	573
– Prime . . . . .	29,014	58	46
Ginnie Mae . . . . .	3,365	–	–
Fannie Mae . . . . .	104	–	–
Freddie Mac . . . . .	1,683	–	–
Commercial mortgage-backed . . . . .	997	–	–
Others . . . . .	3,692	–	–
	<u>49,540</u>	<u>4,294</u>	<u>1,872</u>
<b>Other countries MBS/ABS</b>			
Residential mortgage-backed . . . . .	4,867	–	–
Commercial mortgage-backed . . . . .	521	–	–
Others . . . . .	509	–	–
	<u>5,897</u>	<u>–</u>	<u>–</u>
Total MBS/ABS . . . . .	<u>55,437</u>	<u>4,294</u>	<u>1,872</u>

The Group and the Bank		
	2008	2007
	HK\$m	HK\$m
Fair value movement taken to available-for-sale reserve on		
MBS/ABS for the year (net of impairment charges taken to		
income statement excluding deferred tax impact) . . . . .	<u>(1,340)</u>	<u>(364)</u>
Closing balance of available-for-sale reserve relating to		
MBS/ABS (excluding deferred tax impact) . . . . .	<u>(1,707)</u>	<u>(367)</u>



The carrying values of impaired MBS/ABS by credit rating are analysed as follows:

	The Group and the Bank						
	2008						
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total	Of which impairment allowances
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>US MBS/ABS</b>							
Non-agency residential mortgage-backed							
– Subprime . . . . .	695	–	30	104	–	829	339
– Alt-A . . . . .	662	383	274	431	–	1,750	1,302
– Prime . . . . .	5,162	1,295	1,312	1,825	–	9,594	6,479
	6,519	1,678	1,616	2,360	–	12,173	8,120
<b>Other countries MBS/ABS</b>							
Residential mortgage-backed . . . . .	69	–	–	–	–	69	27
Total MBS/ABS . . . . .	6,588	1,678	1,616	2,360	–	12,242	8,147
Of which impairment allowances . . .	4,195	1,400	938	1,614	–	8,147	

	The Group and the Bank						
	2007						
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total	Of which impairment allowances
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
US MBS/ABS							
Non-agency residential mortgage-backed							
– Subprime . . . . .	2,856	–	–	–	–	2,856	1,253
– Alt-A . . . . .	1,380	–	–	–	–	1,380	573
– Prime . . . . .	58	–	–	–	–	58	46
Total MBS/ABS . . . . .	<u>4,294</u>	–	–	–	–	<u>4,294</u>	<u>1,872</u>
Of which impairment allowances . . .	<u>1,872</u>	–	–	–	–	<u>1,872</u>	

The table below represents an analysis of impairment charges for the year for MBS/ABS held as at 31 December.

	The Group and the Bank					
	2008					
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
US MBS/ABS						
Non-agency residential mortgage-backed						
– Subprime . . . . .	(90)	–	27	27	–	(36)
– Alt-A . . . . .	394	299	157	359	–	1,209
– Prime . . . . .	3,725	1,055	658	1,094	–	6,532
	4,029	1,354	842	1,480	–	7,705
Other countries						
MBS/ABS						
Residential mortgage-backed . . . . .						
	27	–	–	–	–	27
Total MBS/ABS . . . . .	4,056	1,354	842	1,480	–	7,732

	The Group and the Bank					
	2007					
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
US MBS/ABS						
Non-agency residential mortgage-backed						
– Subprime . . . . .	1,253	–	–	–	–	1,253
– Alt-A . . . . .	573	–	–	–	–	573
– Prime . . . . .	46	–	–	–	–	46
Total MBS/ABS . . . . .	<u>1,872</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>1,872</u>

## 4.2 Market Risk

Market risk is the risk of loss that results from movements in market rates and prices. The Group's market risk in trading book arises from trading positions taken from customer-related business and proprietary trading. These positions are subject to daily mark-to-market valuation. 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 and price movements which prevent the Group from realising its investment securities at their carrying amounts. These positions are subject to monthly mark-to-market valuation. The Group manages market risk in its trading book separately from its banking book.

### *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 Risk Committee are the ultimate decision making authorities. Formulation of the risk management procedures and implementation mechanism, and monitoring of the compliance are mainly responsible by senior management (including CE and CRO). RMD is 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 day-to-day basis to ensure that they are within established risk limits and are regularly reported to the senior management. Nanyang and Chiyu have their own independent risk monitoring units to monitor limit compliance on a daily basis.

The Group's control of market risk is based on restricting individual operations to trading within various market risk limits approved by the RC, and 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 arising from the trading book is managed within various major risk limits approved by the RC, including risk positions and/or risk factor sensitivities. Since April 2007 BOCHK has also formally applied Value-at-Risk (VAR) limit as a daily risk management tool. These overall risk limits are divided into sub-limits by reference to different risk products, including interest rate, foreign exchange rate, commodity price and equity products. Transactions are classified into different risk product categories according to the prominent type of risk inherent in the transactions.

The Group also uses the VAR technique to measure potential losses and market risks of its trading book for reporting to the RC and senior management on a periodic basis. VAR is a statistical technique which estimates the potential losses that could occur on risk positions taken over a specified time horizon within a given level of confidence. BOCHK, being the banking entity within the Group with the major trading positions, which are mainly foreign currency positions in major currencies, uses VAR technique to monitor and control market risk on a daily basis.

The Group has changed its VAR calculation from a variance/co-variance basis to historical simulation basis with effect from April 2007. The Group uses historical movements in market rates and prices, a 99% confidence level and a 1-day holding period to calculate portfolio and individual VAR. Movements in market prices are calculated by reference to market data from the last two years.

## VAR

The following table sets out the VAR for all trading market risk exposure<sup>1</sup> of BOCHK.

HK\$m		At 31 December	Minimum for the year	Maximum for the year	Average for the year
VAR for all market risk	– 2008	12.6	3.0	13.5	6.5
	– 2007	3.2	1.4	10.4	4.1
VAR for foreign exchange risk	– 2008	13.1	2.5	14.2	6.0
products	– 2007	2.7	1.0	9.4	4.0
VAR for interest rate risk products	– 2008	4.2	1.0	5.9	2.9
	– 2007	1.5	0.5	3.9	1.6
VAR for equity risk products	– 2008	0.2	0.1	2.8	0.5
	– 2007	0.4	0.1	1.1	0.4
VAR for commodity risk products	– 2008	0.0	0.0	0.5	0.0
	– 2007	0.0	0.0	0.4	0.1

In 2008, the average daily revenue<sup>2</sup> of BOCHK earned from market risk-related trading activities was HK\$5.35 million (2007: HK\$3.06 million).

1 Structural FX positions have been excluded.

2 Revenues from structural FX positions and back to back transactions have been excluded.

Predictive power of the VaR measure is monitored by backtesting, which compares the calculated VaR figure of those trading positions of each business day with the actual revenues arising on those positions on the next business day. These actual revenues exclude non-trading income including fees and commissions. If backtesting revenues are negative and exceed the VaR, a “backtesting exception” is noted. Backtesting results are reported to the Group’s senior management, including CE and CRO.

Although it is a valuable guide to risk, VAR should always be viewed in the context of its limitations. For example:

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a one-day holding period assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a one-day holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99 per cent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence; and
- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

The Group recognises these limitations by augmenting its VAR limits with other position and sensitivity limit structures.

Additionally, the Group applies a wide range of stress testing, both on individual portfolios and on the Group’s consolidated positions. Stress testing programme of the trading book includes sensitivity testing on changes in risk factors with various degrees of severity, as well as scenario analysis on historical events including the 1987 Equity Market Crash, 1994 Bond Market Crash, the 1997 Asian Crisis and the 11 September Event in 2001. The Group also reassessed the stress testing programme to ensure its rigour and robustness in view of the financial crisis in 2008. The Group’s stress-testing regime provides senior management with an assessment of the financial impact of identified extreme events on the market risk exposures of the Group.

For BOCHK, market risk arising from the banking book is managed within various risk limits such as P/L Management Alert Limit (P/L MAL) and P/L Management Alert Trigger (P/L MAT), and the AFS economic value at risk sub-limit for the available-for-sale debt securities portfolio to control the price risk impact on our CAR. The mark-to-market result is reported to ALCO on a monthly basis.

## Currency risk

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

	The Group							
	2008							
	Renminbi	US Dollars	HK Dollars	EURO	Japanese Yen	Pound Sterling	Others	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>Assets</b>								
Cash and balances with banks and other financial institutions . . . . .	53,381	36,592	53,719	2,662	1,425	3,163	2,326	153,268
Placements with banks and other financial institutions maturing between one and twelve months . .	504	31,441	38,728	5,924	–	6,487	6,634	89,718
Financial assets at fair value through profit or loss . . . . .	1,274	1,614	13,465	–	–	–	51	16,404
Derivative financial instruments . . .	–	485	19,032	99	1	–	11	19,628
Hong Kong SAR Government certificates of indebtedness . . . . .	–	–	34,200	–	–	–	–	34,200
Advances and other accounts . . . . .	15,056	97,002	347,976	2,915	1,622	1,002	4,647	470,220
Investment in securities								
– Available-for-sale securities . . . .	828	71,882	24,141	21,160	40,652	1,651	11,051	171,365
– Held-to-maturity securities . . . .	2,165	52,352	32,580	6,132	1,823	791	9,550	105,393
– Loans and receivables . . . . .	–	2,243	9,039	108	–	110	1,095	12,595
Interests in associates . . . . .	–	–	88	–	–	–	–	88
Investment properties. . . . .	63	–	7,664	–	–	–	–	7,727
Properties, plant and equipment . . . .	98	–	22,690	–	–	–	–	22,788
Other assets (including deferred tax assets) . . . . .	121	244	13,314	596	220	19	88	14,602
<b>Total assets.</b> . . . .	<u>73,490</u>	<u>293,855</u>	<u>616,636</u>	<u>39,596</u>	<u>45,743</u>	<u>13,223</u>	<u>35,453</u>	<u>1,117,996</u>
<b>Liabilities</b>								
Hong Kong SAR currency notes in circulation . . . . .	–	–	34,200	–	–	–	–	34,200
Deposits and balances of banks and other financial institutions . . . . .	38,131	24,191	18,558	2,251	693	2,494	2,461	88,779
Financial liabilities at fair value through profit or loss . . . . .	–	1,852	19,890	–	–	–	196	21,938
Derivative financial instruments . . . .	–	513	19,622	297	1	–	17	20,450
Deposits from customers . . . . .	30,518	194,358	505,082	15,584	2,135	13,445	44,744	805,866
Debt securities in issue at amortised cost . . . . .	–	148	845	–	–	–	49	1,042
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	1,331	9,672	16,673	325	7,907	348	646	36,902
Subordinated liabilities. . . . .	–	19,394	–	7,210	–	–	–	26,604
<b>Total liabilities.</b> . . . .	<u>69,980</u>	<u>250,128</u>	<u>614,870</u>	<u>25,667</u>	<u>10,736</u>	<u>16,287</u>	<u>48,113</u>	<u>1,035,781</u>
Net on-balance sheet position . . . . .	<u>3,510</u>	<u>43,727</u>	<u>1,766</u>	<u>13,929</u>	<u>35,007</u>	<u>(3,064)</u>	<u>(12,660)</u>	<u>82,215</u>
Off-balance sheet net notional position* . . . . .	<u>(4)</u>	<u>(33,929)</u>	<u>68,465</u>	<u>(13,826)</u>	<u>(34,817)</u>	<u>3,043</u>	<u>12,542</u>	<u>1,474</u>
Contingent liabilities and commitments . . . . .	9,132	62,401	176,097	3,032	551	303	1,878	253,394

\* 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.

	The Group							
	2007							
	Renminbi	US	HK		Japanese	Pound		
		Dollars	Dollars	EURO	Yen	Sterling	Others	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Assets								
Cash and balances with banks and other financial institutions . . . . .	30,848	49,823	71,727	1,148	160	1,815	3,531	159,052
Placements with banks and other financial institutions maturing between one and twelve months . .	375	23,854	28,750	–	–	–	175	53,154
Financial assets at fair value through profit or loss . . . . .	917	3,246	5,899	–	–	–	240	10,302
Derivative financial instruments . . .	–	773	13,703	–	–	–	1	14,477
Hong Kong SAR Government certificates of indebtedness . . . . .	–	–	32,770	–	–	–	–	32,770
Advances and other accounts . . . . .	13,335	71,309	323,473	4,202	1,667	1,006	5,220	420,212
Investment in securities								
– Available-for-sale securities . . . .	90	62,611	22,563	7,005	28	1,321	6,900	100,518
– Held-to-maturity securities . . . .	864	84,686	59,565	2,486	–	1,554	16,273	165,428
– Loans and receivables . . . . .	–	3,594	26,511	428	–	–	569	31,102
Interests in associates . . . . .	–	–	83	–	–	–	–	83
Investment properties. . . . .	–	–	8,058	–	–	–	–	8,058
Properties, plant and equipment . . . .	72	1	23,215	–	–	–	–	23,288
Other assets (including deferred tax assets) . . . . .	69	947	19,267	160	62	145	136	20,786
<b>Total assets.</b> . . . .	<u>46,570</u>	<u>300,844</u>	<u>635,584</u>	<u>15,429</u>	<u>1,917</u>	<u>5,841</u>	<u>33,045</u>	<u>1,039,230</u>
Liabilities								
Hong Kong SAR currency notes in circulation . . . . .	–	–	32,770	–	–	–	–	32,770
Deposits and balances of banks and other financial institutions. . . . .	27,173	19,422	9,090	147	2,141	92	2,534	60,599
Financial liabilities at fair value through profit or loss . . . . .	–	2,717	8,688	–	–	–	–	11,405
Derivative financial instruments . . . .	–	1,257	9,814	–	–	–	11	11,082
Deposits from customers . . . . .	17,360	166,467	548,813	8,432	2,492	12,284	38,399	794,247
Debt securities in issue at amortised cost . . . . .	–	667	1,422	–	–	–	–	2,089
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	575	9,751	31,932	311	31	386	760	43,746
<b>Total liabilities.</b> . . . .	<u>45,108</u>	<u>200,281</u>	<u>642,529</u>	<u>8,890</u>	<u>4,664</u>	<u>12,762</u>	<u>41,704</u>	<u>955,938</u>
Net on-balance sheet position . . . . .	<u>1,462</u>	<u>100,563</u>	<u>(6,945)</u>	<u>6,539</u>	<u>(2,747)</u>	<u>(6,921)</u>	<u>(8,659)</u>	<u>83,292</u>
Off-balance sheet net notional position. . . . .	<u>394</u>	<u>(97,215)</u>	<u>89,481</u>	<u>(6,478)</u>	<u>2,436</u>	<u>7,050</u>	<u>8,975</u>	<u>4,643</u>
Contingent liabilities and commitments . . . . .	4,873	55,183	163,702	4,693	1,017	259	1,581	231,308

	The Bank							
	2008							
	Renminbi	US Dollars	HK Dollars	EURO	Japanese Yen	Pound Sterling	Others	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Assets								
Cash and balances with banks and other financial institutions . . . . .	52,272	34,528	40,322	1,443	1,391	2,795	682	133,433
Placements with banks and other financial institutions maturing between one and twelve months . .	344	26,876	26,879	2,301	–	6,150	5,350	67,900
Financial assets at fair value through profit or loss . . . . .	1,016	217	11,803	–	–	–	–	13,036
Derivative financial instruments . . .	–	484	18,038	99	1	–	11	18,633
Hong Kong SAR Government certificates of indebtedness . . . . .	–	–	34,200	–	–	–	–	34,200
Advances and other accounts . . . . .	7,453	79,261	290,128	2,631	1,404	975	4,008	385,860
Investment in securities								
– Available-for-sale securities . . . .	116	70,209	21,937	21,160	40,652	1,651	10,967	166,692
– Held-to-maturity securities . . . .	2,165	48,601	23,559	4,834	1,823	643	8,192	89,817
– Loans and receivables . . . . .	–	2,088	6,202	–	–	–	154	8,444
Interests in subsidiaries . . . . .	–	–	12,401	–	–	–	–	12,401
Interests in associates . . . . .	–	–	12	–	–	–	–	12
Investment properties. . . . .	–	–	7,279	–	–	–	–	7,279
Properties, plant and equipment . . . .	3	–	17,546	–	–	–	–	17,549
Other assets. . . . .	34	129	12,616	588	216	2	43	13,628
Total assets. . . . .	63,403	262,393	522,922	33,056	45,487	12,216	29,407	968,884
Liabilities								
Hong Kong SAR currency notes in circulation . . . . .	–	–	34,200	–	–	–	–	34,200
Deposits and balances of banks and other financial institutions. . . . .	36,466	24,442	19,092	2,301	86	2,673	2,783	87,843
Financial liabilities at fair value through profit or loss . . . . .	–	1,474	18,799	–	–	–	196	20,469
Derivative financial instruments . . . .	–	504	18,747	297	1	–	17	19,566
Deposits from customers. . . . .	24,462	168,773	423,516	9,148	1,991	12,755	38,606	679,251
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	948	7,369	13,548	60	7,860	98	511	30,394
Subordinated liabilities. . . . .	–	19,394	–	7,210	–	–	–	26,604
Total liabilities. . . . .	61,876	221,956	527,902	19,016	9,938	15,526	42,113	898,327
Net on-balance sheet position . . . . .	1,527	40,437	(4,980)	14,040	35,549	(3,310)	(12,706)	70,557
Off-balance sheet net notional position . . . . .	(4)	(31,306)	65,827	(13,945)	(35,378)	3,288	12,581	1,063
Contingent liabilities and commitments . . . . .	5,015	51,974	112,245	1,331	485	15	682	171,747

	The Bank							
	2007							
		US	HK		Japanese	Pound		
	Renminbi	Dollars	Dollars	EURO	Yen	Sterling	Others	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Assets								
Cash and balances with banks and other financial institutions. . . . .	29,796	44,625	55,243	382	120	1,412	2,442	134,020
Placements with banks and other financial institutions maturing between one and twelve months . .	226	15,079	16,582	–	–	–	–	31,887
Financial assets at fair value through profit or loss . . . . .	676	987	4,535	–	–	–	171	6,369
Derivative financial instruments . . .	–	748	13,224	–	–	–	–	13,972
Hong Kong SAR Government certificates of indebtedness . . . . .	–	–	32,770	–	–	–	–	32,770
Advances and other accounts . . . . .	7,987	57,672	265,976	3,914	1,477	984	3,886	341,896
Investment in securities								
– Available-for-sale securities . . . .	–	61,900	20,323	7,005	28	1,321	6,815	97,392
– Held-to-maturity securities . . . .	864	81,475	50,652	2,161	–	1,181	14,540	150,873
– Loans and receivables . . . . .	–	1,663	21,121	–	–	–	–	22,784
Interests in subsidiaries . . . . .	–	–	12,866	–	–	–	–	12,866
Interests in associates . . . . .	–	–	12	–	–	–	–	12
Investment properties. . . . .	–	–	7,595	–	–	–	–	7,595
Properties, plant and equipment . . . .	2	–	18,259	–	–	–	–	18,261
Other assets. . . . .	52	885	17,224	133	62	132	72	18,560
<b>Total assets. . . . .</b>	<u>39,603</u>	<u>265,034</u>	<u>536,382</u>	<u>13,595</u>	<u>1,687</u>	<u>5,030</u>	<u>27,926</u>	<u>889,257</u>
Liabilities								
Hong Kong SAR currency notes in circulation . . . . .	–	–	32,770	–	–	–	–	32,770
Deposits and balances of banks and other financial institutions. . . . .	23,968	19,329	9,875	128	1,623	91	1,193	56,207
Financial liabilities at fair value								
through profit or loss . . . . .	–	1,178	6,938	–	–	–	–	8,116
Derivative financial instruments . . . .	–	1,107	9,681	–	–	–	–	10,788
Deposits from customers. . . . .	14,615	138,736	466,095	6,784	2,235	11,694	33,421	673,580
Other accounts and provisions (including current and deferred tax liabilities). . . . .	426	7,226	27,076	53	16	181	607	35,585
<b>Total liabilities. . . . .</b>	<u>39,009</u>	<u>167,576</u>	<u>552,435</u>	<u>6,965</u>	<u>3,874</u>	<u>11,966</u>	<u>35,221</u>	<u>817,046</u>
Net on-balance sheet position . . . . .	<u>594</u>	<u>97,458</u>	<u>(16,053)</u>	<u>6,630</u>	<u>(2,187)</u>	<u>(6,936)</u>	<u>(7,295)</u>	<u>72,211</u>
Off-balance sheet net notional position. . . . .	<u>360</u>	<u>(94,059)</u>	<u>88,394</u>	<u>(6,580)</u>	<u>1,910</u>	<u>6,993</u>	<u>7,260</u>	<u>4,278</u>
Contingent liabilities and commitments . . . . .	2,176	42,963	107,287	2,875	847	20	427	156,595



### ***Interest rate risk***

BOCHK 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 Asset and Liability Management Committee (“ALCO”) and Risk Committee (“RC”) are responsible for interest rate risk management. 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 daily basis. The Treasury Department manages the interest rate risk according to the established policies. The Finance Department closely monitors the related risks according to approved limits and reports the results to ALCO regularly. The Risk Management Department reviews the policies, guidelines and limits proposed by Treasury Department.

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 items 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. The key assumption in gap analysis includes the replacement of contractual maturity of fixed rate mortgage-backed (US prime and Alt-A) securities by behavioural maturity. 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 monthly 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.

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 BOCHK 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 Chief Financial Officer.

The tables below summarise the Group's and the Bank's exposure to interest rate risk as at 31 December. Included in the tables are the Group's and the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

	The Group						
	2008						
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non- interest bearing	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>Assets</b>							
Cash and balances with banks and other financial institutions. . . . .	134,722	–	–	–	–	18,546	153,268
Placements with banks and other financial institutions maturing between one and twelve months . .	–	38,622	51,096	–	–	–	89,718
Financial assets at fair value through profit or loss . . . . .	5,103	7,076	2,311	1,416	415	83	16,404
Derivative financial instruments . . .	–	–	–	–	–	19,628	19,628
Hong Kong SAR Government certificates of indebtedness . . . . .	–	–	–	–	–	34,200	34,200
Advances and other accounts . . . . .	366,581	77,143	20,873	1,258	159	4,206	470,220
Investment in securities							
– Available-for-sale securities. . . .	31,282	28,066	42,437	47,155	21,995	430	171,365
– Held-to-maturity securities . . . .	23,765	38,406	12,514	17,371	13,337	–	105,393
– Loans and receivables . . . . .	1,755	2,675	8,165	–	–	–	12,595
Interests in associates. . . . .	–	–	–	–	–	88	88
Investment properties. . . . .	–	–	–	–	–	7,727	7,727
Properties, plant and equipment. . . .	–	–	–	–	–	22,788	22,788
Other assets (including deferred tax assets) . . . . .	–	–	–	–	–	14,602	14,602
<b>Total assets . . . . .</b>	<b>563,208</b>	<b>191,988</b>	<b>137,396</b>	<b>67,200</b>	<b>35,906</b>	<b>122,298</b>	<b>1,117,996</b>
<b>Liabilities</b>							
Hong Kong SAR currency notes in circulation . . . . .	–	–	–	–	–	34,200	34,200
Deposits and balances of banks and other financial institutions. . . . .	55,274	10,655	3,272	–	–	19,578	88,779
Financial liabilities at fair value through profit or loss . . . . .	6,769	13,412	1,749	8	–	–	21,938
Derivative financial instruments. . . .	–	–	–	–	–	20,450	20,450
Deposits from customers . . . . .	631,968	103,266	32,532	253	–	37,847	805,866
Debt securities in issue at amortised cost. . . . .	459	148	435	–	–	–	1,042
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	8,036	116	493	136	–	28,121	36,902
Subordinated liabilities . . . . .	–	–	26,604	–	–	–	26,604
<b>Total liabilities . . . . .</b>	<b>702,506</b>	<b>127,597</b>	<b>65,085</b>	<b>397</b>	<b>–</b>	<b>140,196</b>	<b>1,035,781</b>
Interest sensitivity gap . . . . .	(139,298)	64,391	72,311	66,803	35,906	(17,898)	82,215

The Group							
2007							
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non- interest bearing	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>Assets</b>							
Cash and balances with banks and other financial institutions. . . . .	152,733	–	–	–	–	6,319	159,052
Placements with banks and other financial institutions maturing between one and twelve months . .	–	42,230	10,924	–	–	–	53,154
Financial assets at fair value through profit or loss . . . . .	3,562	1,637	1,670	2,252	760	421	10,302
Derivative financial instruments . . .	–	–	–	–	–	14,477	14,477
Hong Kong SAR Government certificates of indebtedness . . . . .	–	–	–	–	–	32,770	32,770
Advances and other accounts . . . . .	328,728	58,396	19,372	9,487	643	3,586	420,212
Investment in securities							
– Available-for-sale securities. . . .	11,668	21,320	6,257	19,959	40,869	445	100,518
– Held-to-maturity securities . . . .	25,562	43,920	18,534	43,022	34,390	–	165,428
– Loans and receivables . . . . .	7,459	11,444	12,199	–	–	–	31,102
Interests in associates. . . . .	–	–	–	–	–	83	83
Investment properties. . . . .	–	–	–	–	–	8,058	8,058
Properties, plant and equipment. . . .	–	–	–	–	–	23,288	23,288
Other assets (including deferred tax assets). . . . .	–	–	–	–	–	20,786	20,786
<b>Total assets</b> . . . . .	<u>529,712</u>	<u>178,947</u>	<u>68,956</u>	<u>74,720</u>	<u>76,662</u>	<u>110,233</u>	<u>1,039,230</u>
<b>Liabilities</b>							
Hong Kong SAR currency notes in circulation . . . . .	–	–	–	–	–	32,770	32,770
Deposits and balances of banks and other financial institutions. . . . .	45,728	3,428	6,897	–	–	4,546	60,599
Financial liabilities at fair value through profit or loss . . . . .	6,600	2,355	1,531	919	–	–	11,405
Derivative financial instruments. . . .	–	–	–	–	–	11,082	11,082
Deposits from customers . . . . .	623,580	98,440	35,157	547	–	36,523	794,247
Debt securities in issue at amortised cost. . . . .	–	–	1,977	112	–	–	2,089
Other accounts and provisions (including current and deferred tax liabilities). . . . .	7,624	107	–	128	–	35,887	43,746
<b>Total liabilities</b> . . . . .	<u>683,532</u>	<u>104,330</u>	<u>45,562</u>	<u>1,706</u>	<u>–</u>	<u>120,808</u>	<u>955,938</u>
Interest sensitivity gap . . . . .	<u>(153,820)</u>	<u>74,617</u>	<u>23,394</u>	<u>73,014</u>	<u>76,662</u>	<u>(10,575)</u>	<u>83,292</u>

The Bank							
2008							
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non- interest bearing	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>Assets</b>							
Cash and balances with banks and other financial institutions. . . . .	115,795	–	–	–	–	17,638	133,433
Placements with banks and other financial institutions maturing between one and twelve months . .	–	21,427	46,473	–	–	–	67,900
Financial assets at fair value through profit or loss . . . . .	4,428	6,289	1,608	685	6	20	13,036
Derivative financial instruments . . .	–	–	–	–	–	18,633	18,633
Hong Kong SAR Government certificates of indebtedness . . . . .	–	–	–	–	–	34,200	34,200
Advances and other accounts . . . . .	309,388	61,950	14,342	126	54	–	385,860
Investment in securities							
– Available-for-sale securities. . . .	30,902	27,235	41,417	46,014	21,025	99	166,692
– Held-to-maturity securities . . . .	21,000	31,327	10,404	13,749	13,337	–	89,817
– Loans and receivables . . . . .	–	1,592	6,852	–	–	–	8,444
Interests in subsidiaries. . . . .	–	–	–	–	–	12,401	12,401
Interests in associates. . . . .	–	–	–	–	–	12	12
Investment properties . . . . .	–	–	–	–	–	7,279	7,279
Properties, plant and equipment. . . .	–	–	–	–	–	17,549	17,549
Other assets (including deferred tax assets) . . . . .	–	–	–	–	–	13,628	13,628
<b>Total assets . . . . .</b>	<b>481,513</b>	<b>149,820</b>	<b>121,096</b>	<b>60,574</b>	<b>34,422</b>	<b>121,459</b>	<b>968,884</b>
<b>Liabilities</b>							
Hong Kong SAR currency notes in circulation . . . . .	–	–	–	–	–	34,200	34,200
Deposits and balances of banks and other financial institutions. . . . .	60,026	3,914	3,267	–	–	20,636	87,843
Financial liabilities at fair value through profit or loss . . . . .	6,230	12,745	1,486	8	–	–	20,469
Derivative financial instruments. . . .	–	–	–	–	–	19,566	19,566
Deposits from customers . . . . .	547,198	77,632	21,933	188	–	32,300	679,251
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	7,099	116	493	136	–	22,550	30,394
Subordinated liabilities . . . . .	–	–	26,604	–	–	–	26,604
<b>Total liabilities . . . . .</b>	<b>620,553</b>	<b>94,407</b>	<b>53,783</b>	<b>332</b>	<b>–</b>	<b>129,252</b>	<b>898,327</b>
Interest sensitivity gap . . . . .	<u>(139,040)</u>	<u>55,413</u>	<u>67,313</u>	<u>60,242</u>	<u>34,422</u>	<u>(7,793)</u>	<u>70,557</u>

The Bank							
2007							
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non- interest bearing	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>Assets</b>							
Cash and balances with banks and other financial institutions. . . . .	129,827	–	–	–	–	4,193	134,020
Placements with banks and other financial institutions maturing between one and twelve months . .	–	28,927	2,960	–	–	–	31,887
Financial assets at fair value through profit or loss . . . . .	2,261	959	1,523	1,268	31	327	6,369
Derivative financial instruments . . .	–	–	–	–	–	13,972	13,972
Hong Kong SAR Government certificates of indebtedness . . . . .	–	–	–	–	–	32,770	32,770
Advances and other accounts . . . . .	271,962	48,292	13,132	8,038	457	15	341,896
Investment in securities							
– Available-for-sale securities. . . .	11,244	19,976	5,864	19,701	40,545	62	97,392
– Held-to-maturity securities . . . .	21,599	38,905	16,411	39,568	34,390	–	150,873
– Loans and receivables . . . . .	5,696	8,025	9,063	–	–	–	22,784
Interests in subsidiaries. . . . .	–	–	–	–	–	12,866	12,866
Interests in associates. . . . .	–	–	–	–	–	12	12
Investment properties . . . . .	–	–	–	–	–	7,595	7,595
Properties, plant and equipment. . . .	–	–	–	–	–	18,261	18,261
Other assets . . . . .	–	–	–	–	–	18,560	18,560
<b>Total assets</b> . . . . .	<u>442,589</u>	<u>145,084</u>	<u>48,953</u>	<u>68,575</u>	<u>75,423</u>	<u>108,633</u>	<u>889,257</u>
<b>Liabilities</b>							
Hong Kong SAR currency notes in circulation . . . . .	–	–	–	–	–	32,770	32,770
Deposits and balances of banks and other financial institutions. . . . .	43,348	1,598	4,711	–	–	6,550	56,207
Financial liabilities at fair value through profit or loss . . . . .	4,160	2,004	1,033	919	–	–	8,116
Derivative financial instruments. . . .	–	–	–	–	–	10,788	10,788
Deposits from customers . . . . .	534,799	81,681	25,427	415	–	31,258	673,580
Other accounts and provisions (including current and deferred tax liabilities). . . . .	<u>7,297</u>	<u>107</u>	<u>–</u>	<u>128</u>	<u>–</u>	<u>28,053</u>	<u>35,585</u>
<b>Total liabilities</b> . . . . .	<u>589,604</u>	<u>85,390</u>	<u>31,171</u>	<u>1,462</u>	<u>–</u>	<u>109,419</u>	<u>817,046</u>
Interest sensitivity gap . . . . .	<u>(147,015)</u>	<u>59,694</u>	<u>17,782</u>	<u>67,113</u>	<u>75,423</u>	<u>(786)</u>	<u>72,211</u>

### *Sensitivity analysis to market risk exposure of banking book of the Group*

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 point higher with other variables held constant, profit after tax for the year would have been reduced by HK\$112 million (2007: HK\$106 million). The negative impact is increased compared with 2007 because the short term negative interest sensitivity gaps are enlarged. Reserves would have been reduced by HK\$1,390 million (2007: HK\$1,598 million) of the expected reduction in valuation of available-for-sale portfolio due to the above simulated market rates movement. 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:

	Impact on positions at 31 December	
	2008	2007
	HK\$'m	HK\$'m
<b>Earnings perspective</b>		
<b>Scenarios</b>		
Down 100 basis points parallel shift in HK dollar yield curves . .	<u>(237)</u>	<u>(402)</u>
Up 100 basis points parallel shift in US dollar yield curves . . . .	<u>(371)</u>	<u>(562)</u>

#### *Note:*

BOC-CC is excluded from the analysis in 2007.

BOC-CC is included in the analysis in 2008.

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.

### **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 Risk Committee 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 Chief Executive, Chief Financial Officer, Chief Risk Officer and the Asset and Liability Management

Committee). Daily management of liquidity is carried out by the treasury functions, which is assisted by other functional departments, including the finance and risk management departments which monitor the liquidity risk and provide regular reports to the management and local regulatory bodies.

The liquidity management process is adopted at the Group level. The principal subsidiaries of the Group execute their risk management strategies independently, subject to risk policies that are consistent with those of the Group, and report to the Group's management on a regular basis.

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-liquifiable assets portfolio and establishment of a diversified portfolio of liabilities.

Risk management process includes:

- Perform cash-flow projection 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 asset to serve as 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 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 current risk management mechanism. Any material impact on liquidity risk noted during the risk assessment process will be reported to both the Chief Risk Officer and the Chief Financial Officer.



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

*Non-derivative cash flows*

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

	The Group					
	2008					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
Hong Kong SAR currency notes						
in circulation . . . . .	34,200	–	–	–	–	34,200
Deposits and balances of banks and other financial institutions . . . . .	74,864	10,696	3,291	–	–	88,851
Financial liabilities at fair value						
through profit or loss. . . . .	6,114	6,404	9,077	253	294	22,142
Deposits from customers. . . . .	669,921	102,192	33,052	1,392	–	806,557
Debt securities in issue at amortised cost . . . . .	459	148	436	–	–	1,043
Subordinated liabilities . . . . .	–	–	1,029	4,134	32,233	37,396
Other financial liabilities. . . . .	27,320	198	1,836	4	238	29,596
	<u>812,878</u>	<u>119,638</u>	<u>48,721</u>	<u>5,783</u>	<u>32,765</u>	<u>1,019,785</u>

	The Group					
	2007					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
Hong Kong SAR currency notes						
in circulation . . . . .	32,770	–	–	–	–	32,770
Deposits and balances of banks and other financial institutions . . . . .	50,290	3,456	6,951	–	–	60,697
Financial liabilities at fair value						
through profit or loss. . . . .	2,563	1,966	4,788	1,976	364	11,657
Deposits from customers. . . . .	660,524	99,025	35,789	585	–	795,923
Debt securities in issue at amortised cost . . . . .	7	13	2,021	116	–	2,157
Other financial liabilities. . . . .	29,192	412	450	133	460	30,647
	<u>775,346</u>	<u>104,872</u>	<u>49,999</u>	<u>2,810</u>	<u>824</u>	<u>933,851</u>

The Bank						
2008						
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
Hong Kong SAR currency notes						
in circulation . . . . .	34,200	–	–	–	–	34,200
Deposits and balances of banks and						
other financial institutions . . . . .	80,666	3,926	3,279	–	–	87,871
Financial liabilities at fair value						
through profit or loss . . . . .	5,789	6,141	8,596	10	–	20,536
Deposits from customers . . . . .	579,569	77,773	22,197	203	–	679,742
Subordinated liabilities . . . . .	–	–	1,029	4,134	32,233	37,396
Other financial liabilities . . . . .	25,489	189	1,750	–	–	27,428
	<u>725,713</u>	<u>88,029</u>	<u>36,851</u>	<u>4,347</u>	<u>32,233</u>	<u>887,173</u>

The Bank						
2007						
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
Hong Kong SAR currency notes						
in circulation . . . . .	32,770	–	–	–	–	32,770
Deposits and balances of banks and						
other financial institutions . . . . .	49,913	1,602	4,711	–	–	56,226
Financial liabilities at fair value						
through profit or loss . . . . .	2,188	1,275	3,732	1,039	–	8,234
Deposits from customers . . . . .	566,418	82,167	25,897	437	–	674,919
Other financial liabilities . . . . .	24,169	110	416	128	–	24,823
	<u>675,458</u>	<u>85,154</u>	<u>34,756</u>	<u>1,604</u>	<u>–</u>	<u>796,972</u>

#### *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, currency futures, non-deliverable currency forwards;
- Interest rate derivatives: interest rate swaps;
- Equity derivatives: exchange traded equity options; and
- Bullion derivatives: bullion margin contracts.

The table below analyses the Group's and the Bank'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.

	The Group					
	2008					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Derivatives settled on a net basis						
– Foreign exchange derivatives . . .	(10,465)	(99)	(235)	–	–	(10,799)
– Interest rate derivatives . . . . .	–	(178)	(884)	(3,023)	(724)	(4,809)
– Bullion derivatives . . . . .	(91)	–	–	–	–	(91)
	(10,556)	(277)	(1,119)	(3,023)	(724)	(15,699)

	The Group					
	2007					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Derivatives settled on a net basis						
– Foreign exchange derivatives . . .	(7,213)	(9)	456	21	–	(6,745)
– Interest rate derivatives. . . . .	(1)	(23)	(143)	(309)	(66)	(542)
– Equity derivatives . . . . .	–	(58)	–	–	–	(58)
– Bullion derivatives . . . . .	<u>(1,110)</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>(1,110)</u>
	(8,324)	(90)	313	(288)	(66)	(8,455)

	The Bank					
	2008					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Derivatives settled on a net basis						
– Foreign exchange derivatives . . .	(9,903)	(99)	(245)	–	–	(10,247)
– Interest rate derivatives . . . . .	4	(168)	(831)	(2,897)	(698)	(4,590)
– Bullion derivatives . . . . .	(92)	–	–	–	–	(92)
	(9,991)	(267)	(1,076)	(2,897)	(698)	(14,929)

	The Bank					
	2007					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Derivatives settled on a net basis						
– Foreign exchange derivatives . . .	(7,097)	(9)	461	21	–	(6,624)
– Interest rate derivatives. . . . .	–	(20)	(138)	(269)	(62)	(489)
– Equity derivatives . . . . .	–	(58)	–	–	–	(58)
– Bullion derivatives . . . . .	(1,107)	–	–	–	–	(1,107)
	(8,204)	(87)	323	(248)	(62)	(8,278)

(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 cross currency interest rate swaps, OTC equity options, equity linked swaps and bullion swaps.

The table below analyses the Group's and the Bank'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.

The Group					
2008					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Derivatives settled on a gross basis					
– Foreign exchange derivatives:					
– Outflow . . . . .	(146,872)	(69,270)	(62,608)	(1,722)	(280,472)
– Inflow . . . . .	145,552	68,892	62,246	1,709	278,399
– Interest rate derivatives:					
– Outflow . . . . .	–	–	–	–	–
– Inflow . . . . .	316	–	–	–	316
– Equity derivatives:					
– Outflow . . . . .	(444)	(236)	(1,659)	–	(2,339)
– Inflow . . . . .	462	237	1,659	–	2,358
– Bullion derivatives:					
– Outflow . . . . .	(226)	(131)	–	–	(357)
– Inflow . . . . .	–	–	–	–	–
<b>Total outflow . . . . .</b>	<u>(147,542)</u>	<u>(69,637)</u>	<u>(64,267)</u>	<u>(1,722)</u>	<u>(283,168)</u>
<b>Total inflow . . . . .</b>	<u>146,330</u>	<u>69,129</u>	<u>63,905</u>	<u>1,709</u>	<u>281,073</u>

The Group					
2007					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Derivatives settled on a gross basis					
– Foreign exchange derivatives:					
– Outflow . . . . .	(96,928)	(52,508)	(24,477)	(1,869)	(175,782)
– Inflow . . . . .	96,743	52,301	24,380	1,866	175,290
– Interest rate derivatives:					
– Outflow . . . . .	–	–	–	–	–
– Inflow . . . . .	–	316	–	–	316
– Equity derivatives:					
– Outflow . . . . .	(128)	(70)	(1,002)	(28)	(1,228)
– Inflow . . . . .	221	99	1,002	28	1,350
– Bullion derivatives:					
– Outflow . . . . .	(223)	(427)	(715)	–	(1,365)
– Inflow . . . . .	–	–	–	–	–
<b>Total outflow . . . . .</b>	<b>(97,279)</b>	<b>(53,005)</b>	<b>(26,194)</b>	<b>(1,897)</b>	<b>(178,375)</b>
<b>Total inflow . . . . .</b>	<b>96,964</b>	<b>52,716</b>	<b>25,382</b>	<b>1,894</b>	<b>176,956</b>

The Bank					
2008					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Derivatives settled on a gross basis					
– Foreign exchange derivatives:					
– Outflow . . . . .	(145,888)	(67,501)	(61,934)	(1,568)	(276,891)
– Inflow . . . . .	144,568	67,126	61,584	1,567	274,845
– Interest rate derivatives:					
– Outflow . . . . .	–	–	–	–	–
– Inflow . . . . .	316	–	–	–	316
– Equity derivatives:					
– Outflow . . . . .	(444)	(235)	(1,659)	–	(2,338)
– Inflow . . . . .	462	237	1,659	–	2,358
– Bullion derivatives:					
– Outflow . . . . .	(226)	(131)	–	–	(357)
– Inflow . . . . .	–	–	–	–	–
<b>Total outflow . . . . .</b>	<b>(146,558)</b>	<b>(67,867)</b>	<b>(63,593)</b>	<b>(1,568)</b>	<b>(279,586)</b>
<b>Total inflow . . . . .</b>	<b>145,346</b>	<b>67,363</b>	<b>63,243</b>	<b>1,567</b>	<b>277,519</b>

	The Bank				
	2007				
	Up to	1-3	3-12	1-5 years	Total
	1 month	months	months		
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
Derivatives settled on a gross basis					
– Foreign exchange derivatives:					
– Outflow . . . . .	(95,664)	(52,057)	(23,814)	(1,781)	(173,316)
– Inflow . . . . .	95,482	51,853	23,708	1,785	172,828
– Interest rate derivatives:					
– Outflow . . . . .	–	–	–	–	–
– Inflow . . . . .	–	316	–	–	316
– Equity derivatives:					
– Outflow . . . . .	(124)	(70)	(1,002)	(28)	(1,224)
– Inflow . . . . .	217	99	1,002	28	1,346
– Bullion derivatives:					
– Outflow . . . . .	(223)	(427)	(715)	–	(1,365)
– Inflow . . . . .	–	–	–	–	–
<b>Total outflow</b> . . . . .	<u>(96,011)</u>	<u>(52,554)</u>	<u>(25,531)</u>	<u>(1,809)</u>	<u>(175,905)</u>
<b>Total inflow</b> . . . . .	<u>95,699</u>	<u>52,268</u>	<u>24,710</u>	<u>1,813</u>	<u>174,490</u>

*Off-balance sheet items*

Loan commitments

The contractual amounts of the Group's and the Bank's off-balance sheet financial instruments as at 31 December 2008 that commit to extend credit to customers and other facilities amounting to HK\$219,341 million and HK\$140,617 million (2007: HK\$193,032 million and HK\$121,997 million) are maturing no later than 1 year.

Financial guarantees and other financial facilities

Financial guarantees of the Group and the Bank as at 31 December 2008 amounting to HK\$34,053 million and HK\$31,130 million (2007: HK\$38,276 million and HK\$34,598 million) are maturing no later than 1 year.

(b) *Maturity analysis*

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

	The Group							
	2008							
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>Assets</b>								
Cash and balances with banks and other financial institutions . . . . .	77,935	75,333	–	–	–	–	–	153,268
Placements with banks and other financial institutions maturing between one and twelve months . . . . .	–	–	38,622	51,096	–	–	–	89,718
Financial assets at fair value through profit or loss								
– debt securities held for trading								
– certificates of deposit held . . . . .	–	–	–	–	–	–	–	–
– others . . . . .	–	4,628	6,685	1,927	685	6	–	13,931
– debt securities designated at fair value through profit or loss								
– certificates of deposit held . . . . .	–	25	–	–	–	–	–	25
– others . . . . .	–	226	30	384	1,066	660	–	2,366
– equity securities . . . . .	–	–	–	–	–	–	82	82
Derivative financial instruments . . . . .	14,844	756	1,253	1,439	1,216	120	–	19,628
Hong Kong SAR Government certificates of indebtedness . . . . .	34,200	–	–	–	–	–	–	34,200
Advances and other accounts								
– advances to customers . . . . .	21,941	17,656	31,084	51,336	198,165	137,684	1,007	458,873
– trade bills . . . . .	–	2,910	4,022	677	–	–	–	7,609
– advances to banks and other financial institutions . . . . .	27	–	–	885	2,826	–	–	3,738
Investment in securities								
– debt securities held for available-for-sale								
– certificates of deposit held . . . . .	–	–	23	5,236	2,096	–	–	7,355
– others . . . . .	–	19,849	13,349	40,054	58,135	26,164	6,029	163,580
– debt securities held for held-to-maturity . . . . .								
– certificates of deposit held . . . . .	–	968	2,173	2,162	6,073	–	–	11,376
– others . . . . .	–	2,115	4,933	14,560	49,480	15,905	7,024	94,017
– debt securities held for loans and receivables . . . . .	–	1,755	2,675	8,165	–	–	–	12,595
– equity securities . . . . .	–	–	–	–	–	–	430	430
Interests in associates . . . . .	–	–	–	–	–	–	88	88
Investment properties . . . . .	–	–	–	–	–	–	7,727	7,727
Properties, plant and equipment . . . . .	–	–	–	–	–	–	22,788	22,788
Other assets (including deferred tax assets) . . . . .	2,185	12,050	11	112	65	–	179	14,602
<b>Total assets</b> . . . . .	<u>151,132</u>	<u>138,271</u>	<u>104,860</u>	<u>178,033</u>	<u>319,807</u>	<u>180,539</u>	<u>45,354</u>	<u>1,117,996</u>
<b>Liabilities</b>								
Hong Kong SAR currency notes in circulation . . . . .	34,200	–	–	–	–	–	–	34,200
Deposits and balances of banks and other financial institutions . . . . .	61,206	13,646	10,655	3,272	–	–	–	88,779
Financial liabilities at fair value through profit or loss								
– certificates of deposit issued . . . . .	–	–	–	858	–	–	–	858
– others . . . . .	–	6,111	6,363	8,170	166	270	–	21,080
Derivative financial instruments . . . . .	10,556	2,137	1,689	1,967	2,822	1,279	–	20,450
Deposits from customers . . . . .	429,288	240,523	101,987	32,696	1,372	–	–	805,866
Debt securities in issue at amortised cost . . . . .	–	459	148	435	–	–	–	1,042
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	15,270	15,994	204	2,341	2,857	232	4	36,902
Subordinated liabilities . . . . .	–	–	–	21	–	26,583	–	26,604
<b>Total liabilities</b> . . . . .	<u>550,520</u>	<u>278,870</u>	<u>121,046</u>	<u>49,760</u>	<u>7,217</u>	<u>28,364</u>	<u>4</u>	<u>1,035,781</u>
Net liquidity gap . . . . .	(399,388)	(140,599)	(16,186)	128,273	312,590	152,175	45,350	82,215

The Group							
2007							
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
<b>Assets</b>							
Cash and balances with banks and other financial institutions . . . . .	40,087	118,965	–	–	–	–	159,052
Placements with banks and other financial institutions maturing between one and twelve months . . . . .	–	–	42,230	10,924	–	–	53,154
Financial assets at fair value through profit or loss							
– debt securities held for trading							
– certificates of deposit held . . . . .	–	–	–	80	–	–	80
– others . . . . .	–	1,697	779	2,342	1,307	32	6,157
– debt securities designated at fair value through profit or loss							
– certificates of deposit held . . . . .	–	–	–	120	230	–	350
– others . . . . .	–	36	141	73	1,897	1,147	3,294
– equity securities . . . . .	–	–	–	–	–	–	421
Derivative financial instruments . . . . .	12,686	228	129	929	459	46	14,477
Hong Kong SAR Government certificates of indebtedness . . . . .	32,770	–	–	–	–	–	32,770
Advances and other accounts							
– advances to customers . . . . .	21,174	16,345	25,968	43,608	173,120	130,067	411,655
– trade bills . . . . .	12	2,815	2,227	280	–	–	5,334
– advances to banks and other financial institutions . . . . .	27	–	600	440	2,156	–	3,223
Investment in securities							
– debt securities held for available-for-sale							
– certificates of deposit held . . . . .	–	701	462	2,614	3,689	–	7,466
– others . . . . .	–	5,886	3,776	7,515	30,790	44,084	92,607
– debt securities held for held-to-maturity							
– certificates of deposit held . . . . .	–	1,097	1,490	2,426	6,351	624	11,988
– others . . . . .	–	4,278	12,309	17,166	81,918	34,031	153,440
– debt securities held for loans and receivables . . . . .	–	7,459	11,444	12,199	–	–	31,102
– equity securities . . . . .	–	–	–	–	–	–	445
Interests in associates . . . . .	–	–	–	–	–	–	83
Investment properties . . . . .	–	–	–	–	–	–	8,058
Properties, plant and equipment . . . . .	–	–	–	–	–	–	23,288
Other assets (including deferred tax assets) . . . . .	3,360	16,241	24	174	189	–	20,786
<b>Total assets</b> . . . . .	<b>110,116</b>	<b>175,748</b>	<b>101,579</b>	<b>100,890</b>	<b>302,106</b>	<b>210,031</b>	<b>1,039,230</b>
<b>Liabilities</b>							
Hong Kong SAR currency notes in circulation . . . . .	32,770	–	–	–	–	–	32,770
Deposits and balances of banks and other financial institutions . . . . .	28,200	22,074	3,428	6,897	–	–	60,599
Financial liabilities at fair value through profit or loss							
– certificates of deposit issued . . . . .	–	–	–	1,086	868	–	1,954
– others . . . . .	–	2,554	1,925	3,680	983	309	9,451
Derivative financial instruments . . . . .	8,320	411	352	954	831	214	11,082
Deposits from customers . . . . .	329,668	330,435	98,440	35,157	547	–	794,247
Debt securities in issue at amortised cost . . . . .	–	–	–	1,977	112	–	2,089
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	15,443	15,543	6,968	1,660	4,099	–	43,746
<b>Total liabilities</b> . . . . .	<b>414,401</b>	<b>371,017</b>	<b>111,113</b>	<b>51,411</b>	<b>7,440</b>	<b>523</b>	<b>955,938</b>
Net liquidity gap . . . . .	<u>(304,285)</u>	<u>(195,269)</u>	<u>(9,534)</u>	<u>49,479</u>	<u>294,666</u>	<u>209,508</u>	<u>83,292</u>



	The Bank							
	2008							
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>Assets</b>								
Cash and balances with banks and other financial institutions . . . . .	75,622	57,811	–	–	–	–	–	133,433
Placements with banks and other financial institutions maturing between one and twelve months . . . . .	–	–	21,427	46,473	–	–	–	67,900
Financial assets at fair value through profit or loss								
– debt securities held for trading								
– certificates of deposit held . . . . .	–	–	–	–	–	–	–	–
– others . . . . .	–	4,428	6,260	1,526	582	6	–	12,802
– debt securities designated at fair value through profit or loss								
– certificates of deposit held . . . . .	–	–	–	–	–	–	–	–
– others . . . . .	–	–	29	82	103	–	–	214
– equity securities . . . . .	–	–	–	–	–	–	20	20
Derivative financial instruments . . . . .	13,845	755	1,247	1,454	1,213	119	–	18,633
Hong Kong SAR Government certificates of indebtedness . . . . .	34,200	–	–	–	–	–	–	34,200
Advances and other accounts								
– advances to customers . . . . .	19,102	12,619	26,630	39,534	158,920	118,001	894	375,700
– trade bills . . . . .	–	2,506	3,302	614	–	–	–	6,422
– advances to banks and other financial institutions . . . . .	27	–	–	885	2,826	–	–	3,738
Investment in securities								
– debt securities held for available-for- sale								
– certificates of deposit held . . . . .	–	–	–	4,427	2,096	–	–	6,523
– others . . . . .	–	19,550	13,047	39,515	56,736	25,193	6,029	160,070
– debt securities held for held-to-maturity								
– certificates of deposit held . . . . .	–	365	602	2,135	5,823	–	–	8,925
– others . . . . .	–	1,582	3,927	11,598	41,115	15,646	7,024	80,892
– debt securities held for loans and receivables . . . . .	–	–	1,592	6,852	–	–	–	8,444
– equity securities . . . . .	–	–	–	–	–	–	99	99
Interests in subsidiaries . . . . .	–	–	–	–	–	–	12,401	12,401
Interests in associates . . . . .	–	–	–	–	–	–	12	12
Investment properties . . . . .	–	–	–	–	–	–	7,279	7,279
Properties, plant and equipment . . . . .	–	–	–	–	–	–	17,549	17,549
Other assets (including deferred tax assets) . . .	2,115	11,218	10	95	26	–	164	13,628
<b>Total assets</b> . . . . .	<u>144,911</u>	<u>110,834</u>	<u>78,073</u>	<u>155,190</u>	<u>269,440</u>	<u>158,965</u>	<u>51,471</u>	<u>968,884</u>
<b>Liabilities</b>								
Hong Kong SAR currency notes in circulation .	34,200	–	–	–	–	–	–	34,200
Deposits and balances of banks and other financial institutions . . . . .	63,539	17,123	3,914	3,267	–	–	–	87,843
Financial liabilities at fair value through profit or loss								
– certificates of deposit issued . . . . .	–	–	–	858	–	–	–	858
– others . . . . .	–	5,788	6,105	7,710	8	–	–	19,611
Derivative financial instruments . . . . .	9,987	2,116	1,680	1,972	2,646	1,165	–	19,566
Deposits from customers . . . . .	375,020	204,470	77,632	21,941	188	–	–	679,251
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	11,190	14,738	189	2,047	2,230	–	–	30,394
Subordinated liabilities . . . . .	–	–	–	21	–	26,583	–	26,604
<b>Total liabilities</b> . . . . .	<u>493,936</u>	<u>244,235</u>	<u>89,520</u>	<u>37,816</u>	<u>5,072</u>	<u>27,748</u>	<u>–</u>	<u>898,327</u>
Net liquidity gap . . . . .	(349,025)	(133,401)	(11,447)	117,374	264,368	131,217	51,471	70,557

The Bank							
2007							
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
<b>Assets</b>							
Cash and balances with banks and other financial institutions . . . . .	37,442	96,578	–	–	–	–	134,020
Placements with banks and other financial institutions maturing between one and twelve months . . . . .	–	–	28,927	2,960	–	–	31,887
Financial assets at fair value through profit or loss							
– debt securities held for trading							
– certificates of deposit held . . . . .	–	–	–	80	–	–	80
– others . . . . .	–	1,367	658	2,340	1,306	32	5,703
– debt securities designated at fair value through profit or loss							
– certificates of deposit held . . . . .	–	–	–	–	–	–	–
– others . . . . .	–	–	–	–	259	–	259
– equity securities . . . . .	–	–	–	–	–	327	327
Derivative financial instruments . . . . .	12,194	226	128	942	438	44	13,972
Hong Kong SAR Government certificates of indebtedness . . . . .	32,770	–	–	–	–	–	32,770
Advances and other accounts							
– advances to customers . . . . .	18,560	9,284	20,224	34,194	140,676	110,121	334,253
– trade bills . . . . .	4	2,314	1,825	278	–	–	4,421
– advances to banks and other financial institutions . . . . .	27	–	599	440	2,156	–	3,222
Investment in securities							
– debt securities held for available-for- sale							
– certificates of deposit held . . . . .	–	701	400	2,058	3,589	–	6,748
– others . . . . .	–	5,606	3,367	7,293	30,301	43,459	90,582
– debt securities held for held-to-maturity							
– certificates of deposit held . . . . .	–	–	207	2,234	6,340	624	9,405
– others . . . . .	–	3,009	10,902	13,722	76,539	33,558	141,468
– debt securities held for loans and receivables . . . . .	–	5,696	8,025	9,063	–	–	22,784
– equity securities . . . . .	–	–	–	–	–	62	62
Interests in subsidiaries . . . . .	–	–	–	–	–	12,866	12,866
Interests in associates . . . . .	–	–	–	–	–	12	12
Investment properties . . . . .	–	–	–	–	–	7,595	7,595
Properties, plant and equipment . . . . .	–	–	–	–	–	18,261	18,261
Other assets . . . . .	2,991	15,146	17	158	176	–	18,560
<b>Total assets</b> . . . . .	<u>103,988</u>	<u>139,927</u>	<u>75,279</u>	<u>75,762</u>	<u>261,780</u>	<u>187,838</u>	<u>889,257</u>
<b>Liabilities</b>							
Hong Kong SAR currency notes in circulation .	32,770	–	–	–	–	–	32,770
Deposits and balances of banks and other financial institutions . . . . .	29,921	19,977	1,598	4,711	–	–	56,207
Financial liabilities at fair value through profit or loss							
– certificates of deposit issued . . . . .	–	–	–	662	868	–	1,530
– others . . . . .	–	2,188	1,265	3,004	129	–	6,586
Derivative financial instruments . . . . .	8,201	405	348	942	715	177	10,788
Deposits from customers . . . . .	281,278	284,779	81,681	25,427	415	–	673,580
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	9,718	14,451	6,665	1,271	3,480	–	35,585
<b>Total liabilities</b> . . . . .	<u>361,888</u>	<u>321,800</u>	<u>91,557</u>	<u>36,017</u>	<u>5,607</u>	<u>177</u>	<u>817,046</u>
Net liquidity gap . . . . .	<u>(257,900)</u>	<u>(181,873)</u>	<u>(16,278)</u>	<u>39,745</u>	<u>256,173</u>	<u>187,661</u>	<u>72,211</u>

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 and debt securities 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.

#### 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 an 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 is 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 needs and risk profile.

##### (a) Capital adequacy ratio

	2008	2007
Capital adequacy ratio . . . . .	<u>16.17%</u>	<u>13.08%</u>
Core capital ratio . . . . .	<u>10.86%</u>	<u>12.23%</u>

The capital ratios are computed on the consolidated basis that comprises the positions of BOCHK and certain subsidiaries 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 “Appendix – Subsidiaries of the Bank” on page 327.

**(b) Components of capital base after deductions**

The consolidated 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:

	<u>2008</u>	<u>2007</u>
	HK\$'m	HK\$'m
Core capital:		
Paid up ordinary share capital . . . . .	<b>43,043</b>	43,043
Reserves . . . . .	<b>18,049</b>	22,611
Profit and loss account . . . . .	<b>2,956</b>	207
Minority interests . . . . .	<b>1,124</b>	1,284
	<b>65,172</b>	67,145
Deductions from core capital . . . . .	<b>(1,536)</b>	(483)
Core capital . . . . .	<b>63,636</b>	66,662
Supplementary capital:		
Fair value gains arising from holdings of available-for-sale securities . . . . .	<b>87</b>	18
Fair value gains arising from holdings of securities designated at fair value through profit or loss . . . . .	–	9
Collective loan impairment allowances . . . . .	<b>1,502</b>	1,004
Regulatory reserve . . . . .	<b>4,503</b>	4,130
Term subordinated debt . . . . .	<b>26,583</b>	–
	<b>32,675</b>	5,161
Deductions from supplementary capital . . . . .	<b>(1,536)</b>	(483)
Supplementary capital . . . . .	<b>31,139</b>	4,678
Total capital base after deductions . . . . .	<b>94,775</b>	71,340

Subsidiaries which are not included in the consolidation group for the calculation of capital adequacy ratios are denoted in “Appendix – Subsidiaries of the Bank” on page 327. Investment costs in such subsidiaries are deducted from the capital base.

Term subordinated debt represents subordinated loans qualified as Tier 2 Capital of BOCHK pursuant to the regulatory requirements of the HKMA. Going forward, BOCHK will continue to take proactive measures to manage its capital, with a view to meet its strategic development needs.

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

The capital adequacy ratios shown above are calculated on the consolidation 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 consolidation basis for credit, market, and operational risks.

	2008	2007
	HK\$'m	HK\$'m
Credit risk . . . . .	<b>43,609</b>	40,878
Market risk . . . . .	<b>728</b>	640
Operational risk . . . . .	<b>3,531</b>	3,131
	<b><u>47,868</u></b>	<b><u>44,649</u></b>

(i) *Capital requirements for credit risk*

	2008					
	Total exposures	Exposures after CRM*		Risk-weighted amount		Capital requirement**
	HK\$'m	Rated	Unrated	Rated	Unrated	HK\$'m
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
On-balance sheet exposures						
Sovereign . . . . .	137,693	142,513	–	602	–	48
Public sector entity. . . . .	5,289	21,507	–	4,301	–	344
Multilateral development bank . . . . .	5,887	5,887	–	–	–	–
Bank . . . . .	321,992	318,872	12,807	96,789	5,909	8,216
Securities firm . . . . .	12	–	–	–	–	–
Corporate . . . . .	321,192	67,091	234,426	34,821	234,426	21,540
Cash items. . . . .	39,451	–	39,451	–	–	–
Regulatory retail . . . . .	31,919	–	30,312	–	22,734	1,819
Residential mortgage loans . . . . .	149,084	–	132,716	–	53,708	4,296
Other exposures which are not past due. . . . .	34,896	–	34,313	–	34,313	2,745
Past due exposures . . . . .	800	–	800	–	871	70
Total for on-balance sheet exposures . . .	1,048,215	555,870	484,825	136,513	351,961	39,078
Off-balance sheet exposures						
Off-balance sheet exposures other than OTC derivative transactions or credit derivative contracts . . . . .	46,045	11,156	34,889	6,144	34,113	3,221
OTC derivative transactions. . . . .	6,243	5,750	493	1,871	448	186
Total for off-balance sheet exposures. . .	52,288	16,906	35,382	8,015	34,561	3,407
Total for non-securitisation exposures . .	1,100,503	572,776	520,207	144,528	386,522	42,485
Securitisation exposures . . . . .	24,144	24,144	–	14,057	–	1,124
	1,124,647	596,920	520,207	158,585	386,522	43,609

	Total exposures	Exposures after CRM*		Risk-weighted amount		Capital requirement**
	HK\$'m	Rated HK\$'m	Unrated HK\$'m	Rated HK\$'m	Unrated HK\$'m	HK\$'m
On-balance sheet exposures						
Sovereign . . . . .	46,140	47,096	–	603	–	48
Public sector entity. . . . .	6,091	22,366	–	4,473	–	358
Multilateral development bank . . . . .	1,396	1,396	–	–	–	–
Bank . . . . .	357,628	349,758	12,481	90,907	4,856	7,661
Securities firm . . . . .	34	–	13	–	6	1
Corporate . . . . .	297,638	77,134	208,248	34,861	208,248	19,449
Cash items. . . . .	37,446	–	37,446	–	–	–
Regulatory retail . . . . .	29,867	–	28,232	–	21,174	1,694
Residential mortgage loans . . . . .	137,562	–	121,271	–	48,718	3,897
Other exposures which are not past due . . . . .	37,667	–	36,892	–	36,891	2,951
Past due exposures . . . . .	1,080	71	1,009	14	1,095	89
Total for on-balance sheet exposures . . .	952,549	497,821	445,592	130,858	320,988	36,148
Off-balance sheet exposures						
Off-balance sheet exposures other than OTC derivative transactions or credit derivative contracts . . . . .	54,841	8,046	46,795	4,864	42,494	3,789
OTC derivative transactions. . . . .	3,717	2,565	1,152	643	1,101	139
Total for off-balance sheet exposures. . .	58,558	10,611	47,947	5,507	43,595	3,928
Total for non-securitisation exposures . .	1,011,107	508,432	493,539	136,365	364,583	40,076
Securitisation exposures . . . . .	50,110	50,110	–	10,022	–	802
	1,061,217	558,542	493,539	146,387	364,583	40,878

\* 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 Group's actual regulatory capital.

As at 31 December 2008, credit exposures deducted from the capital base amounted to HK\$2,571 million (2007: HK\$472 million).

The Group used the STC approach for calculation of credit risk.

The ECAIs 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 Group 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.

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:

	<b>2008</b>	2007
	<b>HK\$'m</b>	HK\$'m
Gross total positive fair value . . . . .	<b><u>3,120</u></b>	<u>1,239</u>
Credit equivalent amount . . . . .	<b><u>6,243</u></b>	3,717
Less: recognised collateral . . . . .	<u>—</u>	<u>—</u>
Net credit equivalent amount. . . . .	<b><u>6,243</u></b>	<u>3,717</u>
Net credit equivalent amount analysed by type of issuer:		
Sovereign . . . . .	<b>4</b>	8
Bank . . . . .	<b>5,830</b>	2,654
Corporate . . . . .	<b>406</b>	1,006
Others . . . . .	<b><u>3</u></b>	<u>49</u>
	<b><u>6,243</u></b>	<u>3,717</u>
Risk weighted amount analysed by type of issuer:		
Sovereign . . . . .	<b>4</b>	8
Bank . . . . .	<b>1,908</b>	685
Corporate . . . . .	<b>405</b>	1,002
Others . . . . .	<b><u>3</u></b>	<u>49</u>
	<b><u>2,320</u></b>	<u>1,744</u>
Notional amount of recognised credit derivative contracts which provide credit protection . . . . .	<u>—</u>	<u>—</u>

There is no effect of 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.

### **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 the 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.



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

	2008	
	Covered by recognised collateral	Covered by recognised guarantees
	HK\$'m	HK\$'m
On-balance sheet exposures		
Public sector entity . . . . .	–	70
Securities firm . . . . .	12	–
Corporate . . . . .	5,266	23,915
Regulatory retail . . . . .	1,575	40
Residential mortgage loans . . . . .	84	16,283
Other exposures which are not past due . . . . .	583	–
Past due exposures . . . . .	688	34
Off-balance sheet exposures . . . . .	11,145	8,161
	<u>19,353</u>	<u>48,503</u>

	2007	
	Covered by recognised collateral	Covered by recognised guarantees
	HK\$'m	HK\$'m
On-balance sheet exposures		
Securities firm . . . . .	21	–
Corporate . . . . .	6,593	16,950
Regulatory retail . . . . .	1,590	45
Residential mortgage loans . . . . .	157	16,134
Other exposures which are not past due . . . . .	775	–
Past due exposures . . . . .	862	74
Off-balance sheet exposures . . . . .	9,069	8,612
	<u>19,067</u>	<u>41,815</u>

#### Asset securitisation

The Group has not acted as an originating institution in respect of securitisation transactions during the year. Securitisation exposures arising from the Group's investing activities are analysed as follows:

	2008			
	Total exposures	Risk weighted amounts	Capital requirement	Exposures deducted from capital base
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Traditional securitisations				
Residential mortgages . . . . .	19,830	13,175	1,054	1,769
Commercial mortgages . . . . .	1,382	277	22	–
Student loans . . . . .	1,953	390	31	–
Auto loans . . . . .	785	176	14	–
Credit card receivables . . . . .	194	39	3	–
	<u>24,144</u>	<u>14,057</u>	<u>1,124</u>	<u>1,769</u>

2007				
	<b>Total exposures</b>	<b>Risk weighted amounts</b>	<b>Capital requirement</b>	<b>Exposures deducted from capital base</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>
Traditional securitisations				
Residential mortgages . . . . .	44,370	8,874	710	—
Commercial mortgages . . . . .	1,560	312	25	—
Student loans . . . . .	1,641	328	26	—
Auto loans . . . . .	1,760	352	28	—
Credit card receivables . . . . .	779	156	13	—
	<u>50,110</u>	<u>10,022</u>	<u>802</u>	<u>—</u>

(ii) Capital charge for market risk

	<b>2008</b>	<b>2007</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Interest rate exposures . . . . .	<b>569</b>	450
Equity exposures . . . . .	<b>14</b>	56
Foreign exchange exposures . . . . .	<b>142</b>	132
Commodity exposures . . . . .	<b>3</b>	2
	<u><b>728</b></u>	<u>640</u>

The Group used the STM approach for calculation of market risk.

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

	<b>2008</b>		<b>2007</b>	
	<b>Long</b>	<b>Short</b>	<b>Long</b>	<b>Short</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>
Interest rate exposures . . . . .	<b>383,286</b>	<b>382,934</b>	208,062	207,180
Equity exposures . . . . .	<b>82</b>	<b>22</b>	333	303
Foreign exchange exposures (Net) . . . . .	<b>1,463</b>	—	1,458	—
Commodities exposures . . . . .	<b>11</b>	<b>15</b>	11	20
	<u><b>384,842</b></u>	<u><b>382,971</b></u>	<u>209,864</u>	<u>207,503</u>

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\$m	HK\$m
Realised gains from sales or liquidations . . . . .	<u>97</u>	<u>1</u>
Unrealised gains on revaluation recognised in reserves but not through profit or loss . . . . .	<u>163</u>	<u>27</u>
Unrealised gains included in supplementary capital. . . . .	<u>87</u>	<u>18</u>

*(iii) Capital charge for operational risk*

	2008	2007
	HK\$m	HK\$m
Capital charge for operational risk. . . . .	<u>3,531</u>	<u>3,131</u>

The Group used the STO approach for calculation of operational risk.

#### **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, banks and other financial institutions***

Substantially all the advances to customers, banks and other financial institutions 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. The Group's carrying value and fair value as at 31 December 2008 amounted to HK\$105,393 million (2007: HK\$165,428 million) and HK\$102,148 million (2007: HK\$166,110 million) respectively. The Bank's carrying value and fair value as at 31 December 2008 amounted to HK\$89,817 million (2007: HK\$150,873 million) and HK\$86,751 million (2007: HK\$151,539 million) respectively.

***Loans and receivables, Certificates of deposit issued and Debt securities in issue***

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.

***Subordinated liabilities***

All the subordinated liabilities are on floating rate terms, bear interest at prevailing market interest rates and their carrying value approximates fair value.

## 5. Net interest income

	2008	2007
	HK\$'m	HK\$'m
<b>Interest income</b>		
Cash and due from banks and other financial institutions . . . . .	5,523	8,311
Advances to customers . . . . .	16,255	20,801
Listed investments . . . . .	2,922	2,500
Unlisted investments . . . . .	9,082	13,046
Others . . . . .	403	651
	<u>34,185</u>	<u>45,309</u>
<b>Interest expense</b>		
Due to banks, customers and other financial institutions . . . . .	(14,037)	(25,895)
Debt securities in issue . . . . .	(130)	(103)
Subordinated liabilities . . . . .	(243)	–
Others . . . . .	(776)	(771)
	<u>(15,186)</u>	<u>(26,769)</u>
<b>Net interest income . . . . .</b>	<u><u>18,999</u></u>	<u><u>18,540</u></u>

Included within interest income is HK\$20 million (2007: HK\$47 million) of interest with respect to income recognised on advances classified as impaired for the year ended 31 December 2008. Interest accrued on impaired investment in securities amounted to HK\$362 million (2007: HK\$1 million).

Included within interest income and interest expense are HK\$33,673 million (2007: HK\$44,789 million) and HK\$14,400 million (2007: HK\$26,015 million) for financial assets and financial liabilities that are not recognised at fair value through profit or loss respectively.

## 6. Net fees and commission income

	2008	2007
	HK\$'m	HK\$'m
<b>Fees and commission income</b>		
Securities brokerage		
– Stockbroking . . . . .	2,380	3,560
– Bonds . . . . .	259	211
Credit cards . . . . .	1,220	1,027
Bills commissions . . . . .	683	588
Loan commissions . . . . .	513	347
Payment services . . . . .	486	464
Insurance . . . . .	449	454
Asset management . . . . .	218	683
Trust services . . . . .	173	153
Guarantees . . . . .	37	32
Others		
– RMB business . . . . .	223	137
– currency exchange . . . . .	204	184
– safe deposit box . . . . .	188	182
– information search . . . . .	44	42
– correspondent banking . . . . .	44	37
– low deposit balance accounts . . . . .	28	33
– postage and telegrams . . . . .	18	27
– dormant accounts . . . . .	17	20
– agency services . . . . .	16	20
– BOC cards . . . . .	28	28
– sundries . . . . .	247	251
	<u>7,475</u>	<u>8,480</u>
<b>Fees and commission expenses . . . . .</b>	<b>(2,011)</b>	<b>(1,897)</b>
<b>Net fees and commission income . . . . .</b>	<b><u>5,464</u></b>	<b><u>6,583</u></b>
Of which arise from		
– financial assets or financial liabilities not at fair value through profit or loss		
– Fees and commission income . . . . .	680	403
– Fees and commission expenses . . . . .	(43)	(60)
	<u>637</u>	<u>343</u>
– trust and other fiduciary activities		
– Fees and commission income . . . . .	296	254
– Fees and commission expenses . . . . .	(6)	(6)
	<u>290</u>	<u>248</u>

## 7. Net trading income

	2008	2007
	HK\$'m	HK\$'m
Net gain/(loss) from:		
– foreign exchange and foreign exchange products . . . . .	1,809	800
– interest rate instruments . . . . .	(127)	30
– equity instruments . . . . .	119	181
– commodities. . . . .	113	2
	<u>1,914</u>	<u>1,013</u>

## 8. Net loss on investment in securities

	2008	2007
	HK\$'m	HK\$'m
Net loss from disposal of available-for-sale securities . . . . .	(14)	(55)
Net gain from redemption of held-to-maturity securities . . . . .	–	2
Net loss from disposal of loans and receivables . . . . .	(1)	–
	<u>(15)</u>	<u>(53)</u>

## 9. Other operating income

	2008	2007
	HK\$'m	HK\$'m
Dividend income from investment in securities		
– unlisted investments . . . . .	16	15
Gross rental income from investment properties . . . . .	320	254
Less: Outgoings in respect of investment properties . . . . .	(52)	(52)
Others . . . . .	150	539
	<u>434</u>	<u>756</u>

Included in the “Outgoings in respect of investment properties” is HK\$2 million (2007: HK\$3 million) of direct operating expenses related to investment properties that were not let during the year.

# 10. Net charge of impairment allowances

	2008	2007
	HK\$'m	HK\$'m
<b>Advances to customers</b>		
Individually assessed		
– new allowances . . . . .	813	330
– releases . . . . .	(83)	(299)
– recoveries . . . . .	<u>(722)</u>	<u>(1,311)</u>
Net charge/(reversal) of individually assessed loan impairment allowances (Note 24) . . . . .	<u>8</u>	<u>(1,280)</u>
Collectively assessed . . . . .		
– new allowances . . . . .	691	625
– releases . . . . .	(10)	–
– recoveries . . . . .	<u>(28)</u>	<u>(30)</u>
Net charge of collectively assessed loan impairment allowances (Note 24) . . . . .	<u>653</u>	<u>595</u>
Net charge/(reversal) of loan impairment allowances . . . . .	<u>661</u>	<u>(685)</u>
<b>Available-for-sale securities</b>		
Net charge of impairment losses on available-for-sale securities		
Individually assessed . . . . .	<u>5,109</u>	<u>289</u>
<b>Held-to-maturity securities</b>		
Net charge of impairment allowances on held-to-maturity securities		
Individually assessed (Note 25) . . . . .	<u>4,061</u>	<u>1,844</u>
<b>Others</b>	<u>12</u>	<u>–</u>
<b>Net charge of impairment allowances . . . . .</b>	<u><b>9,843</b></u>	<u><b>1,448</b></u>

## 11. Operating expenses

	2008	2007
	HK\$'m	HK\$'m
Staff costs (including directors' emoluments)		
– salaries and other costs . . . . .	4,049	4,281
– termination benefit . . . . .	55	14
– pension cost . . . . .	368	299
	<u>4,472</u>	<u>4,594</u>
Premises and equipment expenses (excluding depreciation)		
– rental of premises . . . . .	402	342
– information technology . . . . .	408	376
– others . . . . .	254	231
	<u>1,064</u>	<u>949</u>
Depreciation (Note 29) . . . . .	990	785
Auditors' remuneration		
– audit services . . . . .	32	31
– non-audit services . . . . .	5	5
Other operating expenses . . . . .	2,073	1,295
	<u>8,636</u>	<u>7,659</u>

## 12. Net (loss)/gain from disposal of/fair value adjustments on investment properties

	2008	2007
	HK\$'m	HK\$'m
Net gain on disposal of investment properties . . . . .	14	8
Net (loss)/gain on fair value adjustments on investment properties (Note 28) . . . . .	(132)	1,056
	<u>(118)</u>	<u>1,064</u>

## 13. Net gain from disposal/revaluation of properties, plant and equipment

	2008	2007
	HK\$'m	HK\$'m
Net gain on disposal of premises . . . . .	35	23
Net loss on disposal of other fixed assets . . . . .	(4)	(16)
Net (loss)/gain on revaluation of premises (Note 29) . . . . .	(13)	21
	<u>18</u>	<u>28</u>



## 14. Taxation

Taxation in the income statement represents:

	<u>2008</u>	<u>2007</u>
	HK\$'m	HK\$'m
Hong Kong profits tax		
Current tax		
– current year taxation . . . . .	1,326	2,985
– over-provision in prior years . . . . .	<u>(13)</u>	<u>(29)</u>
	<u>1,313</u>	<u>2,956</u>
Deferred tax (credit)/charge (Note 36)		
– origination and reversal of temporary differences . . . . .	(241)	198
– impact of change of Hong Kong tax rate . . . . .	<u>(124)</u>	<u>–</u>
	<u>(365)</u>	<u>198</u>
Hong Kong profits tax . . . . .	948	3,154
Overseas taxation . . . . .	<u>222</u>	<u>101</u>
	<u>1,170</u>	<u>3,255</u>

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:

	<u>2008</u>	<u>2007</u>
	HK\$'m	HK\$'m
Profit before taxation . . . . .	7,908	18,802
Calculated at a taxation rate of 16.5% (2007: 17.5%) . . . . .	1,305	3,290
Effect of different taxation rates in other countries . . . . .	64	5
Income not subject to taxation . . . . .	(225)	(80)
Expenses not deductible for taxation purposes . . . . .	55	69
Tax losses not recognised . . . . .	1	1
Utilisation of previously unrecognised tax losses . . . . .	(17)	(1)
Over-provision in prior years . . . . .	<u>(13)</u>	<u>(29)</u>
Taxation charge . . . . .	<u>1,170</u>	<u>3,255</u>
Effective tax rate . . . . .	<u>14.8%</u>	<u>17.3%</u>

## 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\$6,123 million (2007: HK\$12,701 million).

## 16. Dividends

	2008		2007	
	Per share	Total	Per share	Total
	HK\$	HK\$m	HK\$	HK\$m
First interim dividend . . . . .	<b>0.092</b>	<b>3,960</b>	0.102	4,390
Second interim dividend . . . . .	–	–	0.095	4,089
Third interim dividend . . . . .	–	–	0.137	5,897
	<u><b>0.092</b></u>	<u><b>3,960</b></u>	<u>0.334</u>	<u>14,376</u>

## 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\$312 million (2007: approximately HK\$261 million), after a deduction of forfeited contributions of approximately HK\$10 million (2007: approximately HK\$15 million). For the MPF Scheme, the Group contributed approximately HK\$35 million (2007: approximately HK\$26 million) for the year ended 31 December 2008.

## 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 BOCHK (Holdings) dated 10 July 2002.

The purpose of the Share Option Scheme is to provide the participants with the opportunity to acquire proprietary interests in BOCHK (Holdings). The Board of BOCHK (Holdings) may, in its absolute discretion, offer to grant options under the Share Option Scheme to any person as the Board of BOCHK (Holdings) may select. The subscription price for the shares shall be determined on the date of grant by the Board of BOCHK (Holdings) 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 Board of BOCHK (Holdings) and from time to time as specified in the offer and on or before the termination date prescribed by the Board of BOCHK (Holdings).

The purpose of the Sharesave Plan is to encourage broad-based employee ownership of the shares of BOCHK (Holdings). 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 Board of BOCHK (Holdings). 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 together with approximately 60 senior management personnel of BOCHK (Holdings) and employees of BOC were granted options by BOC (BVI), the indirect holding company of the Bank, pursuant to a Pre-Listing Share Option Scheme to purchase from BOC (BVI) an aggregate of 31,132,600 existing issued shares of BOCHK (Holdings). 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.

Details of the share options outstanding as at 31 December 2008 are disclosed as follows:

	Directors	Senior management	Others*	Total number of share options	Average exercise price (HK\$ per share)
At 1 January 2008 . . . . .	<b>6,651,600</b>	<b>2,253,100</b>	<b>1,446,000</b>	<b>10,350,700</b>	<b>8.5</b>
Less: Share options exercised during the year . . . . .	<b>(361,500)</b>	<b>(891,900)</b>	<b>(1,446,000)</b>	<b>(2,699,400)</b>	<b>8.5</b>
At 31 December 2008 . . . . .	<b><u>6,290,100</u></b>	<b><u>1,361,200</u></b>	<b><u>–</u></b>	<b><u>7,651,300</u></b>	<b><u>8.5</u></b>
Exercisable at 31 December 2008 . . . . .	<b><u>6,290,100</u></b>	<b><u>1,361,200</u></b>	<b><u>–</u></b>	<b><u>7,651,300</u></b>	<b><u>8.5</u></b>
At 1 January 2007 . . . . .	8,459,100	3,980,450	1,446,000	13,885,550	8.5
Transfer . . . . .	(1,446,000)	–	1,446,000	–	8.5
Less: Share options exercised during the year . . . . .	<b>(361,500)</b>	<b>(1,727,350)</b>	<b>(1,446,000)</b>	<b>(3,534,850)</b>	<b>8.5</b>
At 31 December 2007 . . . . .	<b><u>6,651,600</u></b>	<b><u>2,253,100</u></b>	<b><u>1,446,000</u></b>	<b><u>10,350,700</u></b>	<b><u>8.5</u></b>
Exercisable at 31 December 2007 . . . . .	<b><u>6,651,600</u></b>	<b><u>2,253,100</u></b>	<b><u>1,446,000</u></b>	<b><u>10,350,700</u></b>	<b><u>8.5</u></b>

\* Represented share options held by ex-directors of the Group.

Share options were exercised on a regular basis throughout the year, the weighted average share price during the year was HK\$18.65 (2007: HK\$19.38).

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.

## 19. Directors' and senior management's emoluments

### (a) 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:

	Directors' fees	Basic salaries, allowances and benefits in kind	Contributions to pension schemes	Bonus	Total
For the year 2008	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<i><b>Executive Directors</b></i>					
He Guangbei . . . . .	100	6,013	—	—	6,113
Lee Raymond Wing Hung . . . . .	414	6,979	247	—	7,640
Gao Yingxin . . . . .	100	4,308	—	—	4,408
	<u>614</u>	<u>17,300</u>	<u>247</u>	—	<u>18,161</u>
<i><b>Non-executive Directors</b></i>					
Xiao Gang . . . . .	—	—	—	—	—
Sun Changji . . . . .	300	—	—	—	300
Li Zaohang . . . . .	250	—	—	—	250
Zhou Zaiqun . . . . .	365	—	—	—	365
Zhang Yanling . . . . .	250	—	—	—	250
Fung Victor Kwok King* . . . . .	300	—	—	—	300
Koh Beng Seng* . . . . .	350	—	—	—	350
Shan Weijian* . . . . .	350	—	—	—	350
Tung Chee Chen* . . . . .	300	—	—	—	300
Tung Savio Wai-Hok* . . . . .	350	—	—	—	350
Yang Linda Tsao* . . . . .	400	—	—	—	400
	<u>3,215</u>	<u>—</u>	<u>—</u>	—	<u>3,215</u>
	<u>3,829</u>	<u>17,300</u>	<u>247</u>	—	<u>21,376</u>

*Note:* Basic salaries, allowances and benefits in kind for the year 2008 include fixed guaranteed bonus.

	Directors' fees	Basic salaries, allowances and benefits in kind	Contributions to pension schemes	Bonus	Total
For the year 2007	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>Executive Directors</b>					
He Guangbei . . . . .	100	5,326	–	3,000	8,426
Lee Raymond Wing Hung** . . . . .	259	3,044	112	1,339	4,754
Gao Yingxin** . . . . .	100	2,278	–	1,120	3,498
	<u>459</u>	<u>10,648</u>	<u>112</u>	<u>5,459</u>	<u>16,678</u>
<b>Non-executive Directors</b>					
Xiao Gang . . . . .	–	–	–	–	–
Sun Changji . . . . .	300	–	–	–	300
Hua Qingshan . . . . .	137	–	–	–	137
Li Zaohang . . . . .	250	–	–	–	250
Zhou Zaiqun . . . . .	300	–	–	–	300
Zhang Yanling . . . . .	250	–	–	–	250
Fung Victor Kwok King* . . . . .	300	–	–	–	300
Koh Beng Seng* . . . . .	350	–	–	–	350
Shan Weijian* . . . . .	350	–	–	–	350
Tung Chee Chen* . . . . .	300	–	–	–	300
Tung Savio Wai-Hok* . . . . .	350	–	–	–	350
Yang Linda Tsao* . . . . .	400	–	–	–	400
	<u>3,287</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>3,287</u>
	<u>3,746</u>	<u>10,648</u>	<u>112</u>	<u>5,459</u>	<u>19,965</u>

*Note:*

\* Independent Non-executive Directors

\*\* The directors were appointed on 25 May 2007, therefore the amounts of their emoluments for 2007 were disclosed on a pro-rata basis.

In July 2002, options were granted to several directors of the Bank by the indirect holding company, BOC (BVI), 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.

For the year ended 31 December 2008, one of the directors waived emoluments of HK\$200,000 (2007: HK\$200,000).

**(b) Five highest paid individuals**

The five individuals whose emoluments were the highest in the Group for the year include 2 (2007: 3) directors whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining 3 (2007: 2) individuals during the year are as follows:

	<b>2008</b>	<b>2007</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Basic salaries and allowances . . . . .	<b>13</b>	8
Bonuses . . . . .	<b>–</b>	4
Contributions to pension schemes . . . . .	<b>1</b>	1
Director's fee from subsidiaries . . . . .	<b>1</b>	–
	<b><u>15</u></b>	<b><u>13</u></b>

*Note:* Basic salaries and allowances for the year 2008 include fixed guaranteed bonus.

Emoluments of individuals were within the following bands:

	<b>Number of individuals</b>	
	<b>2008</b>	<b>2007</b>
HK\$4,000,001 – HK\$4,500,000 . . . . .	<b>1</b>	–
HK\$4,500,001 – HK\$5,000,000 . . . . .	<b>1</b>	–
HK\$5,500,001 – HK\$6,000,000 . . . . .	<b>1</b>	1
HK\$6,500,001 – HK\$7,000,000 . . . . .	<b>–</b>	<b><u>1</u></b>

**20. Cash and balances with banks and other financial institutions**

	<b>The Group</b>		<b>The Bank</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>
Cash . . . . .	<b>4,232</b>	3,334	<b>3,741</b>	2,852
Balances with central banks . . . . .	<b>66,158</b>	30,627	<b>64,407</b>	29,814
Balances with banks and other financial institutions . . . . .	<b>7,544</b>	6,126	<b>7,473</b>	4,776
Placements with banks and other financial institutions maturing within one month . .	<b>75,334</b>	118,965	<b>57,812</b>	96,578
	<b><u>153,268</u></b>	<b><u>159,052</u></b>	<b><u>133,433</u></b>	<b><u>134,020</u></b>

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

	The Group					
	Trading securities		Financial assets designated at fair value through profit or loss		Total	
	2008	2007	2008	2007	2008	2007
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
At fair value						
Debt securities						
– Listed in Hong Kong	412	190	358	727	770	917
– Listed outside Hong Kong. . . . .	35	537	890	1,002	925	1,539
	447	727	1,248	1,729	1,695	2,456
– Unlisted. . . . .	13,484	5,510	1,143	1,915	14,627	7,425
	13,931	6,237	2,391	3,644	16,322	9,881
Equity securities						
– Listed in Hong Kong	20	327	–	–	20	327
– Unlisted. . . . .	62	94	–	–	62	94
	82	421	–	–	82	421
Total . . . . .	14,013	6,658	2,391	3,644	16,404	10,302

	The Bank					
	Trading securities		Financial assets designated at fair value through profit or loss		Total	
	2008	2007	2008	2007	2008	2007
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
At fair value						
Debt securities						
– Listed in Hong Kong	226	189	98	101	324	290
– Listed outside Hong Kong. . . . .	1	537	116	158	117	695
	227	726	214	259	441	985
– Unlisted. . . . .	12,575	5,057	–	–	12,575	5,057
	12,802	5,783	214	259	13,016	6,042
Equity securities						
– Listed in Hong Kong	20	327	–	–	20	327
Total . . . . .	12,822	6,110	214	259	13,036	6,369

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

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Sovereigns . . . . .	<b>12,709</b>	3,756	<b>11,760</b>	3,261
Public sector entities. . . . .	<b>272</b>	413	<b>153</b>	299
Banks and other financial institutions . . . .	<b>1,915</b>	3,899	<b>1,029</b>	2,352
Corporate entities . . . . .	<b>1,508</b>	2,234	<b>94</b>	457
	<b><u>16,404</u></b>	<b><u>10,302</u></b>	<b><u>13,036</u></b>	<b><u>6,369</u></b>

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

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Treasury bills . . . . .	<b>12,458</b>	3,517	<b>11,551</b>	3,066
Certificates of deposit held . . . . .	<b>25</b>	430	–	80
Other financial assets at fair value through profit or loss. . . . .	<b>3,921</b>	6,355	<b>1,485</b>	3,223
	<b><u>16,404</u></b>	<b><u>10,302</u></b>	<b><u>13,036</u></b>	<b><u>6,369</u></b>

## 22. Derivative financial instruments and hedge accounting

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

Currency forwards represent commitments to purchase and sell foreign currency on a future date. Interest rate futures are contractual obligations to receive or pay a net amount based on changes in interest rates or buy or sell interest rate financial instruments on a future date at an agreed price in the financial market under the administration of the stock exchange. Forward rate agreements are individually negotiated interest rate futures that call for a cash settlement at a future date for the difference between a contracted rate of interest and the current market rate, based on a notional principal amount.

Currency, interest rate and precious metal swaps are commitments to exchange one set of cash flows or commodity for another. Swaps result in an exchange of currencies, interest rates (for example, fixed rate for floating rate), or precious metals (for example, silver swaps) 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, equity and precious metal 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 and metal prices relative to their terms. The aggregate fair values of derivative financial instruments assets and liabilities can fluctuate significantly from time to time.

**(a) Derivative financial instruments**

The Group trades derivatives products (both exchange-traded or OTC) mainly for customer business. The Group strictly follows risk management policies in providing derivatives products to our customers and in trading of derivatives products in the interbank market.

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 derivatives transactions, and the maximum tenor of the deal and management alert limit (MAL) in profit and loss is set. Every derivative transaction must be input into the relevant system for settlement, mark to market revaluation, reporting and control.

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

	The Group			
	2008			
			Not qualified for hedge accounting*	
	Trading	Hedging		Total
	HK\$m	HK\$m	HK\$m	HK\$m
Exchange rate contracts				
Spot and forwards . . . . .	182,624	–	–	182,624
Swaps. . . . .	248,956	–	68	249,024
Foreign currency option contracts				
– Options purchased. . . . .	2,518	–	–	2,518
– Options written. . . . .	2,754	–	–	2,754
	<u>436,852</u>	<u>–</u>	<u>68</u>	<u>436,920</u>
Interest rate contracts				
Futures . . . . .	4,290	–	–	4,290
Swaps. . . . .	68,392	19,931	10,045	98,368
Interest rate option contracts				
– Bond options written. . . . .	775	–	–	775
	<u>73,457</u>	<u>19,931</u>	<u>10,045</u>	<u>103,433</u>
Bullion contracts . . . . .	<u>3,880</u>	<u>–</u>	<u>–</u>	<u>3,880</u>
Equity contracts . . . . .	<u>5,070</u>	<u>–</u>	<u>–</u>	<u>5,070</u>
Other contracts. . . . .	<u>144</u>	<u>–</u>	<u>–</u>	<u>144</u>
Total . . . . .	<u>519,403</u>	<u>19,931</u>	<u>10,113</u>	<u>549,447</u>

The Group				
2007				
	Trading	Hedging	Not qualified for hedge accounting*	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Exchange rate contracts				
Spot and forwards . . . . .	258,556	—	—	258,556
Swaps. . . . .	156,554	—	—	156,554
Foreign currency option contracts				
– Options purchased. . . . .	5,607	—	—	5,607
– Options written. . . . .	5,875	—	—	5,875
	<u>426,592</u>	<u>—</u>	<u>—</u>	<u>426,592</u>
Interest rate contracts				
Futures . . . . .	226	—	—	226
Swaps. . . . .	36,714	6,708	3,253	46,675
Interest rate option contracts				
– Swaptions written . . . . .	780	—	—	780
– Bond options written. . . . .	780	—	—	780
	<u>38,500</u>	<u>6,708</u>	<u>3,253</u>	<u>48,461</u>
Bullion contracts . . . . .	<u>12,950</u>	<u>—</u>	<u>—</u>	<u>12,950</u>
Equity contracts . . . . .	<u>5,378</u>	<u>—</u>	<u>—</u>	<u>5,378</u>
Other contracts. . . . .	<u>172</u>	<u>—</u>	<u>—</u>	<u>172</u>
Total . . . . .	<u>483,592</u>	<u>6,708</u>	<u>3,253</u>	<u>493,553</u>

\* Derivative transactions which do not qualify as hedges 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.

The Bank				
2008				
	Trading	Hedging	Not qualified for hedge accounting	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Exchange rate contracts				
Spot and forwards . . . . .	173,705	–	–	173,705
Swaps. . . . .	246,356	–	–	246,356
Foreign currency option contracts				
– Options purchased. . . . .	2,518	–	–	2,518
– Options written. . . . .	2,754	–	–	2,754
	<u>425,333</u>	<u>–</u>	<u>–</u>	<u>425,333</u>
Interest rate contracts				
Futures . . . . .	4,290	–	–	4,290
Swaps. . . . .	66,329	19,931	8,295	94,555
Interest rate option contracts				
– Bond options written. . . . .	775	–	–	775
	<u>71,394</u>	<u>19,931</u>	<u>8,295</u>	<u>99,620</u>
Bullion contracts . . . . .	3,878	–	–	3,878
Equity contracts . . . . .	5,069	–	–	5,069
Other contracts. . . . .	130	–	–	130
Total . . . . .	<u>505,804</u>	<u>19,931</u>	<u>8,295</u>	<u>534,030</u>

The Bank				
2007				
	Trading	Hedging	Not qualified for hedge accounting	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Exchange rate contracts				
Spot and forwards . . . . .	248,700	–	–	248,700
Swaps . . . . .	154,572	–	–	154,572
Foreign currency option contracts				
– Options purchased . . . . .	5,607	–	–	5,607
– Options written . . . . .	5,875	–	–	5,875
	<u>414,754</u>	<u>–</u>	<u>–</u>	<u>414,754</u>
Interest rate contracts				
Futures . . . . .	226	–	–	226
Swaps . . . . .	34,900	6,708	540	42,148
Interest rate option contracts				
– Swaptions written . . . . .	780	–	–	780
– Bond options written . . . . .	780	–	–	780
	<u>36,686</u>	<u>6,708</u>	<u>540</u>	<u>43,934</u>
Bullion contracts . . . . .	<u>12,652</u>	<u>–</u>	<u>–</u>	<u>12,652</u>
Equity contracts . . . . .	<u>5,355</u>	<u>–</u>	<u>–</u>	<u>5,355</u>
Other contracts . . . . .	<u>155</u>	<u>–</u>	<u>–</u>	<u>155</u>
Total . . . . .	<u>469,602</u>	<u>6,708</u>	<u>540</u>	<u>476,850</u>

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

The Group								
2008								
Fair value assets				Fair value liabilities				
Trading	Hedging	Not qualified for hedge accounting	Total	Trading	Hedging	Not qualified for hedge accounting	Total	
HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Exchange rate contracts								
Spot and forwards . . . . .	15,152	–	–	15,152	(10,962)	–	–	(10,962)
Swaps . . . . .	1,624	–	1	1,625	(3,933)	–	(3)	(3,936)
Foreign currency option contracts								
– Options purchased . . .	21	–	–	21	–	–	–	–
– Options written . . . .	–	–	–	(24)	–	–	–	(24)
	<u>16,797</u>	<u>–</u>	<u>1</u>	<u>16,798</u>	<u>(14,919)</u>	<u>–</u>	<u>(3)</u>	<u>(14,922)</u>
Interest rate contracts								
Futures . . . . .	2	–	–	2	(6)	–	–	(6)
Swaps . . . . .	1,420	–	18	1,438	(2,329)	(1,769)	(166)	(4,264)
Interest rate option contracts								
– Bond options written .	–	–	–	(25)	–	–	–	(25)
	<u>1,422</u>	<u>–</u>	<u>18</u>	<u>1,440</u>	<u>(2,360)</u>	<u>(1,769)</u>	<u>(166)</u>	<u>(4,295)</u>
Bullion contracts . . . . .	248	–	–	248	(91)	–	–	(91)
Equity contracts . . . . .	1,142	–	–	1,142	(1,142)	–	–	(1,142)
Total . . . . .	<u>19,609</u>	<u>–</u>	<u>19</u>	<u>19,628</u>	<u>(18,512)</u>	<u>(1,769)</u>	<u>(169)</u>	<u>(20,450)</u>

The Group								
2007								
Fair value assets					Fair value liabilities			
			Not qualified for hedge accounting	Total			Not qualified for hedge accounting	Total
	Trading	Hedging			Trading	Hedging		
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Exchange rate contracts								
Spot and forwards . . . . .	12,588	–	–	12,588	(7,822)	–	–	(7,822)
Swaps . . . . .	269	–	–	269	(634)	–	–	(634)
Foreign currency option contracts								
– Options purchased . . .	48	–	–	48	–	–	–	–
– Options written . . . .	–	–	–	–	(51)	–	–	(51)
	<u>12,905</u>	<u>–</u>	<u>–</u>	<u>12,905</u>	<u>(8,507)</u>	<u>–</u>	<u>–</u>	<u>(8,507)</u>
Interest rate contracts								
Swaps . . . . .	492	10	23	525	(885)	(124)	(90)	(1,099)
Interest rate option contracts								
– Swaptions written . . .	–	–	–	–	(17)	–	–	(17)
– Bond options written .	–	–	–	–	(23)	–	–	(23)
	<u>492</u>	<u>10</u>	<u>23</u>	<u>525</u>	<u>(925)</u>	<u>(124)</u>	<u>(90)</u>	<u>(1,139)</u>
Bullion contracts . . . . .	<u>774</u>	<u>–</u>	<u>–</u>	<u>774</u>	<u>(1,110)</u>	<u>–</u>	<u>–</u>	<u>(1,110)</u>
Equity contracts . . . . .	<u>273</u>	<u>–</u>	<u>–</u>	<u>273</u>	<u>(326)</u>	<u>–</u>	<u>–</u>	<u>(326)</u>
Total . . . . .	<u>14,444</u>	<u>10</u>	<u>23</u>	<u>14,477</u>	<u>(10,868)</u>	<u>(124)</u>	<u>(90)</u>	<u>(11,082)</u>

The Bank								
2008								
Fair value assets				Fair value liabilities				
		Not qualified for hedge accounting	Total			Not qualified for hedge accounting	Total	
Trading	Hedging			Trading	Hedging			
HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Exchange rate contracts								
Spot and forwards . . . . .	14,164	–	–	14,164	(10,398)	–	–	(10,398)
Swaps . . . . .	1,622	–	–	1,622	(3,917)	–	–	(3,917)
Foreign currency option contracts								
– Options purchased . . .	21	–	–	21	–	–	–	–
– Options written . . . .	–	–	–	(24)	–	–	–	(24)
	<u>15,807</u>	–	–	<u>15,807</u>	<u>(14,339)</u>	–	–	<u>(14,339)</u>
Interest rate contracts								
Futures . . . . .	2	–	–	2	(6)	–	–	(6)
Swaps . . . . .	1,420	–	18	1,438	(2,178)	(1,769)	(15)	(3,962)
Interest rate option contracts . . . . .								
– Bond options written .	–	–	–	(25)	–	–	–	(25)
	<u>1,422</u>	–	18	<u>1,440</u>	<u>(2,209)</u>	<u>(1,769)</u>	<u>(15)</u>	<u>(3,993)</u>
Bullion contracts . . . . .	244	–	–	244	(92)	–	–	(92)
Equity contracts . . . . .	1,142	–	–	1,142	(1,142)	–	–	(1,142)
Total . . . . .	<u>18,615</u>	–	18	<u>18,633</u>	<u>(17,782)</u>	<u>(1,769)</u>	<u>(15)</u>	<u>(19,566)</u>

The Bank								
2007								
Fair value assets					Fair value liabilities			
Trading	Hedging	Not qualified for hedge accounting	Total		Trading	Hedging	Not qualified for hedge accounting	Total
HK\$'m	HK\$'m	HK\$'m	HK\$'m		HK\$'m	HK\$'m	HK\$'m	HK\$'m
Exchange rate contracts								
Spot and forwards . . . . .	12,100	–	–	12,100	(7,705)	–	–	(7,705)
Swaps . . . . .	265	–	–	265	(617)	–	–	(617)
Foreign currency option contracts								
– Options purchased . . .	48	–	–	48	–	–	–	–
– Options written . . . .	–	–	–	–	(51)	–	–	(51)
	<u>12,413</u>	<u>–</u>	<u>–</u>	<u>12,413</u>	<u>(8,373)</u>	<u>–</u>	<u>–</u>	<u>(8,373)</u>
Interest rate contracts								
Swaps . . . . .	502	10	3	515	(811)	(124)	(6)	(941)
Interest rate option contracts . . . . .								
– Swaptions written . . .	–	–	–	–	(17)	–	–	(17)
– Bond options written .	–	–	–	–	(23)	–	–	(23)
	<u>502</u>	<u>10</u>	<u>3</u>	<u>515</u>	<u>(851)</u>	<u>(124)</u>	<u>(6)</u>	<u>(981)</u>
Bullion contracts . . . . .	<u>772</u>	<u>–</u>	<u>–</u>	<u>772</u>	<u>(1,108)</u>	<u>–</u>	<u>–</u>	<u>(1,108)</u>
Equity contracts . . . . .	<u>272</u>	<u>–</u>	<u>–</u>	<u>272</u>	<u>(326)</u>	<u>–</u>	<u>–</u>	<u>(326)</u>
Total . . . . .	<u>13,959</u>	<u>10</u>	<u>3</u>	<u>13,972</u>	<u>(10,658)</u>	<u>(124)</u>	<u>(6)</u>	<u>(10,788)</u>

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

The Group		
	2008	2007
	HK\$'m	HK\$'m
Exchange rate contracts		
Forwards . . . . .	318	1,017
Swaps . . . . .	1,377	492
Foreign currency option contracts		
– Options purchased . . . . .	4	19
Interest rate contracts		
Futures . . . . .	2	–
Swaps . . . . .	577	104
Bullion contracts . . . . .	5	63
Equity contracts . . . . .	37	49
	<u>2,320</u>	<u>1,744</u>



	The Bank	
	2008	2007
	HK\$'m	HK\$'m
Exchange rate contracts		
Forwards . . . . .	313	1,011
Swaps . . . . .	1,368	487
Foreign currency option contracts		
– Options purchased . . . . .	5	19
Interest rate contracts		
Swaps . . . . .	572	93
Bullion contracts . . . . .	5	63
Equity contracts . . . . .	37	52
	<u>2,300</u>	<u>1,725</u>

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 69% (2007: 52%) and 70% (2007: 52%) of the Group's and the Bank's transactions in derivative contracts are conducted with other financial institutions respectively.

#### (b) Hedge accounting

The Group designated all derivatives held for hedging as fair value hedges.

The Group uses interest rate swaps to hedge against change in fair value of financial assets arising from movements in market rates.

Gains or losses on fair value hedges for the year are as follows:

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Net gain/(loss) on				
– hedging instruments . . . . .	(1,656)	(125)	(1,656)	(116)
– hedged items . . . . .	<u>1,677</u>	<u>114</u>	<u>1,677</u>	<u>105</u>
	<u>21</u>	<u>(11)</u>	<u>21</u>	<u>(11)</u>

## 23. Advances and other accounts

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Personal loans and advances . . . . .	<b>151,746</b>	141,686	<b>123,956</b>	114,816
Corporate loans and advances . . . . .	<b>309,428</b>	271,354	<b>253,288</b>	220,391
Advances to customers . . . . .	<b>461,174</b>	413,040	<b>377,244</b>	335,207
Loan impairment allowances				
– Individually assessed . . . . .	<b>(800)</b>	(381)	<b>(531)</b>	(306)
– Collectively assessed . . . . .	<b>(1,501)</b>	(1,004)	<b>(1,013)</b>	(648)
	<b>458,873</b>	411,655	<b>375,700</b>	334,253
Trade bills . . . . .	<b>7,609</b>	5,334	<b>6,422</b>	4,421
Advances to banks and other financial institutions . . . . .	<b>3,738</b>	3,223	<b>3,738</b>	3,222
Total . . . . .	<b>470,220</b>	420,212	<b>385,860</b>	341,896

As at 31 December 2008, advances to customers of the Group and the Bank included accrued interest on gross advances of HK\$1,293 million (2007: HK\$1,454 million) and HK\$1,058 million (2007: HK\$1,209 million) respectively.

As at 31 December 2008 and 2007, no impairment allowance was made in respect of trade bills and advances to banks and other financial institutions.

## 24. Loan impairment allowances

	The Group		
	2008		
	Individual assessment		
	Personal	Corporate	Total
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2008 . . . . .	<b>82</b>	<b>299</b>	<b>381</b>
(Credited)/charged to income statement (Note 10) . . .	<b>(30)</b>	<b>38</b>	<b>8</b>
Loans written off during the year as uncollectible . . .	<b>(13)</b>	<b>(286)</b>	<b>(299)</b>
Recoveries . . . . .	<b>33</b>	<b>689</b>	<b>722</b>
Unwind of discount on allowance . . . . .	<b>(1)</b>	<b>(11)</b>	<b>(12)</b>
At 31 December 2008 . . . . .	<b>71</b>	<b>729</b>	<b>800</b>

	The Bank		
	2008		
	Individual assessment		
	Personal	Corporate	Total
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2008 . . . . .	76	230	306
Credited to income statement . . . . .	(22)	(142)	(164)
Loans written off during the year as uncollectible . . .	(11)	(246)	(257)
Recoveries . . . . .	27	630	657
Unwind of discount on allowance . . . . .	(1)	(10)	(11)
At 31 December 2008 . . . . .	<u>69</u>	<u>462</u>	<u>531</u>

	The Group		
	2007		
	Individual assessment		
	Personal	Corporate	Total
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2007 . . . . .	117	429	546
Credited to income statement (Note 10) . . . . .	(52)	(1,228)	(1,280)
Loans written off during the year as uncollectible . . .	(27)	(145)	(172)
Recoveries . . . . .	50	1,261	1,311
Unwind of discount on allowance . . . . .	(6)	(18)	(24)
At 31 December 2007 . . . . .	<u>82</u>	<u>299</u>	<u>381</u>

	The Bank		
	2007		
	Individual assessment		
	Personal	Corporate	Total
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2007 . . . . .	108	362	470
Credited to income statement . . . . .	(27)	(1,068)	(1,095)
Loans written off during the year as uncollectible . . .	(25)	(123)	(148)
Recoveries . . . . .	25	1,076	1,101
Unwind of discount on allowance . . . . .	(5)	(17)	(22)
At 31 December 2007 . . . . .	<u>76</u>	<u>230</u>	<u>306</u>

	The Group		
	2008		
	Collective assessment		
	Personal	Corporate	Total
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2008 . . . . .	173	831	1,004
Charged to income statement (Note 10) . . . . .	156	497	653
Loans written off during the year as uncollectible . . .	(175)	(1)	(176)
Recoveries . . . . .	28	–	28
Unwind of discount on allowance . . . . .	(3)	(5)	(8)
At 31 December 2008 . . . . .	<u>179</u>	<u>1,322</u>	<u>1,501</u>

	The Bank		
	2008		
	Collective assessment		
	Personal	Corporate	Total
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2008 . . . . .	91	557	648
(Credited)/charged to income statement . . . . .	(2)	375	373
Loans written off during the year as uncollectible . . .	–	–	–
Recoveries . . . . .	–	–	–
Unwind of discount on allowance . . . . .	(3)	(5)	(8)
At 31 December 2008 . . . . .	<u>86</u>	<u>927</u>	<u>1,013</u>

	The Group		
	2007		
	Collective assessment		
	Personal	Corporate	Total
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2007 . . . . .	107	450	557
Charged to income statement (Note 10) . . . . .	197	398	595
Loans written off during the year as uncollectible . . .	(155)	–	(155)
Recoveries . . . . .	30	–	30
Unwind of discount on allowance . . . . .	(6)	(17)	(23)
At 31 December 2007 . . . . .	<u>173</u>	<u>831</u>	<u>1,004</u>

The Bank			
2007			
Collective assessment			
	Personal	Corporate	Total
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2007 . . . . .	31	305	336
Charged to income statement . . . . .	65	261	326
Loans written off during the year as uncollectible . . .	–	–	–
Recoveries . . . . .	–	–	–
Unwind of discount on allowance . . . . .	(5)	(9)	(14)
At 31 December 2007 . . . . .	<u>91</u>	<u>557</u>	<u>648</u>

## 25. Investment in securities

	The Group		The Bank	
	2008	2007	2008	2007
<b>(a) Available-for-sale securities</b>				
Debt securities, at fair value				
– Listed in Hong Kong . . . . .	<b>4,588</b>	3,659	<b>3,864</b>	3,500
– Listed outside Hong Kong . . . . .	<b>44,692</b>	18,455	<b>44,128</b>	18,203
	<b>49,280</b>	22,114	<b>47,992</b>	21,703
– Unlisted . . . . .	<b>121,655</b>	77,959	<b>118,601</b>	75,627
	<b>170,935</b>	100,073	<b>166,593</b>	97,330
Equity securities, at fair value				
– Unlisted . . . . .	<b>430</b>	445	<b>99</b>	62
	<b>171,365</b>	100,518	<b>166,692</b>	97,392
<b>(b) Held-to-maturity securities</b>				
Listed, at amortised cost				
– in Hong Kong . . . . .	<b>4,082</b>	4,107	<b>3,460</b>	3,525
– outside Hong Kong . . . . .	<b>21,302</b>	21,078	<b>18,646</b>	19,279
	<b>25,384</b>	25,185	<b>22,106</b>	22,804
Unlisted, at amortised cost . . . . .	<b>84,449</b>	141,925	<b>72,151</b>	129,751
	<b>109,833</b>	167,110	<b>94,257</b>	152,555
Impairment allowances . . . . .	<b>(4,440)</b>	(1,682)	<b>(4,440)</b>	(1,682)
	<b>105,393</b>	165,428	<b>89,817</b>	150,873
<b>(c) Loans and receivables</b>				
Unlisted, at amortised cost . . . . .	<b>12,595</b>	31,102	<b>8,444</b>	22,784
<b>Total . . . . .</b>	<b>289,353</b>	297,048	<b>264,953</b>	271,049
Market value of listed held-to-maturity securities	<b>24,354</b>	24,776	<b>21,248</b>	22,418

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

<b>The Group</b>				
<b>2008</b>				
	<b>Available-for-sale securities</b>	<b>Held-to-maturity securities</b>	<b>Loans and receivables</b>	<b>Total</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>
Sovereigns . . . . .	<b>70,274</b>	<b>1,079</b>	–	<b>71,353</b>
Public sector entities . . . . .	<b>9,202</b>	<b>12,481</b>	–	<b>21,683</b>
Banks and other financial institutions . . . .	<b>70,576</b>	<b>71,426</b>	<b>12,595</b>	<b>154,597</b>
Corporate entities . . . . .	<b>21,313</b>	<b>20,407</b>	–	<b>41,720</b>
	<b><u>171,365</u></b>	<b><u>105,393</u></b>	<b><u>12,595</u></b>	<b><u>289,353</u></b>
<b>The Group</b>				
<b>2007</b>				
	<b>Available-for-sale securities</b>	<b>Held-to-maturity securities</b>	<b>Loans and receivables</b>	<b>Total</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>
Sovereigns . . . . .	13,402	1,814	–	15,216
Public sector entities . . . . .	9,673	20,530	–	30,203
Banks and other financial institutions . . . .	43,854	108,547	31,102	183,503
Corporate entities . . . . .	33,589	34,537	–	68,126
	<b><u>100,518</u></b>	<b><u>165,428</u></b>	<b><u>31,102</u></b>	<b><u>297,048</u></b>
<b>The Bank</b>				
<b>2008</b>				
	<b>Available-for-sale securities</b>	<b>Held-to-maturity securities</b>	<b>Loans and receivables</b>	<b>Total</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>
Sovereigns . . . . .	<b>69,433</b>	<b>979</b>	–	<b>70,412</b>
Public sector entities . . . . .	<b>9,202</b>	<b>11,543</b>	–	<b>20,745</b>
Banks and other financial institutions . . . .	<b>68,848</b>	<b>58,932</b>	<b>8,444</b>	<b>136,224</b>
Corporate entities . . . . .	<b>19,209</b>	<b>18,363</b>	–	<b>37,572</b>
	<b><u>166,692</u></b>	<b><u>89,817</u></b>	<b><u>8,444</u></b>	<b><u>264,953</u></b>

	The Bank			
	2007			
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Sovereigns . . . . .	12,713	1,615	–	14,328
Public sector entities . . . . .	9,673	18,823	–	28,496
Banks and other financial institutions . . . .	43,047	98,225	22,784	164,056
Corporate entities . . . . .	<u>31,959</u>	<u>32,210</u>	<u>–</u>	<u>64,169</u>
	<u>97,392</u>	<u>150,873</u>	<u>22,784</u>	<u>271,049</u>

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\$'m	HK\$'m	HK\$'m
At 1 January 2008 . . . . .	<b>100,518</b>	<b>165,428</b>	<b>31,102</b>
Additions . . . . .	<b>182,457</b>	<b>56,121</b>	<b>33,918</b>
Disposals, redemptions and maturity . . . . .	<b>(101,229)</b>	<b>(106,014)</b>	<b>(52,627)</b>
Amortisation . . . . .	<b>544</b>	<b>(1,042)</b>	<b>640</b>
Change in fair value . . . . .	<b>(7,691)</b>	<b>–</b>	<b>–</b>
Impairment losses . . . . .	<b>–</b>	<b>(4,061)</b>	<b>–</b>
Exchange differences . . . . .	<b>(3,234)</b>	<b>(5,039)</b>	<b>(438)</b>
At 31 December 2008 . . . . .	<u><b>171,365</b></u>	<u><b>105,393</b></u>	<u><b>12,595</b></u>

	The Group		
	2007		
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2007 . . . . .	100,389	165,588	36,114
Additions . . . . .	103,595	93,912	59,147
Disposals, redemptions and maturity . . . . .	(104,590)	(94,989)	(65,713)
Amortisation . . . . .	378	225	1,472
Change in fair value . . . . .	(803)	–	–
Impairment losses . . . . .	–	(1,844)	–
Exchange differences . . . . .	<u>1,549</u>	<u>2,536</u>	<u>82</u>
At 31 December 2007 . . . . .	<u>100,518</u>	<u>165,428</u>	<u>31,102</u>

The Bank			
2008			
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2008 . . . . .	97,392	150,873	22,784
Additions . . . . .	173,453	35,635	11,888
Disposals, redemptions and maturity . . . . .	(93,770)	(87,204)	(26,500)
Amortisation . . . . .	524	(1,104)	302
Change in fair value . . . . .	(7,676)	–	–
Impairment losses . . . . .	–	(4,061)	–
Exchange differences . . . . .	(3,231)	(4,322)	(30)
At 31 December 2008 . . . . .	<u>166,692</u>	<u>89,817</u>	<u>8,444</u>

The Bank			
2007			
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2007 . . . . .	97,514	146,473	30,750
Additions . . . . .	99,422	77,610	40,692
Disposals, redemptions and maturity . . . . .	(100,624)	(73,799)	(49,841)
Amortisation . . . . .	357	157	1,184
Change in fair value . . . . .	(812)	–	–
Impairment losses . . . . .	–	(1,844)	–
Exchange differences . . . . .	1,535	2,276	(1)
At 31 December 2007 . . . . .	<u>97,392</u>	<u>150,873</u>	<u>22,784</u>

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

	The Group			
	Available-for-sale securities		Held-to-maturity securities	
	2008	2007	2008	2007
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Treasury bills . . . . .	60,980	9,396	100	200
Certificates of deposit held . . . . .	7,355	7,466	11,376	11,988
Others . . . . .	103,030	83,656	93,917	153,240
	171,365	100,518	105,393	165,428



	The Bank			
	Available-for-sale securities		Held-to-maturity securities	
	2008	2007	2008	2007
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Treasury bills . . . . .	<b>60,140</b>	8,708	—	—
Certificates of deposit held . . . . .	<b>6,523</b>	6,748	<b>8,925</b>	9,405
Others . . . . .	<b>100,029</b>	81,936	<b>80,892</b>	141,468
	<b><u>166,692</u></b>	<u>97,392</u>	<b><u>89,817</u></b>	<u>150,873</u>

The movements in impairment allowances on held-to-maturity securities are summarised as follows:

	The Group and the Bank	
	2008	2007
	HK\$'m	HK\$'m
At 1 January . . . . .	<b>1,682</b>	—
Charged to income statement (Note 10) . . . . .	<b>4,061</b>	1,844
Disposals . . . . .	<b>(1,303)</b>	(162)
At 31 December . . . . .	<b><u>4,440</u></b>	<u>1,682</u>

## 26. Interests in subsidiaries

	The Bank	
	2008	2007
	HK\$'m	HK\$'m
Unlisted shares, at cost . . . . .	<b>12,190</b>	12,423
Less: Provision for impairment in value . . . . .	<b>(22)</b>	(21)
	<b>12,168</b>	12,402
Amounts due from subsidiaries . . . . .	<b>233</b>	464
	<b><u>12,401</u></b>	<u>12,866</u>

The following is a list of principal subsidiaries as at 31 December 2008:

Name	Country of incorporation & place of operation	Particulars of issued share capital	Interest held	Principal activities
Nanyang Commercial Bank, Limited	Hong Kong	6,000,000 ordinary shares of HK\$100 each	100%	Banking business
Chiyu Banking Corporation Limited	Hong Kong	3,000,000 ordinary shares of HK\$100 each	70.49%	Banking business
BOC Credit Card (International) Limited	Hong Kong	4,800,000 ordinary shares of HK\$100 each	100%	Credit card services
Po Sang Futures Limited	Hong Kong	250,000 ordinary shares of HK\$100 each	*100%	Commodities brokerage

\* Shares held indirectly by the Bank

## 27. Interests in associates

	The Group	
	2008	2007
	HK\$'m	HK\$'m
At 1 January . . . . .	<b>83</b>	60
Investment cost addition . . . . .	–	24
Share of result . . . . .	<b>9</b>	4
Share of tax . . . . .	(2)	(1)
Dividends received . . . . .	(2)	(3)
Dissolution of an associate . . . . .	–	(1)
At 31 December . . . . .	<b><u>88</u></b>	<b><u>83</u></b>

As at 31 December 2008, the Bank held HK\$13 million (2007: HK\$13 million) of unlisted shares in its associates with HK\$1 million (2007: HK\$1 million) of provision for impairment in value.

The Group's interests in its associates, all of which are unlisted, are as follows:

Name	CJM Insurance Brokers Limited	Joint Electronic Teller Services Limited	BOC Services Company Limited			
	2008 and 2007	2008 and 2007	2008 and 2007			
Place of incorporation	Hong Kong	Hong Kong	PRC			
Particulars of issued share capital/registered capital	6,000,000 ordinary shares of HK\$1 each	100,238 ordinary shares of HK\$100 each	Registered capital RMB50,000,000			
Principal activities	Insurance broker	Operation of a private inter-bank message switching network in respect of ATM services	Credit card back-end service support			
	2008	2007	2008	2007	2008	2007
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Assets . . . . .	47,846	64,331	371,144	354,104	108,145	53,677
Liabilities . . . . .	35,310	51,815	86,283	77,593	45,250	—
Revenues . . . . .	11,389	10,330	75,297	70,033	118,274	—
Profit after taxation . . .	1,519	1,481	34,752	33,649	5,166	—
	2008	2007	2008	2007	2008	2007
Interest held . . . . .	33.33%	33.33%	19.96%	19.96%	45.00%	45.00%

## 28. Investment properties

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
At 1 January . . . . .	<b>8,058</b>	7,481	<b>7,595</b>	6,992
Disposals . . . . .	<b>(186)</b>	(200)	<b>(160)</b>	(123)
Fair value (losses)/gains (Note 12) . . . . .	<b>(132)</b>	1,056	<b>(194)</b>	988
Reclassification (to)/from properties, plant and equipment (Note 29) . . . . .	<b>(13)</b>	(279)	<b>38</b>	(262)
At 31 December . . . . .	<b><u>7,727</u></b>	<b><u>8,058</u></b>	<b><u>7,279</u></b>	<b><u>7,595</u></b>

As at 31 December 2008, investment properties are included in the balance sheets 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		The Bank	
	2008	2007	2008	2007
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Held in Hong Kong				
On long-term lease (over 50 years) . . . .	<b>7,040</b>	7,251	<b>6,808</b>	7,051
On medium-term lease (10 – 50 years) . .	<b>505</b>	528	<b>286</b>	301
On short-term lease (less than 10 years) .	–	48	–	48
Held outside Hong Kong				
On long-term lease (over 50 years) . . . .	<b>1</b>	3	<b>1</b>	3
On medium-term lease (10 – 50 years) . .	<b>177</b>	224	<b>184</b>	192
On short-term lease (less than 10 years) .	<b>4</b>	4	–	–
	<b><u>7,727</u></b>	<b><u>8,058</u></b>	<b><u>7,279</u></b>	<b><u>7,595</u></b>

## 29. Properties, plant and equipment

	The Group		
	Premises	Equipment, fixtures and fittings	Total
	HK\$'m	HK\$'m	HK\$'m
Net book value at 1 January 2008 . . . . .	<b>20,783</b>	<b>2,505</b>	<b>23,288</b>
Additions . . . . .	<b>42</b>	<b>772</b>	<b>814</b>
Disposals . . . . .	<b>(68)</b>	<b>(5)</b>	<b>(73)</b>
Revaluation . . . . .	<b>(265)</b>	<b>–</b>	<b>(265)</b>
Depreciation for the year (Note 11) . . . . .	<b>(400)</b>	<b>(590)</b>	<b>(990)</b>
Reclassification from investment properties (Note 28). . . . .	<b>13</b>	<b>–</b>	<b>13</b>
Exchange difference . . . . .	<b>–</b>	<b>1</b>	<b>1</b>
Net book value at 31 December 2008 . . . . .	<b><u>20,105</u></b>	<b><u>2,683</u></b>	<b><u>22,788</u></b>
At 31 December 2008			
Cost or valuation . . . . .	<b>20,105</b>	<b>6,209</b>	<b>26,314</b>
Accumulated depreciation and impairment . . . . .	<b>–</b>	<b>(3,526)</b>	<b>(3,526)</b>
Net book value at 31 December 2008 . . . . .	<b><u>20,105</u></b>	<b><u>2,683</u></b>	<b><u>22,788</u></b>
Net book value at 1 January 2007 . . . . .	17,906	1,829	19,735
Additions . . . . .	–	1,145	1,145
Disposals . . . . .	(16)	(17)	(33)
Revaluation . . . . .	2,946	–	2,946
Depreciation for the year (Note 11) . . . . .	(332)	(453)	(785)
Reclassification from investment properties (Note 28). . . . .	279	–	279
Exchange difference . . . . .	–	1	1
Net book value at 31 December 2007 . . . . .	<b><u>20,783</u></b>	<b><u>2,505</u></b>	<b><u>23,288</u></b>
At 31 December 2007			
Cost or valuation . . . . .	20,783	5,615	26,398
Accumulated depreciation and impairment . . . . .	–	(3,110)	(3,110)
Net book value at 31 December 2007 . . . . .	<b><u>20,783</u></b>	<b><u>2,505</u></b>	<b><u>23,288</u></b>
The analysis of cost or valuation of the above assets is as follows:			
At 31 December 2008			
At cost. . . . .	<b>–</b>	<b>6,209</b>	<b>6,209</b>
At valuation. . . . .	<b><u>20,105</u></b>	<b><u>–</u></b>	<b><u>20,105</u></b>
	<b><u>20,105</u></b>	<b><u>6,209</u></b>	<b><u>26,314</u></b>
At 31 December 2007			
At cost. . . . .	–	5,615	5,615
At valuation. . . . .	<b><u>20,783</u></b>	<b><u>–</u></b>	<b><u>20,783</u></b>
	<b><u>20,783</u></b>	<b><u>5,615</u></b>	<b><u>26,398</u></b>

	The Bank		
	Premises	Equipment, fixtures and fittings	Total
	HK\$'m	HK\$'m	HK\$'m
Net book value at 1 January 2008 . . . . .	<b>15,974</b>	<b>2,287</b>	<b>18,261</b>
Additions . . . . .	–	<b>627</b>	<b>627</b>
Disposals . . . . .	(66)	(4)	(70)
Revaluation . . . . .	(385)	–	(385)
Depreciation for the year . . . . .	(322)	(524)	(846)
Reclassification from investment properties (Note 28). . . . .	(38)	–	(38)
Net book value at 31 December 2008 . . . . .	<u><b>15,163</b></u>	<u><b>2,386</b></u>	<u><b>17,549</b></u>
At 31 December 2008			
Cost or valuation . . . . .	<b>15,163</b>	<b>5,442</b>	<b>20,605</b>
Accumulated depreciation and impairment . . . . .	–	(3,056)	(3,056)
Net book value at 31 December 2008 . . . . .	<u><b>15,163</b></u>	<u><b>2,386</b></u>	<u><b>17,549</b></u>
Net book value at 1 January 2007 . . . . .	13,628	1,630	15,258
Additions . . . . .	–	1,070	1,070
Disposals . . . . .	–	(14)	(14)
Revaluation . . . . .	2,354	–	2,354
Depreciation for the year . . . . .	(270)	(399)	(669)
Reclassification from investment properties (Note 28). . . . .	262	–	262
Net book value at 31 December 2007 . . . . .	<u>15,974</u>	<u>2,287</u>	<u>18,261</u>
At 31 December 2007			
Cost or valuation . . . . .	15,974	4,959	20,933
Accumulated depreciation and impairment . . . . .	–	(2,672)	(2,672)
Net book value at 31 December 2007 . . . . .	<u>15,974</u>	<u>2,287</u>	<u>18,261</u>
The analysis of cost or valuation of the above assets is as follows:			
At 31 December 2008			
At cost. . . . .	–	<b>5,442</b>	<b>5,442</b>
At valuation . . . . .	<u><b>15,163</b></u>	–	<u><b>15,163</b></u>
	<u><b>15,163</b></u>	<u><b>5,442</b></u>	<u><b>20,605</b></u>
At 31 December 2007			
At cost. . . . .	–	4,959	4,959
At valuation . . . . .	<u>15,974</u>	–	<u>15,974</u>
	<u>15,974</u>	<u>4,959</u>	<u>20,933</u>

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

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Held in Hong Kong				
On long-term lease (over 50 years) . . . .	<b>12,825</b>	12,955	<b>9,418</b>	9,562
On medium-term lease (10 – 50 years) . .	<b>6,873</b>	7,584	<b>5,700</b>	6,385
Held outside Hong Kong				
On long-term lease (over 50 years) . . . .	<b>75</b>	57	–	–
On medium-term lease (10 – 50 years) . .	<b>306</b>	170	<b>45</b>	27
On short-term lease (less than 10 years) .	<b>26</b>	17	–	–
	<u><b>20,105</b></u>	<u>20,783</u>	<u><b>15,163</b></u>	<u>15,974</u>

As at 31 December 2008, premises are included in the balance sheets 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, the income statement and minority interests respectively as follows:

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
(Decrease)/increase in valuation (charged)/credited to premises revaluation reserve . . . . .	<b>(261)</b>	2,908	<b>(385)</b>	2,336
(Decrease)/increase in valuation (charged)/credited to income statement (Note 13) . . . . .	<b>(13)</b>	21	–	18
Increase in valuation credited to minority interests . . . . .	<b>9</b>	17	–	–
	<u><b>(265)</b></u>	<u>2,946</u>	<u><b>(385)</b></u>	<u>2,354</u>

As at 31 December 2008, the net book value of premises that would have been included in the Group's and the Bank's balance sheets had the assets been carried at cost less accumulated depreciation and impairment losses was HK\$6,123 million (2007: HK\$6,072 million) and HK\$4,787 million (2007: HK\$4,809 million) respectively.

### 30. Other assets

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Reposessed assets . . . . .	<b>124</b>	76	<b>116</b>	64
Precious metals . . . . .	<b>1,347</b>	1,741	<b>1,347</b>	1,741
Accounts receivable and prepayments . . . .	<b>13,084</b>	18,959	<b>12,162</b>	16,755
	<b><u>14,555</u></b>	<b><u>20,776</u></b>	<b><u>13,625</u></b>	<b><u>18,560</u></b>

### 31. Hong Kong SAR currency notes in circulation

The Hong Kong SAR currency notes in circulation are secured by deposit of funds in respect of which the Hong Kong SAR Government certificates of indebtedness are held.

### 32. Financial liabilities at fair value through profit or loss

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Trading liabilities				
– Short positions in Exchange Fund				
Bills (Note 35) . . . . .	<b>12,141</b>	3,492	<b>11,494</b>	2,915
Financial liabilities designated at fair value through profit or loss				
– Structured deposits (Note 33) . . . . .	<b>8,939</b>	5,959	<b>8,117</b>	3,671
– Certificates of deposit issued . . . . .	<b>858</b>	1,954	<b>858</b>	1,530
	<b><u>9,797</u></b>	<b><u>7,913</u></b>	<b><u>8,975</u></b>	<b><u>5,201</u></b>
	<b><u>21,938</u></b>	<b><u>11,405</u></b>	<b><u>20,469</u></b>	<b><u>8,116</u></b>

The carrying amount of financial liabilities designated at fair value through profit or loss as at 31 December 2008 is more than the amount that the Group and the Bank would be contractually required to pay at maturity to the holders by HK\$5 million and HK\$20 million respectively, and it was less than the amount that the Group and the Bank would be contractually required to pay at maturity to the holders by HK\$44 million and HK\$34 million respectively as at 31 December 2007. The amount of change in the fair values of financial liabilities at fair value through profit or loss, during the year and cumulatively, attributable to changes in credit risk is insignificant.

### 33. Deposits from customers

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Current, savings and other deposit accounts (per balance sheet) . . . . .	<b>805,866</b>	794,247	<b>679,251</b>	673,580
Structured deposits reported as financial liabilities at fair value through profit or loss (Note 32) . . . . .	<b>8,939</b>	5,959	<b>8,117</b>	3,671
	<b><u>814,805</u></b>	<b><u>800,206</u></b>	<b><u>687,368</u></b>	<b><u>677,251</u></b>
Analysed by:				
Demand deposits and current accounts				
– corporate customers . . . . .	<b>35,946</b>	32,715	<b>29,650</b>	27,929
– individual customers . . . . .	<b>10,175</b>	7,854	<b>8,809</b>	6,515
	<b><u>46,121</u></b>	<b><u>40,569</u></b>	<b><u>38,459</u></b>	<b><u>34,444</u></b>
Savings deposits				
– corporate customers . . . . .	<b>116,278</b>	76,721	<b>103,742</b>	64,728
– individual customers . . . . .	<b>261,355</b>	209,985	<b>228,370</b>	180,358
	<b><u>377,633</u></b>	<b><u>286,706</u></b>	<b><u>332,112</u></b>	<b><u>245,086</u></b>
Time, call and notice deposits				
– corporate customers . . . . .	<b>153,376</b>	172,860	<b>125,130</b>	143,623
– individual customers . . . . .	<b>237,675</b>	300,071	<b>191,667</b>	254,098
	<b><u>391,051</u></b>	<b><u>472,931</u></b>	<b><u>316,797</u></b>	<b><u>397,721</u></b>
	<b><u>814,805</u></b>	<b><u>800,206</u></b>	<b><u>687,368</u></b>	<b><u>677,251</u></b>

### 34. Other accounts and provisions

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Dividend payable . . . . .	–	5,897	–	5,897
Other accounts payable . . . . .	<b>33,086</b>	32,663	<b>27,479</b>	25,472
Provisions . . . . .	<b>576</b>	9	<b>389</b>	9
	<b><u>33,662</u></b>	<b><u>38,569</u></b>	<b><u>27,868</u></b>	<b><u>31,378</u></b>



### 35. Assets pledged as security

As at 31 December 2008, liabilities of the Group and the Bank amounting to HK\$12,141 million and HK\$11,494 million respectively (2007: HK\$3,492 million and HK\$2,915 million) were secured by assets deposited with central depositories to facilitate settlement operations. The amount of assets pledged by the Group and the Bank to secure these liabilities was HK\$12,243 million and HK\$11,595 million respectively (2007: HK\$3,836 million and HK\$3,259 million) included in “Trading securities” and “Available-for-sale securities”.

### 36. 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 differences	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
At 1 January 2008 . . . . .	533	3,777	(2)	(169)	(182)	3,957
Charged/(credited) to income statement (Note 14) . . . . .	12	(200)	(17)	(85)	(75)	(365)
Credited to equity and minority interests . . . . .	—	(113)	—	—	(727)	(840)
At 31 December 2008 . . . . .	<u>545</u>	<u>3,464</u>	<u>(19)</u>	<u>(254)</u>	<u>(984)</u>	<u>2,752</u>

	The Bank				
	2008				
	Accelerated tax depreciation	Asset revaluation	Impairment allowance	Other temporary differences	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
At 1 January 2008 . . . . .	507	3,133	(106)	(182)	3,352
Charged/(credited) to income statement . . . . .	13	(181)	(66)	(34)	(268)
Credited to equity . . . . .	—	(154)	—	(703)	(857)
At 31 December 2008 . . . . .	<u>520</u>	<u>2,798</u>	<u>(172)</u>	<u>(919)</u>	<u>2,227</u>

	The Group					
	2007					
	Accelerated tax depreciation	Asset revaluation	Losses	Impairment allowance	Other temporary differences	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
At 1 January 2007 . . . . .	400	3,155	(3)	(89)	(74)	3,389
Charged/(credited) to income statement (Note 14) . . . . .	133	143	1	(80)	1	198
Charged/(credited) to equity and minority interests . . . . .	—	479	—	—	(109)	370
At 31 December 2007 . . . . .	<u>533</u>	<u>3,777</u>	<u>(2)</u>	<u>(169)</u>	<u>(182)</u>	<u>3,957</u>

	The Bank				
	2007				
	Accelerated tax depreciation	Asset revaluation	Impairment allowance	Other temporary differences	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
At 1 January 2007 . . . . .	374	2,606	(56)	(74)	2,850
Charged/(credited) to income statement . . . . .	133	137	(50)	2	222
Charged/(credited) to equity . . . . .	—	390	—	(110)	280
At 31 December 2007 . . . . .	<u>507</u>	<u>3,133</u>	<u>(106)</u>	<u>(182)</u>	<u>3,352</u>

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\$m	HK\$m	HK\$m	HK\$m
Deferred tax assets . . . . .	(47)	(10)	(3)	—
Deferred tax liabilities . . . . .	<u>2,799</u>	<u>3,967</u>	<u>2,230</u>	<u>3,352</u>
	<u>2,752</u>	<u>3,957</u>	<u>2,227</u>	<u>3,352</u>

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$m	HK\$m	HK\$m	HK\$m
Deferred tax assets to be recovered after more than twelve months . . . . .	(47)	(10)	(3)	—
Deferred tax liabilities to be settled after more than twelve months . . . . .	<u>3,762</u>	<u>4,115</u>	<u>3,139</u>	<u>3,500</u>
	<u>3,715</u>	<u>4,105</u>	<u>3,136</u>	<u>3,500</u>

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

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$m	HK\$m	HK\$m	HK\$m
Fair value reserves in shareholders' equity:				
– premises . . . . .	(114)	476	(154)	390
– available-for-sale securities . . . . .	(727)	(109)	(703)	(110)
– minority interests . . . . .	<u>1</u>	<u>3</u>	<u>–</u>	<u>–</u>
	<u>(840)</u>	<u>370</u>	<u>(857)</u>	<u>280</u>

### 37. Subordinated liabilities

Principal amount	Interest rate	Due date	The Group and The Bank	
			Carrying amount at	
			31 December	
			2008	2007
			HK\$m	HK\$m
<b>Subordinated loans</b>				
EUR 660m . . . . .	6-month EURIBOR + 0.85%*	June 2018	7,210	–
USD 2,500m . . . . .	6-month LIBOR + 2.00%**	December 2018	<u>19,394</u>	–
			<u>26,604</u>	–

During 2008, BOCHK obtained floating-rate subordinated loans from BOC, the intermediate holding company. The subordinated loans are repayable prior to maturity after the first 5-year tenure at the option of the borrower. Amounts qualified as supplementary capital for regulatory purposes as shown in Note 4.4(b).

\* 6-month EURIBOR plus 0.85% for the first 5 years, 6-month EURIBOR plus 1.35% for the remaining tenure payable semi-annually.

\*\* 6-month LIBOR plus 2.00% for the first 5 years, 6-month LIBOR plus 2.50% for the remaining tenure payable semi-annually.

### 38. Share capital

	2008	2007
	HK\$m	HK\$m
Authorised:		
100,000,000,000 ordinary shares of HK\$1.00 each . . . . .	<u>100,000</u>	<u>100,000</u>
Issued and fully paid:		
43,042,840,858 ordinary shares of HK\$1.00 each . . . . .	<u>43,043</u>	<u>43,043</u>

### 39. 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 32 to 33 of the financial statements respectively.

#### 40. Notes to consolidated cash flow statement

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

	2008	2007
	HK\$'m	HK\$'m
Operating profit . . . . .	8,001	17,707
Depreciation . . . . .	990	785
Net charge of impairment allowances . . . . .	9,843	1,448
Unwind of discount on impairment . . . . .	(20)	(47)
Advances written off net of recoveries . . . . .	275	1,014
Interest expense on subordinated liabilities . . . . .	243	–
Change in cash and balances with banks and other financial institutions with original maturity over three months . . . . .	7,781	(27,873)
Change in placements with banks and other financial institutions with original maturity over three months . . . . .	(26,893)	(2,613)
Change in financial assets at fair value through profit or loss . . . . .	2,174	3,741
Change in derivative financial instruments . . . . .	4,217	(54)
Change in advances and other accounts . . . . .	(50,924)	(67,650)
Change in investment in securities . . . . .	(2,882)	5,039
Change in other assets . . . . .	6,209	(6,214)
Change in deposits and balances of banks and other financial institutions . . . . .	28,180	11,565
Change in financial liabilities at fair value through profit or loss . . . . .	10,533	(3,722)
Change in deposits from customers . . . . .	11,619	98,631
Change in debt securities in issue at amortised cost . . . . .	(1,047)	2,089
Change in other accounts and provisions . . . . .	(4,907)	8,298
Exchange difference . . . . .	(729)	13
Operating cash inflow before taxation . . . . .	<u>2,663</u>	<u>42,157</u>
Cash flows from operating activities included:		
– Interest received . . . . .	34,595	44,279
– Interest paid . . . . .	15,278	27,131
– Dividend received . . . . .	<u>16</u>	<u>15</u>

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

	2008	2007
	HK\$'m	HK\$'m
Cash and balances with banks and other financial institutions with original maturity within three months . . . . .	128,003	126,006
Placements with banks and other financial institutions with original maturity within three months . . . . .	23,610	13,939
Treasury bills with original maturity within three months . . . . .	22,277	10,244
Certificates of deposit held with original maturity within three months . . . . .	<u>1,035</u>	<u>1,868</u>
	<u>174,925</u>	<u>152,057</u>

#### 41. 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:

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$m	HK\$m	HK\$m	HK\$m
Direct credit substitutes . . . . .	<b>1,419</b>	2,120	<b>2,052</b>	3,841
Transaction-related contingencies . . . . .	<b>10,153</b>	7,075	<b>9,634</b>	6,801
Trade-related contingencies . . . . .	<b>22,481</b>	29,081	<b>19,444</b>	23,956
Commitments that are unconditionally cancellable without prior notice . . . . .	<b>103,684</b>	50,034	<b>45,881</b>	1,403
Other commitments with an original maturity of				
– up to one year . . . . .	<b>63,257</b>	84,809	<b>49,938</b>	69,263
– over one year . . . . .	<b>52,400</b>	58,189	<b>44,798</b>	51,331
	<b><u>253,394</u></b>	<b><u>231,308</u></b>	<b><u>171,747</u></b>	<b><u>156,595</u></b>
Credit risk weighted amount . . . . .	<b><u>40,252</u></b>	<b><u>47,356</u></b>	<b><u>34,633</u></b>	<b><u>42,850</u></b>

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

#### 42. Capital commitments

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

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$m	HK\$m	HK\$m	HK\$m
Authorised and contracted for but not provided for . . . . .	<b>121</b>	165	<b>115</b>	156
Authorised but not contracted for . . . . .	<b>15</b>	1	<b>14</b>	1
	<b><u>136</u></b>	<b><u>166</u></b>	<b><u>129</u></b>	<b><u>157</u></b>

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.

### 43. 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:

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Land and buildings				
– not later than one year . . . . .	<b>424</b>	316	<b>317</b>	266
– later than one year but not later than five years . . . . .	<b>531</b>	295	<b>337</b>	236
– later than five years . . . . .	<b>14</b>	–	<b>2</b>	–
	<b><u>969</u></b>	<b><u>611</u></b>	<b><u>656</u></b>	<b><u>502</u></b>

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:

	The Group		The Bank	
	2008	2007	2008	2007
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Land and buildings				
– not later than one year . . . . .	<b>270</b>	251	<b>250</b>	235
– later than one year but not later than five years . . . . .	<b>234</b>	215	<b>224</b>	212
	<b><u>504</u></b>	<b><u>466</u></b>	<b><u>474</u></b>	<b><u>447</u></b>

The Group and the Bank lease their investment properties (Note 28) 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.

### 44. Litigation

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

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

#### **45. 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 three business segments is provided in segmental reporting. They are Personal Banking, Corporate Banking and Treasury.

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. "Others" refers to those items related to the Group as a whole but independent of the other three business segments, including the Group's holdings of premises, investment properties, equity investments and interests in associates.

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. 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.

	The Group						
	2008						
	Personal	Corporate	Treasury	Others	Subtotal	Eliminations	Consolidated
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Net interest (expenses)/income							
– external . . . . .	(3,241)	6,924	15,322	(6)	18,999	–	18,999
– inter-segment . . . . .	9,752	(975)	(8,144)	(633)	–	–	–
	6,511	5,949	7,178	(639)	18,999	–	18,999
Net fees and commission							
income/(expenses) . . . . .	3,597	2,032	(95)	14	5,548	(84)	5,464
Net trading income/(expenses) . . . . .	548	186	1,298	(119)	1,913	1	1,914
Net loss on financial instruments							
designated at fair value through profit							
or loss . . . . .	–	–	(316)	–	(316)	–	(316)
Net loss on investment in securities . . .	–	–	(15)	–	(15)	–	(15)
Other operating income . . . . .	34	44	7	1,719	1,804	(1,370)	434
Net operating income before							
impairment allowances . . . . .	10,690	8,211	8,057	975	27,933	(1,453)	26,480
Net charge of impairment allowances . .	(129)	(544)	(9,170)	–	(9,843)	–	(9,843)
Net operating income/(expense) . . . . .	10,561	7,667	(1,113)	975	18,090	(1,453)	16,637
Operating expenses . . . . .	(5,669)	(2,143)	(831)	(1,446)	(10,089)	1,453	(8,636)
Operating profit/(loss) . . . . .	4,892	5,524	(1,944)	(471)	8,001	–	8,001
Net loss from disposal of/fair value							
adjustments on investment properties .	–	–	–	(118)	(118)	–	(118)
Net gain from disposal/revaluation of							
properties, plant and equipment . . . .	–	–	–	18	18	–	18
Share of profits less losses of associates .	–	–	–	7	7	–	7
Profit/(loss) before taxation . . . . .	4,892	5,524	(1,944)	(564)	7,908	–	7,908
Assets							
Segment assets . . . . .	165,148	324,606	603,965	30,422	1,124,141	(6,795)	1,117,346
Interests in associates . . . . .	–	–	–	88	88	–	88
Unallocated corporate assets . . . . .	–	–	–	562	562	–	562
	165,148	324,606	603,965	31,072	1,124,791	(6,795)	1,117,996
Liabilities							
Segment liabilities . . . . .	523,682	309,254	203,481	1,446	1,037,863	(6,795)	1,031,068
Unallocated corporate liabilities . . . . .	–	–	–	4,713	4,713	–	4,713
	523,682	309,254	203,481	6,159	1,042,576	(6,795)	1,035,781
Other information							
Additions of properties, plant and							
equipment . . . . .	12	5	–	797	814	–	814
Depreciation . . . . .	271	132	108	479	990	–	990
Amortisation of securities . . . . .	–	–	142	–	142	–	142



	The Group						
	2007						
	Personal	Corporate	Treasury	Others	Subtotal	Eliminations	Consolidated
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Net interest (expenses)/income							
– external . . . . .	(8,552)	5,067	22,015	10	18,540	–	18,540
– inter-segment . . . . .	16,696	672	(16,146)	(1,222)	–	–	–
	8,144	5,739	5,869	(1,212)	18,540	–	18,540
Net fees and commission							
income/(expenses). . . . .	4,983	1,778	47	(138)	6,670	(87)	6,583
Net trading income . . . . .	538	151	236	87	1,012	1	1,013
Net loss on financial instruments							
designated at fair value through profit							
or loss . . . . .	–	–	(25)	–	(25)	–	(25)
Net loss on investment in securities . . .	–	–	(53)	–	(53)	–	(53)
Other operating income . . . . .	410	1	1	1,687	2,099	(1,343)	756
<b>Net operating income before</b>							
<b>impairment allowances . . . . .</b>	14,075	7,669	6,075	424	28,243	(1,429)	26,814
Net (charge)/reversal of impairment							
allowances . . . . .	(112)	797	(2,133)	–	(1,448)	–	(1,448)
<b>Net operating income.</b> . . . .	13,963	8,466	3,942	424	26,795	(1,429)	25,366
Operating expenses . . . . .	(5,829)	(1,940)	(627)	(692)	(9,088)	1,429	(7,659)
<b>Operating profit/(loss) . . . . .</b>	8,134	6,526	3,315	(268)	17,707	–	17,707
Net gain from disposal of/fair value							
adjustments on investment properties . .	–	–	–	1,064	1,064	–	1,064
Net (loss)/gain from disposal/							
revaluation of properties, plant and							
equipment . . . . .	(5)	–	–	33	28	–	28
Share of profits less losses of associates .	–	–	–	3	3	–	3
<b>Profit before taxation . . . . .</b>	8,129	6,526	3,315	832	18,802	–	18,802
<b>Assets</b>							
Segment assets. . . . .	162,634	281,680	566,661	33,057	1,044,032	(5,123)	1,038,909
Interests in associates . . . . .	–	–	–	83	83	–	83
Unallocated corporate assets . . . . .	–	–	–	238	238	–	238
	162,634	281,680	566,661	33,378	1,044,353	(5,123)	1,039,230
<b>Liabilities</b>							
Segment liabilities . . . . .	545,397	284,353	116,095	8,432	954,277	(5,123)	949,154
Unallocated corporate liabilities . . . . .	–	–	–	6,784	6,784	–	6,784
	545,397	284,353	116,095	15,216	961,061	(5,123)	955,938
<b>Other information</b>							
Additions of properties, plant and							
equipment . . . . .	14	8	–	1,123	1,145	–	1,145
Depreciation . . . . .	234	90	56	405	785	–	785
Amortisation of securities . . . . .	–	–	2,075	–	2,075	–	2,075

	The Bank						
	2008						
	Personal	Corporate	Treasury	Others	Subtotal	Eliminations	Consolidated
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Net interest (expenses)/income							
– external . . . . .	(3,144)	5,010	13,331	8	15,205	–	15,205
– inter-segment . . . . .	8,129	(385)	(7,123)	(621)	–	–	–
	4,985	4,625	6,208	(613)	15,205	–	15,205
Net fees and commission							
income/(expenses) . . . . .	2,694	1,476	(44)	(136)	3,990	–	3,990
Net trading income . . . . .	480	139	1,412	–	2,031	–	2,031
Net loss on financial instruments							
designated at fair value through profit							
or loss . . . . .	–	–	(90)	–	(90)	–	(90)
Net loss on investment in securities . . .	–	–	(111)	–	(111)	–	(111)
Other operating income . . . . .	3	13	6	3,173	3,195	(1,152)	2,043
Net operating income before							
impairment allowances . . . . .	8,162	6,253	7,381	2,424	24,220	(1,152)	23,068
Net reversal/(charge) of impairment							
allowances . . . . .	32	(242)	(9,169)	(2)	(9,381)	–	(9,381)
Net operating income/(expense) . . . . .	8,194	6,011	(1,788)	2,422	14,839	(1,152)	13,687
Operating expenses . . . . .	(4,299)	(1,453)	(805)	(1,200)	(7,757)	1,152	(6,605)
Operating profit/(loss) . . . . .	3,895	4,558	(2,593)	1,222	7,082	–	7,082
Net loss from disposal of/fair value							
adjustments on investment properties .	–	–	–	(180)	(180)	–	(180)
Net gain from disposal/revaluation of							
properties, plant and equipment . . . .	–	–	–	32	32	–	32
Profit/(loss) before taxation . . . . .	3,895	4,558	(2,593)	1,074	6,934	–	6,934
Assets							
Segment assets . . . . .	132,868	262,339	536,654	36,545	968,406	–	968,406
Interests in associates . . . . .	–	–	–	12	12	–	12
Unallocated corporate assets . . . . .	–	–	–	466	466	–	466
	132,868	262,339	536,654	37,023	968,884	–	968,884
Liabilities							
Segment liabilities . . . . .	429,780	263,705	200,783	9	894,277	–	894,277
Unallocated corporate liabilities . . . . .	–	–	–	4,050	4,050	–	4,050
	429,780	263,705	200,783	4,059	898,327	–	898,327
Other information							
Additions of properties, plant and							
equipment . . . . .	–	–	–	627	627	–	627
Depreciation . . . . .	252	120	107	367	846	–	846
Amortisation of securities . . . . .	–	–	(277)	–	(277)	–	(277)

	The Bank						
	2007						
	Personal	Corporate	Treasury	Others	Subtotal	Eliminations	Consolidated
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Net interest (expenses)/income							
– external . . . . .	(7,650)	3,221	19,208	28	14,807	–	14,807
– inter-segment . . . . .	14,060	1,391	(14,256)	(1,195)	–	–	–
	6,410	4,612	4,952	(1,167)	14,807	–	14,807
Net fees and commission							
income/(expenses) . . . . .	3,797	1,313	39	(130)	5,019	–	5,019
Net trading income . . . . .	417	79	234	–	730	–	730
Net gain on financial instruments							
designated at fair value through profit							
or loss . . . . .	–	–	16	–	16	–	16
Net loss on investment in securities . . .	–	–	(53)	–	(53)	–	(53)
Other operating income . . . . .	7	1	1	2,277	2,286	(1,146)	1,140
<b>Net operating income before</b>							
<b>impairment allowances . . . . .</b>	10,631	6,005	5,189	980	22,805	(1,146)	21,659
Net (charge)/reversal of impairment							
allowances . . . . .	(4)	773	(2,133)	–	(1,364)	–	(1,364)
<b>Net operating income . . . . .</b>	10,627	6,778	3,056	980	21,441	(1,146)	20,295
Operating expenses . . . . .	(4,559)	(1,434)	(602)	(563)	(7,158)	1,146	(6,012)
<b>Operating profit . . . . .</b>	6,068	5,344	2,454	417	14,283	–	14,283
Net gain from disposal of/fair value							
adjustments on investment properties .	–	–	–	990	990	–	990
Net (loss)/gain from disposal/							
revaluation of properties, plant and							
equipment . . . . .	(5)	–	–	9	4	–	4
<b>Profit before taxation . . . . .</b>	6,063	5,344	2,454	1,416	15,277	–	15,277
<b>Assets</b>							
Segment assets . . . . .	129,876	227,466	493,569	38,110	889,021	–	889,021
Interests in associates . . . . .	–	–	–	12	12	–	12
Unallocated corporate assets . . . . .	–	–	–	224	224	–	224
	129,876	227,466	493,569	38,346	889,257	–	889,257
<b>Liabilities</b>							
Segment liabilities . . . . .	455,901	239,244	109,914	5,909	810,968	–	810,968
Unallocated corporate liabilities . . . . .	–	–	–	6,078	6,078	–	6,078
	455,901	239,244	109,914	11,987	817,046	–	817,046
<b>Other information</b>							
Additions of properties, plant and							
equipment . . . . .	–	–	–	1,070	1,070	–	1,070
Depreciation . . . . .	211	85	56	317	669	–	669
Amortisation of securities . . . . .	–	–	1,698	–	1,698	–	1,698

#### 46. 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\$m	HK\$m
Aggregate amount of relevant loans outstanding at year end . . . .	<u>655</u>	<u>622</u>
Maximum aggregate amount of relevant loans outstanding during the year . . . . .	<u>667</u>	<u>839</u>

#### 47. 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) Advances to third parties guaranteed by BOC group companies

As at 31 December 2008, BOC, the intermediate holding company, provided guarantees for loans in favour of the Group amounting to HK\$6,980 million (2007: HK\$3,693 million) to certain third parties. BOC held equity interests of not more than 20% in these third parties.

##### (b) Advances acquired from BOC

During 2008, the Group has entered into an agreement with BOC to acquire advances amounting to USD300 million arising from trade finance facilities granted to customers. The outstanding amount of such advances at balance sheet date has been included as “advances to customers” in the financial statements.

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

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

		2008		
		Immediate and intermediate holding companies	Associates	Other related parties <sup>1</sup>
		HK\$'m	HK\$'m	HK\$'m
Income statement items:				
Interest income . . . . .	(i)	<b>1,047</b>	–	<b>35</b>
Interest expense . . . . .	(ii)	<b>(701)</b>	<b>(1)</b>	<b>(152)</b>
Insurance commission received (net) . . . . .	(iii)	–	–	<b>240</b>
Administrative services fees				
received/receivable . . . . .	(iv)	<b>34</b>	–	<b>19</b>
Rental fees received/receivable . . . . .	(iv)	<b>4</b>	–	<b>56</b>
Credit card commission paid/payable (net) . .	(v)	<b>(56)</b>	–	<b>(3)</b>
Securities brokerage commission				
paid/payable (net) . . . . .	(v)	–	–	<b>(322)</b>
Rental, property management and letting				
agency fees paid/payable . . . . .	(v)	–	–	<b>(89)</b>
Funds selling commission received . . . . .	(vi)	–	–	<b>70</b>
Correspondent banking fee received . . . . .	(vii)	<b>13</b>	–	–
Loans services fees received . . . . .		–	–	<b>2</b>
Net trading gains/(losses). . . . .		<b><u>692</u></b>	<b><u>–</u></b>	<b><u>(110)</u></b>

2007				
		Immediate and intermediate holding companies	Associates	Other related parties <sup>1</sup>
	Notes	HK\$'m	HK\$'m	HK\$'m
Income statement items:				
Interest income . . . . .	(i)	596	–	25
Interest expense . . . . .	(ii)	(510)	(3)	(363)
(Insurance premium paid)/insurance commission received (net) . . . . .	(iii)	–	(2)	316
Administrative services fees received/receivable . . . . .	(iv)	34	–	43
Rental fees received/receivable . . . . .	(iv)	–	–	29
Credit card commission paid/payable (net) . .	(v)	(96)	–	(3)
Securities brokerage commission paid/payable (net) . . . . .	(v)	–	–	(494)
Rental, property management and letting agency fees paid/payable . . . . .	(v)	–	–	(77)
Funds selling commission received . . . . .	(vi)	–	–	224
Correspondent banking fee received . . . . .	(vii)	14	–	–
Loans services fees received . . . . .		–	–	2
Net trading gains/(losses). . . . .		<u>11</u>	<u>–</u>	<u>(3)</u>

2008				
		Immediate and intermediate holding companies	Associates	Other related parties <sup>1</sup>
	Notes	HK\$m	HK\$m	HK\$m
Balance sheet items:				
Cash and balances with banks and other financial institutions . . . . .	(i)	25,614	–	26
Placements with banks and other financial institutions maturing between one and twelve months . . . . .	(i)	8,489	–	–
Financial assets at fair value through profit or loss . . . . .		618	–	–
Derivative financial instruments assets . . . . .	(viii)	782	–	4
Advances and other accounts . . . . .	(i)	1	–	1,619
Investment in securities . . . . .	(i)	1,280	–	–
Other assets . . . . .	(ix)	55	–	1,960
Deposits and balances of banks and other financial institutions . . . . .	(ii)	31,497	–	463
Deposits from customers . . . . .	(ii)	445	46	10,971
Derivative financial instruments liabilities . .	(viii)	68	–	161
Other accounts and provisions . . . . .	(ix)	99	–	2,210
Subordinated liabilities . . . . .	(x)	26,604	–	–
Off-balance sheet items:				
Contingent liabilities and commitments . . . . .	(xi)	<u>9,037</u>	<u>–</u>	<u>4,227</u>

2007				
	Notes	Immediate and intermediate holding companies	Associates	Other related parties <sup>1</sup>
		HK\$m	HK\$m	HK\$m
Balance sheet items:				
Cash and balances with banks and other financial institutions . . . . .	(i)	22,854	–	30
Placements with banks and other financial institutions maturing between one and twelve months . . . . .	(i)	8,917	–	–
Financial assets at fair value through profit or loss . . . . .		438	–	–
Derivative financial instruments assets . . . . .	(viii)	30	–	3
Advances and other accounts . . . . .	(i)	21	–	–
Investment in securities . . . . .	(i)	347	–	–
Other assets . . . . .	(ix)	66	–	5,079
Deposits and balances of banks and other financial institutions . . . . .	(ii)	15,478	–	680
Deposits from customers . . . . .	(ii)	458	85	7,465
Derivative financial instruments liabilities . . . . .	(viii)	14	–	23
Other accounts and provisions . . . . .	(ix)	5,997	–	5,538
Off-balance sheet items:				
Contingent liabilities and commitments . . . . .	(xi)	<u>2,248</u>	<u>–</u>	<u>3,727</u>

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 group companies including deposit of cash and balances with banks and other financial institutions, placement of interbank deposits, investment in securities 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 BOC group companies at the relevant market rates at the time of the transactions. Interest on subordinated loans is charged at the contracted rate as denoted in Note 37.

**(iii) Insurance premium paid/insurance commission received (net)**

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



**(iv) Administrative services fees and rental fees received/receivable**

In the ordinary course of business, the Group receives 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 fee 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 BOC group companies. 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 BOC group company to customers of the Group at the relevant market rates at the time of the transactions.

**(vii) Correspondent banking fee received**

In the ordinary course of business, BOC provides services to the Group's customers including remittance services and advising on and collecting letters of credit issued by the Group. The Group shares the fees paid by its customers with BOC on the basis agreed between the parties from time to time.

**(viii) 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\$25,236 million (2007: HK\$13,219 million) whilst the corresponding derivative financial instruments assets and liabilities amounted to HK\$786 million (2007: HK\$33 million) and HK\$229 million (2007: HK\$37 million) respectively. These transactions are executed at the relevant market rates at the time of the transactions.

**(ix) 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.

**(x) Subordinated liabilities**

BOCHK entered into subordinated credit facility agreements with BOC for the purposes of capital management. Major commercial terms of the loans are stated in Note 37.

**(xi) 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.

**(d) 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 2007 is detailed as follows:

	<u>2008</u>	<u>2007</u>
	HK\$'m	HK\$'m
Salaries and other short-term employee benefits . . . . .	<b>53</b>	43
Post-employment benefits . . . . .	<u><b>1</b></u>	<u>1</u>
	<u><b>54</b></u>	<u><b>44</b></u>

**(e) 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:

	<u>2008</u>		<u>2007</u>	
	Interest income/ (expense)	Outstanding balance at end of the year	Interest income/ (expense)	Outstanding balance at end of the year
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances and other accounts . . . . .	<b>4</b>	<b>81</b>	8	120
Treasury bonds . . . . .	<b>79</b>	<b>1,776</b>	57	1,422
Due from banks and other financial institutions . . . . .	<b>660</b>	<b>51,769</b>	262	29,405
Due to banks and other financial institutions . . . . .	<u><b>(1)</b></u>	<u><b>2</b></u>	<u><b>(1)</b></u>	<u><b>1</b></u>

**(f) Transactions with Central SAFE and other companies controlled by Central SAFE**

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

The Group did not have any balances or enter into any transactions with Central SAFE for the year ended 31 December 2008 (2007: Nil).

Central SAFE has controlling equity interests in certain other entities 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:

	2008		2007	
	Interest income/ (expense)	Outstanding balance at end of the year	Interest income/ (expense)	Outstanding balance at end of the year
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances and other accounts. . . . .	–	–	–	23
Investment in securities. . . . .	196	5,479	89	2,433
Financial assets at fair value through profit or loss . . . . .	–	13	–	9
Due from banks and other financial institutions . . . . .	171	3,780	85	1,443
Due to banks and other financial institutions . . . . .	<u>(67)</u>	<u>1,214</u>	<u>(21)</u>	<u>2,417</u>

**(g) Transactions with other state-controlled entities**

The state-controlled entities are those, other than BOC (the intermediate holding company 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 stated-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\$m	HK\$m	HK\$m	HK\$m
Advances and other accounts (Gross). . . . .	<b>1,870</b>	<b>57,260</b>	1,899	39,828
Individually assessed loan impairment allowances . . . . .	–	<b>122</b>	–	28
Investment in securities. . . . .	<b>276</b>	<b>6,153</b>	323	7,158
Financial assets at fair value through profit or loss . . . . .	<b>44</b>	<b>847</b>	31	1,219
Due from banks and other financial institutions . . . . .	<b>107</b>	<b>2,154</b>	452	6,969
Due to banks and other financial institutions . . . . .	<b>(237)</b>	<b>25,082</b>	(286)	18,667
Deposits from customers. . . . .	<u><b>(808)</b></u>	<u><b>59,983</b></u>	<u>(1,163)</u>	<u>29,927</u>

	2008	2007
	HK\$m	HK\$m
(ii) Contingent liabilities and commitments (including guarantees) . . . . .	<u><b>43,866</b></u>	<u>36,145</u>

	2008	2007
	HK\$m	HK\$m
(iii) Outstanding derivative transactions (notional amount). . . . .	<u><b>6,685</b></u>	<u>1,686</u>

**48. Liquidity ratio**

	2008	2007
Average liquidity ratio . . . . .	<u><b>41.74%</b></u>	<u>50.92%</u>

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 to the Banking Ordinance.

## 49. Currency concentrations

The following is a summary of the major foreign currency exposures arising from trading, non-trading and structural positions. The net options position is calculated based on the basis of delta-weighted positions of all foreign exchange options contracts.

2008								
Equivalent in million of HK\$								
	US Dollars	Japanese Yen	Euro	Australian Dollars	Pound Sterling	Renminbi Yuan	Others	Total
Spot assets . . . . .	322,611	45,677	39,953	26,578	13,662	69,588	11,006	529,075
Spot liabilities . . . . .	(278,441)	(10,671)	(26,033)	(28,009)	(16,730)	(68,161)	(22,252)	(450,297)
Forward purchases . . . . .	328,459	28,024	31,497	17,948	18,249	22,282	39,376	485,835
Forward sales . . . . .	(364,547)	(62,847)	(45,720)	(16,688)	(15,190)	(22,273)	(28,126)	(555,391)
Net options position . . . . .	131	2	7	8	(9)	–	3	142
Net long/(short) position . . . .	8,213	185	(296)	(163)	(18)	1,436	7	9,364
Net structural position . . . . .	158	–	–	–	–	1,719	–	1,877
2007								
Equivalent in million of HK\$								
	US Dollars	Japanese Yen	Euro	Australian Dollars	Pound Sterling	Renminbi Yuan	Others	Total
Spot assets . . . . .	321,190	2,019	15,739	27,376	6,028	44,929	7,364	424,645
Spot liabilities . . . . .	(220,339)	(4,764)	(9,215)	(24,055)	(12,951)	(44,055)	(19,615)	(334,994)
Forward purchases . . . . .	159,983	22,718	25,775	22,051	25,907	26,760	43,162	326,356
Forward sales . . . . .	(257,677)	(20,215)	(32,238)	(25,426)	(18,858)	(26,322)	(30,823)	(411,559)
Net options position . . . . .	107	(16)	(17)	22	(5)	–	(9)	82
Net long/(short) position . . . .	3,264	(258)	44	(32)	121	1,312	79	4,530
Net structural position . . . . .	84	–	–	–	–	459	–	543

## 50. 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:

	<u>Banks</u>	<u>Public sector entities</u>	<u>Others</u>	<u>Total</u>
	<u>HK\$'m</u>	<u>HK\$'m</u>	<u>HK\$'m</u>	<u>HK\$'m</u>
<b>At 31 December 2008</b>				
Asia, other than Hong Kong				
– Mainland China . . . . .	62,532	52,228	47,481	162,241
– Japan . . . . .	19,475	39,462	1,522	60,459
– Others . . . . .	42,366	54	16,293	58,713
	<u>124,373</u>	<u>91,744</u>	<u>65,296</u>	<u>281,413</u>
North America				
– United States . . . . .	3,812	29,065	60,801	93,678
– Others . . . . .	20,380	686	150	21,216
	<u>24,192</u>	<u>29,751</u>	<u>60,951</u>	<u>114,894</u>
Western Europe . . . . .				
– Germany . . . . .	35,693	664	1,252	37,609
– Others . . . . .	126,866	353	6,946	134,165
	<u>162,559</u>	<u>1,017</u>	<u>8,198</u>	<u>171,774</u>
Total . . . . .	<u>311,124</u>	<u>122,512</u>	<u>134,445</u>	<u>568,081</u>

	<u>Banks</u>	<u>Public sector entities</u>	<u>Others</u>	<u>Total</u>
	<u>HK\$'m</u>	<u>HK\$'m</u>	<u>HK\$'m</u>	<u>HK\$'m</u>
<b>At 31 December 2007</b>				
Asia, other than Hong Kong				
– Mainland China . . . . .	56,017	30,753	29,699	116,469
– Japan . . . . .	26,513	–	2,222	28,735
– Others . . . . .	46,512	469	17,363	64,344
	<u>129,042</u>	<u>31,222</u>	<u>49,284</u>	<u>209,548</u>
North America				
– United States . . . . .	6,200	27,179	76,783	110,162
– Others . . . . .	18,081	–	68	18,149
	<u>24,281</u>	<u>27,179</u>	<u>76,851</u>	<u>128,311</u>
Western Europe				
– Germany . . . . .	41,201	–	2,331	43,532
– Others . . . . .	148,144	3	11,827	159,974
	<u>189,345</u>	<u>3</u>	<u>14,158</u>	<u>203,506</u>
Total . . . . .	<u>342,668</u>	<u>58,404</u>	<u>140,293</u>	<u>541,365</u>

## 51. 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 arising from non-bank counterparties at 31 December are summarised as follows:

2008			
	On-balance sheet exposure	Off-balance sheet exposure	Individually assessed impairment allowances
	HK\$m	HK\$m	HK\$m
Mainland China entities . . . . .	79,365	66,107	53
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China . . . . .	25,979	13,701	119
Other non-bank Mainland China exposures . . . . .	14,095	7,824	56
	<u>119,439</u>	<u>87,632</u>	<u>228</u>
2007			
	On-balance sheet exposure	Off-balance sheet exposure	Individually assessed impairment allowances
	HK\$m	HK\$m	HK\$m
Mainland China entities . . . . .	60,275	44,698	23
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China . . . . .	23,142	17,535	13
Other non-bank Mainland China exposures . . . . .	10,133	8,261	8
	<u>93,550</u>	<u>70,494</u>	<u>44</u>

## 52. 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.

## 53. Approval of financial statements

The financial statements were approved and authorised for issue by the Board of Directors on 24 March 2009.

## UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

### RISK MANAGEMENT

#### Overview

The Group believes that sound risk management is crucial to the success of 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 that various risks are properly managed and controlled in the course of conducting business. The Group has a sound risk management organisational structure for implementing 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 its committees, has the primary responsibility for formulating risk management strategies and ensuring that the Group has an effective risk management system to implement these strategies. The Risk 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 considers that any transaction should not proceed. The Audit Committee (AC) assists the Board in fulfilling its role in overseeing the internal control system.

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 Chief Risk Officer (CRO) assists the CE in fulfilling his responsibilities in the day-to-day management of risks. The CRO 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 CRO 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.

Various units of the Group have their respective risk management responsibilities. Business units act as the first line of defence while risk management units, which are independent from the business units, are responsible for the day-to-day management of different kinds of risks. Risk management units have the primary responsibilities for drafting, reviewing and updating various risk management policies and procedures.

The Group's principal banking subsidiaries, Nanyang, Nanyang (China) and Chiyu, are subject to risk policies that are consistent with those of the Group. These subsidiaries execute their risk management strategies independently and report to the Group's management on a regular basis.



## **Credit Risk Management**

Credit risk is the risk that a customer or counterparty will be unable to or unwilling to meet its obligations under a contract. It arises principally from the lending, trade finance and treasury businesses, and covers inter-bank transactions as well as investments in bonds and securities. For details of the Group's Credit Risk Management, please refer to Note 4 to the Financial Statements in this Annual Report.

## **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, basis risk, yield curve risk and option risk. For details of the Group's Interest Rate Risk Management, please refer to Note 4 to the Financial Statements in this Annual Report.

## **Market Risk Management**

Market risk is the risk of loss that results from movements in market rates and prices. The Group's market risk in the trading book arises from customer-related business and proprietary trading. Trading positions are subject to daily mark-to-market valuation. The risk includes potential losses arising from a change in foreign exchange and interest rates as well as the prices of equities and commodities. The major market risk in the 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 management framework***

Market risk is managed within various major risk limits approved by the RC, including risk positions and/or risk factor sensitivities. Since April 2007, BOCHK has also formally applied Value-at-Risk (VAR) limit as a daily risk management tool. These overall risk limits are divided into sub-limits by reference to different risk products, including interest rates, foreign exchange rates, commodities and equities. Transactions are classified into different risk product categories according to the prominent type of risk inherent in the transactions.

Market risk arising from the banking book is managed within various risk limits such as P/L Management Alert Limit (P/L MAL) and P/L Management Alert Trigger (P/L MAT) which are approved by ALCO. The mark-to-market result is reported to ALCO on a monthly basis.

As aforesaid, the Group's risk management objective is to enhance shareholder value by maintaining risk exposures within acceptable limits. The Group's market risk management framework comprises three levels. The Board of Directors and its Risk Committee are the ultimate decision-making authorities. The formulation of risk management procedures and the implementation mechanism, and the monitoring of compliance are mainly the responsibility of the Group's senior management (including CE and CRO). RMD is responsible for overseeing 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 day-to-day basis to ensure that they are within the established risk limits and are regularly reported to the senior management. Nanyang and Chiyu have their own independent risk monitoring units to monitor limit compliance on a daily basis.

The Group's controls of market risk by restricting individual operations to trade only a list of permissible instruments authorised by senior management and within various market risk limits approved by RC. The individual operations are also required to enforce rigorous new product approval procedures to ensure that all risks that may arise are thoroughly identified, properly measured and adequately controlled.

The Group also uses the VAR technique to measure potential losses and market risks of its trading book for reporting to the RC and senior management on a periodic basis. VAR is a statistical technique which estimates the potential losses that could occur on risk positions taken over a specified time horizon within a given level of confidence. BOCHK, being the banking entity within the Group with the major trading positions, which are mainly foreign currency positions in major currencies, uses VAR technique to monitor and control market risk on a daily basis.

The Group has changed its VAR calculation from a variance/co-variance basis to a historical simulation basis with effect from April 2007. The Group uses historical movements in market rates and prices, a 99% confidence level and a 1-day holding period to calculate portfolio and individual VAR. Movements in market prices are calculated by reference to market data from the last two years.

#### VAR

The following table sets out the VAR for all trading market risk exposure<sup>1</sup> of BOCHK.

HK\$m		At 31 December	Minimum for the year	Maximum for the year	Average for the year
VAR for all market risk	– 2008	12.6	3.0	13.5	6.5
	– 2007	3.2	1.4	10.4	4.1
VAR for foreign exchange risk products	– 2008	13.1	2.5	14.2	6.0
	– 2007	2.7	1.0	9.4	4.0
VAR for interest rate risk products	– 2008	4.2	1.0	5.9	2.9
	– 2007	1.5	0.5	3.9	1.6
VAR for equity risk products	– 2008	0.2	0.1	2.8	0.5
	– 2007	0.4	0.1	1.1	0.4
VAR for commodity risk products	– 2008	0.0	0.0	0.5	0.0
	– 2007	0.0	0.0	0.4	0.1

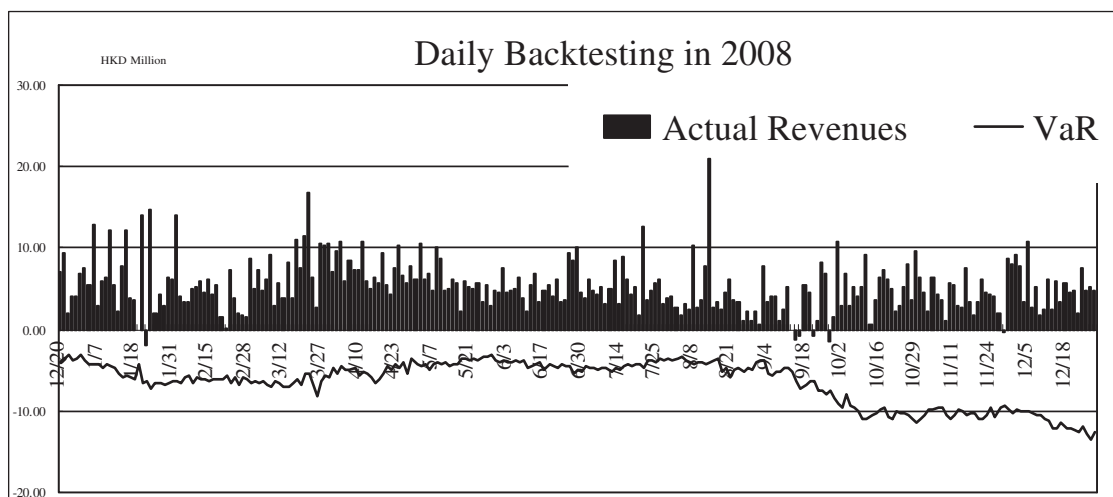
In 2008, the average daily revenue<sup>2</sup> of BOCHK earned from market risk-related trading activities was HK\$5.35 million (2007: HK\$3.06 million).

<sup>1</sup> Structural FX positions have been excluded.

<sup>2</sup> Revenues from structural FX positions and back-to-back transactions have been excluded.

The predictive power of the VAR measure is monitored by backtesting, which compares the calculated VAR figure of those trading positions of each business day with the actual revenues arising on those positions on the next business day. These actual revenues exclude non-trading income, including fees and commissions. If backtesting revenues are negative and exceeding the VAR, a “backtesting exception” is noted. Backtesting results are reported to the Group’s senior management, including CE and CRO.

Generally speaking, the number of backtesting exceptions in a rolling 12-month period will not exceed four times, given a 99% confidence level. BOCHK conducts backtesting on a monthly basis and the graph below shows the backtesting result of the trading VAR of BOCHK.



There is no actual loss exceeding the VAR estimate for BOCHK in 2008.

Although a valuable guide to risk, VAR should always be viewed in the context of its limitations. For example:

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a one-day holding period assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a one-day holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99 per cent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence; and
- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

The Group recognises these limitations by augmenting its VAR limits with other position and sensitivity limit structures. Additionally, the Group applies a wide range of stress testing, both on individual portfolios and on the Group's consolidated positions. The stress testing programme of the trading book includes sensitivity testing on changes in risk factors with various degrees of severity, as well as scenario analysis on historical events including the 1987 Equity Market Crash, 1994 Bond Market Crash, the 1997 Asian Financial Crisis and the 11 September event in the United States in 2001. The Group also reassesses the stress testing programme to ensure its adequacy in view of the financial market crisis in 2008. The Group's stress-testing regime provides the senior management with an assessment of the financial impact of identified extreme events on the market risk exposures of the Group.

### Liquidity Risk Management

The aim of liquidity management is to enable 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 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 (under normal condition and stress conditions respectively) 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 returns 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. TD manages the liquidity risk according to the established policies. FD monitors the Group's liquidity risks and reports to ALCO regularly. RMD reviews the policies, guidelines and limits proposed by TD.

In 2008, the Group further enhanced its liquidity risk management process by putting in place more stringent stress testing requirements in view of the then prevailing market situation.

### **Operational Risk Management**

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

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 authorisation is the fundamental principle followed by the Group. RMD formulates corporate-level policies and procedures concerning operational risk management which are approved by RC. The management of respective business lines is responsible for managing and reporting operational risks specific to their business units by applying the respective tools such as key risk indicators, self assessment and operational risk events reporting mechanism to identify, assess and control the risks inherent in their business processes, activities and products. These are followed by periodic monitoring and ongoing review of changes by RMD. Besides the current operational risk status, trends derived from historical data are served as alert on potential risks. RMD evaluates the operational risk profile, records operational risk data and reports operational risk issues to RC and the senior management. The Group also takes out insurance to mitigate unforeseeable operational risks.

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.

### **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.

The recent Lehman Minibonds incident has had an adverse impact on the Group's reputation as there have been alleged cases of mis-selling. The Group is handling customer's complaints cautiously so as to minimise the reputation risk.

## **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 legal or regulatory sanctions, financial loss, or loss to reputation a bank may suffer as a result of its failure to comply with all applicable laws and regulations. Legal and compliance risks are managed by the Legal and Compliance Department headed by a General Manager who reports to the Chief Risk Officer.

## **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 Board of Directors reviews and approves the policy for the management of strategic risks. Key strategic issues have to be fully evaluated and properly endorsed by the senior management and the Board.

The Group will regularly review its business strategies to cope with the latest market situation and developments.

## **Capital Management**

The major objective of capital management is to maximise shareholders' total 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 complied with all the statutory capital standards for all the periods in 2008.

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.

In 2008, the Group took further measures to strengthen its capital position, including the borrowing of subordinated loans from the parent bank.

## **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.

## APPENDIX

### SUBSIDIARIES OF THE BANK

The particulars of our subsidiaries are as follows:

<u>Name of company</u>	<u>Country/place and date of incorporation/operation</u>	<u>Issued and fully paid up share capital/registered capital</u>	<u>Percentage of attributable equity interest</u>	<u>Principal activities</u>
Nanyang Commercial Bank, Limited	Hong Kong 2 February 1948	Ordinary shares HK\$600,000,000	100.00%	Banking business
Chiyu Banking Corporation Limited	Hong Kong 24 April 1947	Ordinary shares HK\$300,000,000	70.49%	Banking business
BOC Credit Card (International) Limited	Hong Kong 9 September 1980	Ordinary shares HK\$480,000,000	100.00%	Credit card services
Arene Trading Limited	Hong Kong 22 August 1978	Ordinary shares HK\$500,000	100.00%	Property holding and investment
Bank of China (Hong Kong) Nominees Limited*	Hong Kong 1 October 1985	Ordinary shares HK\$2	100.00%	Nominee services
Bank of China (Hong Kong) Trustees Limited*	Hong Kong 6 November 1987	Ordinary shares HK\$3,000,000	100.00%	Trustee and agency services
BOC Group Trustee Company Limited*	Hong Kong 1 December 1997	Ordinary shares HK\$200,000,000	64.20%	Trustee services
BOC Travel Services Limited	Hong Kong 24 August 1982	Ordinary shares HK\$2,000,000	100.00%	Travel services
BOCHK Financial Products (Cayman) Limited	Cayman 10 November 2006	Ordinary shares US\$50,000	100.00%	Note issuing
BOCHK Information Technology (Shenzhen) Co., Ltd.*	PRC 16 April 1990	Registered capital HK\$70,000,000	100.00%	Property holding and investment
BOCHK Information Technology Services (Shenzhen) Ltd*	PRC 26 May 1993	Registered capital HK\$40,000,000	100.00%	Information technology services
BOCI-Prudential Trustee Limited*	Hong Kong 11 October 1999	Ordinary shares HK\$300,000,000	41.10%	Trustee services
Che Hsing (Nominees) Limited*	Hong Kong 23 April 1980	Ordinary shares HK\$10,000	100.00%	Nominee services
Chiyu Banking Corporation (Nominees) Limited*	Hong Kong 3 November 1981	Ordinary shares HK\$100,000	70.49%	Investment holding

<b>Name of company</b>	<b>Country/place and date of incorporation/operation</b>	<b>Issued and fully paid up share capital/registered capital</b>	<b>Percentage of attributable equity interest</b>	<b>Principal activities</b>
Chung Chiat Company Limited	Hong Kong 9 April 1980	Ordinary shares HK\$200	100.00%	Property holding and investment
Dwell Bay Limited	Hong Kong 19 December 1980	Ordinary shares HK\$100,000	100.00%	Property holding and investment
Glister Company Limited*	Hong Kong 26 March 2001	Ordinary shares HK\$2	70.49%	Investment holding
Glory Cardinal Limited*	Hong Kong 4 May 2001	Ordinary shares HK\$2	70.49%	Investment holding
Grace Charter Limited*	Hong Kong 4 May 2001	Ordinary shares HK\$2	70.49%	Investment holding
G.Z.Y. Microfilm Technology (Shenzhen) Co., Ltd.*	PRC 24 September 1993	Registered capital HK\$40,000,000	100.00%	Property holding and investment
Hua Chiao Commercial (Nominees) Limited*	Hong Kong 28 October 1986	Ordinary shares HK\$10,000	100.00%	Nominee services
Kincheng Finance (H.K.) Limited	Hong Kong 30 March 1979	Ordinary shares HK\$100	100.00%	Loan financing
Kincheng Investments & Developments (H.K.) Limited	Hong Kong 15 May 1981	Ordinary shares HK\$6,000	100.00%	Property holding and investment
Kincheng (Nominees) Limited*	Hong Kong 12 December 1980	Ordinary shares HK\$100,000	100.00%	Nominee services
Kiu Nam Investment Corporation Limited	Hong Kong 9 November 1963	Ordinary shares HK\$2,000,000	100.00%	Property holding and investment
Kwong Li Nam Investment Agency Limited*	Hong Kong 25 May 1984	Ordinary shares HK\$3,050,000	100.00%	Investment agency
Nan Song Company, Limited*	Hong Kong 13 April 1965	Ordinary shares HK\$1,000,000	100.00%	Property investment and investment holding
Nanyang Commercial Bank (China) Limited	PRC 14 December 2007	Registered capital RMB2,500,000,000	100.00%	Banking business
Nanyang Commercial Bank (Nominees) Limited*	Hong Kong 22 August 1980	Ordinary shares HK\$50,000	100.00%	Nominee services
Nanyang Commercial Bank Trustee Limited*	Hong Kong 22 October 1976	Ordinary shares HK\$3,000,000	100.00%	Trustee services

<b>Name of company</b>	<b>Country/place and date of incorporation/operation</b>	<b>Issued and fully paid up share capital/registered capital</b>	<b>Percentage of attributable equity interest</b>	<b>Principal activities</b>
Nanyang Finance Company Limited	Hong Kong 16 March 1979	Ordinary shares HK\$50,000,000	100.00%	Financial services
Pacific Trend Profits Corporation*	British Virgin Islands 20 April 2001	Registered shares US\$1	70.49%	Investment holding
Patson (HK) Limited*	Hong Kong 18 August 1970	Ordinary shares HK\$1,000,000	100.00%	Property investment
Perento Limited	Hong Kong 27 September 1983	Ordinary shares HK\$10,000	100.00%	Property holding and investment
Po Hay Enterprises Limited	Hong Kong 2 October 1979	Ordinary shares HK\$100,000	100.00%	Property holding and investment
Po Sang Financial Investment Services Company Limited*	Hong Kong 23 September 1980	Ordinary shares HK\$25,000,000	100.00%	Gold trading and investment holding
Po Sang Futures Limited*	Hong Kong 19 October 1993	Ordinary shares HK\$25,000,000	100.00%	Commodities brokerage
Po Sang (Nominees) Limited*	Hong Kong 29 April 1993	Ordinary shares HK\$10,000	100.00%	Nominee services
Rams City (Nominees) Limited*	Hong Kong 2 May 1986	Ordinary shares HK\$2,000,000	100.00%	Nominee services
Sanicon Investment Limited	Hong Kong 24 January 2000	Ordinary shares HK\$2	100.00%	Property holding and investment
Seng Sun Development Company, Limited*	Hong Kong 11 December 1961	Ordinary shares HK\$2,800,000	70.49%	Investment holding
Shenstone Limited	Hong Kong 4 September 1979	Ordinary shares HK\$2	100.00%	Property holding and investment
Sin Chiao Enterprises Corporation, Limited*	Hong Kong 13 September 1961	Ordinary shares HK\$3,000,000	100.00%	Property holding and investment
Sin Hua Trustee Limited*	Hong Kong 27 October 1978	Ordinary shares HK\$3,000,000	100.00%	Trustee services
Sin Mei (Nominee) Limited*	Hong Kong 27 April 1982	Ordinary shares HK\$100,000	100.00%	Nominee services
Sin Yeh Shing Company Limited	Hong Kong 28 November 1980	Ordinary shares HK\$100,000	100.00%	Property holding and investment



<b>Name of company</b>	<b>Country/place and date of incorporation/operation</b>	<b>Issued and fully paid up share capital/registered capital</b>	<b>Percentage of attributable equity interest</b>	<b>Principal activities</b>
Sino Information Services Company Limited	Hong Kong 11 February 1993	Ordinary shares HK\$7,000,000	100.00%	Information services
The China-South Sea (Nominees) Services Limited*	Hong Kong 13 February 1981	Ordinary shares HK\$100,000	100.00%	Nominee services
The China State (Nominees) Limited*	Hong Kong 14 May 1982	Ordinary shares HK\$100,000	100.00%	Nominee services
The China State Trustee Limited*	Hong Kong 17 July 1981	Ordinary shares HK\$3,000,000	100.00%	Trustee services
Track Link Investment Limited	Hong Kong 8 February 1994	Ordinary shares HK\$2	100.00%	Property holding and investment
Yien Yieh (Nominee) Limited*	Hong Kong 26 June 2001	Ordinary shares HK\$2,000	100.00%	Nominee services

Po Sang (Nominees) Limited will dissolve in May 2009.

**Remarks:**

Name of subsidiaries which are not included in the consolidation group for regulatory purposes in respect of capital adequacy is marked with \* in the above table. BOCHK and its subsidiaries specified by the HKMA form the basis of consolidation 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.

## DEFINITIONS

In this Annual Report, unless the context otherwise requires, the following terms shall have the meanings set out below:

Terms	Meanings
“ABS” . . . . .	Asset-backed securities
“AC” . . . . .	The Audit Committee
“ALCO” . . . . .	The Asset and Liability Management Committee
“ATM” . . . . .	Automated Teller Machine
“Board” or “Board of Directors” . . . . .	The Board of Directors of BOCHK
“Board of BOCHK (Holdings)” . . . . .	The Board of Directors of BOCHK (Holdings)
“BOC” . . . . .	Bank of China Limited, a joint stock commercial bank with limited liability established under the laws of the PRC, the H shares and A shares of which are listed on the Hong Kong Stock Exchange and the Shanghai Stock Exchange respectively
“BOC (BVI)” . . . . .	BOC Hong Kong (BVI) Limited, a company incorporated under the laws of the British Virgin Islands and a wholly owned subsidiary of BOC Hong Kong (Group) Limited
“BOC-CC” . . . . .	BOC Credit Card (International) Limited, a company incorporated under the laws of Hong Kong and a wholly owned subsidiary of BOCHK
“BOCHK” or “the Bank” . . . . .	Bank of China (Hong Kong) Limited, a company incorporated under the laws of Hong Kong and a wholly owned subsidiary of BOCHK (Holdings)
“BOCHK (Holdings)” . . . . .	BOC Hong Kong (Holdings) Limited, a company incorporated under the laws of Hong Kong
“BOCI-Prudential Manager” . . . . .	BOCI-Prudential Asset Management Limited, a company incorporated under the laws of Hong Kong, in which BOCI Asset Management Limited, a wholly owned subsidiary of BOC International Holdings Limited, and Prudential Corporation Holdings Limited hold equity interests of 64% and 36% respectively

Terms	Meanings
“BOCI-Prudential Trustee” . . . . .	BOCI-Prudential Trustee Limited, a company incorporated under the laws of Hong Kong, in which BOC Group Trustee Company Limited and Prudential Corporation Holdings Limited hold equity interests of 64% and 36% respectively
“CAR” . . . . .	Capital Adequacy Ratio, computed on the consolidated basis that comprises the positions of BOCHK and certain subsidiaries specified by the HKMA for its regulatory purposes and in accordance with the Banking (Capital) Rules
“CCO” . . . . .	Chief Credit Officer
“CE” . . . . .	Chief Executive
“CRO” . . . . .	Chief Risk Officer
“Central SAFE” . . . . .	Central SAFE Investments Limited
“Chiyu” . . . . .	Chiyu Banking Corporation Limited, a company incorporated under the laws of Hong Kong, in which BOCHK holds an equity interest of 70.49%
“ECAI(s)” . . . . .	External Credit Assessment Institution(s)
“ESPD” . . . . .	The Economics & Strategic Planning Department
“EURIBOR” . . . . .	Euro Interbank Offered Rate
“Fitch” . . . . .	Fitch Ratings
“Group” . . . . .	The Bank and its subsidiaries collectively referred as the Group
“HK GAAP” . . . . .	Generally Accepted Accounting Principles in Hong Kong
“HKAS(s)” . . . . .	Hong Kong Accounting Standard(s)
“HKAS-Int” . . . . .	HKAS Interpretation
“HKFRS(s)” . . . . .	Hong Kong Financial Reporting Standard(s)
“HKICPA” . . . . .	Hong Kong Institute of Certified Public Accountants
“HKMA” . . . . .	Hong Kong Monetary Authority
“Hong Kong” or “Hong Kong SAR” . .	Hong Kong Special Administrative Region

Terms	Meanings
“Listing Rules” . . . . .	The Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited
“Mainland China” . . . . .	The mainland of the PRC
“MBS” . . . . .	Mortgage-backed securities
“MPF” . . . . .	Mandatory Provident Fund
“MPF Schemes Ordinance”. . . . .	The Mandatory Provident Fund Schemes Ordinance, Chapter 485 of the Laws of Hong Kong, as amended
“Moody’s”. . . . .	Moody’s Investors Service
“Nanyang”. . . . .	Nanyang Commercial Bank, Limited, a company incorporated under the laws of Hong Kong and a wholly owned subsidiary of BOCHK
“ORSO schemes”. . . . .	The Occupational Retirement Schemes under Occupational Retirement Schemes Ordinance, Chapter 426 of the Laws of Hong Kong
“PRC”. . . . .	The People’s Republic of China
“RC”. . . . .	The Risk Committee
“RMB” or “Renminbi” . . . . .	Renminbi, the lawful currency of the PRC
“RMD” . . . . .	The Risk Management Department
“STC approach”. . . . .	Standardised (Credit Risk) Approach
“STM approach” . . . . .	Standardised (Market Risk) Approach
“STO approach”. . . . .	Standardised (Operational Risk) Approach
“Share Option Scheme” . . . . .	The Share Option Scheme conditionally approved and adopted by the shareholders of the Bank on 10 July 2002
“Sharesave Plan” . . . . .	The Sharesave Plan conditionally approved and adopted by the shareholders of the Bank on 10 July 2002
“Standard & Poor’s” . . . . .	Standard & Poor’s Ratings Services
“Stock Exchange” . . . . .	The Stock Exchange of Hong Kong Limited

Terms	Meanings
“TD” . . . . .	The Treasury Department
“US” . . . . .	The United States of America
“VAR” . . . . .	Value at Risk

## INDEPENDENT AUDITOR'S REPORT

**To the shareholders of**  
**Bank of China (Hong Kong) Limited**  
(incorporated in Hong Kong with limited liability)

We have audited the consolidated financial statements of Bank of China (Hong Kong) Limited (the "Bank") and its subsidiaries (together, the "Group") set out on pages 29 to 289, which comprise the consolidated and company balance sheets as at 31 December 2007, and the consolidated income statement, the consolidated and company statements of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### **Directors' responsibility for the financial statements**

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

### **Auditor's responsibility**

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

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

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

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

### **Opinion**

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

**PricewaterhouseCoopers**  
*Certified Public Accountants*

Hong Kong, 25 March 2008

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#### *Note:*

1. The Independent Auditor's Report on the consolidated financial statements of the Issuer set out herein are reproduced from the Issuer's annual report for the year ended December 31, 2007, and page references included in the Independent Auditor's Report refer to pages set out in such annual report.

# CONSOLIDATED INCOME STATEMENT

For the year ended 31 December

	Notes	2007 HK\$'m	2006 HK\$'m
Interest income . . . . .		45,309	39,856
Interest expense . . . . .		(26,769)	(24,571)
<b>Net interest income</b> . . . . .	5	18,540	15,285
Fees and commission income . . . . .		8,480	5,186
Fees and commission expenses . . . . .		(1,897)	(1,259)
<b>Net fees and commission income</b> . . . . .	6	6,583	3,927
Net trading income . . . . .	7	1,013	1,567
Net loss on financial instruments designated at fair value through profit or loss . . . . .		(25)	(100)
Net loss on investments in securities . . . . .	8	(53)	(5)
Other operating income . . . . .	9	756	326
<b>Net operating income before impairment allowances</b> . . . . .		26,814	21,000
Net (charge)/reversal of impairment allowances . . . . .	10	(1,448)	1,794
<b>Net operating income</b> . . . . .		25,366	22,794
Operating expenses . . . . .	11	(7,659)	(6,495)
<b>Operating profit</b> . . . . .		17,707	16,299
Net gain from disposal of/fair value adjustments on investment properties . . . . .	12	1,064	605
Net gain/(loss) from disposal/revaluation of properties, plant and equipment . . . . .	13	28	(16)
Share of profits less losses of associates . . . . .		3	5
<b>Profit before taxation</b> . . . . .		18,802	16,893
Taxation . . . . .	14	(3,255)	(2,858)
<b>Profit for the year</b> . . . . .		15,547	14,035
<b>Attributable to:</b>			
Equity holders of the Bank . . . . .		15,277	13,844
Minority interests . . . . .		270	191
		15,547	14,035
<b>Dividends</b> . . . . .	16	14,376	9,298

The notes on pages 37 to 289 are an integral part of these financial statements.

# CONSOLIDATED BALANCE SHEET

As at 31 December

	Notes	2007 HK\$'m	2006 HK\$'m
<b>ASSETS</b>			
Cash and balances with banks and other financial institutions . . . . .	20	<b>159,052</b>	105,236
Placements with banks and other financial institutions maturing between one and twelve months . . . . .		<b>53,154</b>	56,373
Financial assets at fair value through profit or loss . . . . .	21	<b>10,302</b>	13,194
Derivative financial instruments . . . . .	22	<b>14,477</b>	7,393
Hong Kong SAR Government certificates of indebtedness . .		<b>32,770</b>	34,750
Advances and other accounts . . . . .	23	<b>420,212</b>	352,844
Investment in securities . . . . .	25	<b>297,048</b>	302,091
Interests in associates . . . . .	27	<b>83</b>	60
Investment properties . . . . .	28	<b>8,058</b>	7,481
Properties, plant and equipment . . . . .	29	<b>23,288</b>	19,735
Deferred tax assets . . . . .	36	<b>10</b>	2
Other assets . . . . .	30	<b>20,776</b>	14,630
Total assets . . . . .		<b><u>1,039,230</u></b>	<b><u>913,789</u></b>
<b>LIABILITIES</b>			
Hong Kong SAR currency notes in circulation . . . . .	31	<b>32,770</b>	34,750
Deposits and balances of banks and other financial institutions . . . . .		<b>60,599</b>	49,034
Financial liabilities at fair value through profit or loss . . .	32	<b>11,405</b>	15,127
Derivative financial instruments . . . . .	22	<b>11,082</b>	4,052
Deposits from customers . . . . .	33	<b>794,247</b>	695,616
Debt securities in issue at amortised cost . . . . .		<b>2,089</b>	–
Other accounts and provisions . . . . .	34	<b>38,569</b>	30,271
Current tax liabilities . . . . .		<b>1,210</b>	1,128
Deferred tax liabilities . . . . .	36	<b>3,967</b>	3,391
Total liabilities . . . . .		<b><u>955,938</u></b>	<b><u>833,369</u></b>
<b>EQUITY</b>			
Share capital . . . . .	37	<b>43,043</b>	43,043
Reserves . . . . .	38	<b>38,700</b>	35,958
Capital and reserves attributable to the equity holders of the Bank . . . . .		<b><u>81,743</u></b>	<b><u>79,001</u></b>
Minority interests . . . . .		<b><u>1,549</u></b>	<b><u>1,419</u></b>
Total equity . . . . .		<b><u>83,292</u></b>	<b><u>80,420</u></b>
Total liabilities and equity . . . . .		<b><u>1,039,230</u></b>	<b><u>913,789</u></b>

The notes on pages 37 to 289 are an integral part of these financial statements

Approved by the Board of Directors on 25 March 2008 and signed on behalf of the Board by:

**XIAO Gang**

*Director*

**HE Guangbei**

*Director*

**SUN Changji**

*Director*

**LEE Wing Hung**

*Chief Financial Officer*



**BALANCE SHEET***As at 31 December*

	<u>Notes</u>	<u>2007</u> HK\$'m	<u>2006</u> HK\$'m
<b>ASSETS</b>			
Cash and balances with banks and other financial institutions . . . . .	20	<b>134,020</b>	85,188
Placements with banks and other financial institutions maturing between one and twelve months . . . . .		<b>31,887</b>	38,044
Financial assets at fair value through profit or loss . . . . .	21	<b>6,369</b>	10,548
Derivative financial instruments . . . . .	22	<b>13,972</b>	7,092
Hong Kong SAR Government certificates of indebtedness . . . . .		<b>32,770</b>	34,750
Advances and other accounts . . . . .	23	<b>341,896</b>	293,296
Investment in securities . . . . .	25	<b>271,049</b>	274,737
Interests in subsidiaries . . . . .	26	<b>12,866</b>	12,857
Interests in associates . . . . .	27	<b>12</b>	26
Investment properties . . . . .	28	<b>7,595</b>	6,992
Properties, plant and equipment . . . . .	29	<b>18,261</b>	15,258
Other assets . . . . .	30	<b>18,560</b>	14,095
Total assets . . . . .		<b><u>889,257</u></b>	<b><u>792,883</u></b>
<b>LIABILITIES</b>			
Hong Kong SAR currency notes in circulation . . . . .	31	<b>32,770</b>	34,750
Deposits and balances of banks and other financial institutions . . . . .		<b>56,207</b>	47,970
Financial liabilities at fair value through profit or loss . . . . .	32	<b>8,116</b>	11,173
Derivative financial instruments . . . . .	22	<b>10,788</b>	3,854
Deposits from customers . . . . .	33	<b>673,580</b>	593,850
Other accounts and provisions . . . . .	34	<b>31,378</b>	24,995
Current tax liabilities . . . . .		<b>855</b>	921
Deferred tax liabilities . . . . .	36	<b>3,352</b>	2,850
Total liabilities . . . . .		<b><u>817,046</u></b>	<b><u>720,363</u></b>
<b>EQUITY</b>			
Share capital . . . . .	37	<b>43,043</b>	43,043
Reserves . . . . .	38	<b>29,168</b>	29,477
Capital and reserves attributable to the equity holders of the Bank . . . . .		<b><u>72,211</u></b>	<b><u>72,520</u></b>
Total liabilities and equity . . . . .		<b><u>889,257</u></b>	<b><u>792,883</u></b>

The notes on pages 37 to 289 are an integral part of these financial statements

Approved by the Board of Directors on 25 March 2008 and signed on behalf of the Board by:

**XIAO Gang**

*Director*

**HE Guangbei**

*Director*

**SUN Changji**

*Director*

**LEE Wing Hung**

*Chief Financial Officer*

# CONSOLIDATED 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*	Translation reserve	Retained earnings	Total	Minority interests	Total equity
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
At 1 January 2006 . . . . .	43,043	5,165	(245)	3,526	(4)	22,042	73,527	1,298	74,825
Net profit for the year . . . . .	–	–	–	–	–	13,844	13,844	191	14,035
Currency translation difference . . . . .	–	–	–	–	4	–	4	–	4
2006 interim dividend . . . . .	–	–	–	–	–	(9,298)	(9,298)	(70)	(9,368)
Revaluation of premises . . . . .	–	1,209	–	–	–	–	1,209	–	1,209
Release upon disposal of premises . . . . .	–	(55)	–	–	–	55	–	–	–
Change in fair value of available-for-sale securities taken to equity . . . . .	–	–	99	–	–	–	99	–	99
Amortisation with respect to available-for-sale securities transferred to held-to-maturity securities . . . . .	–	–	50	–	–	(247)	(197)	–	(197)
Release of reserve upon disposal of available-for-sale securities . . . . .	–	–	(1)	–	–	(3)	(4)	–	(4)
Release to deferred tax liabilities . . . . .	–	(165)	(18)	–	–	–	(183)	–	(183)
Transfer from retained earnings . . . . .	–	–	–	95	–	(95)	–	–	–
At 31 December 2006. . . . .	<u>43,043</u>	<u>6,154</u>	<u>(115)</u>	<u>3,621</u>	<u>–</u>	<u>26,298</u>	<u>79,001</u>	<u>1,419</u>	<u>80,420</u>
Bank and subsidiaries. . . . .	43,043	6,154	(115)	3,621	–	26,282	78,985	–	–
Associates . . . . .	–	–	–	–	–	16	16	–	–
	<u>43,043</u>	<u>6,154</u>	<u>(115)</u>	<u>3,621</u>	<u>–</u>	<u>26,298</u>	<u>79,001</u>	<u>–</u>	<u>–</u>
At 1 January 2007 . . . . .	<b>43,043</b>	<b>6,154</b>	<b>(115)</b>	<b>3,621</b>	<b>–</b>	<b>26,298</b>	<b>79,001</b>	<b>1,419</b>	<b>80,420</b>
Net profit for the year . . . . .	–	–	–	–	–	15,277	15,277	270	15,547
Currency translation difference . . . . .	–	–	–	–	14	–	14	–	14
2006 dividend paid . . . . .	–	–	–	–	–	–	–	(79)	(79)
2007 interim dividend. . . . .	–	–	–	–	–	(14,376)	(14,376)	(78)	(14,454)
Revaluation of premises . . . . .	–	2,908	–	–	–	–	2,908	17	2,925
Release upon disposal of premises . . . . .	–	(23)	–	–	–	23	–	–	–
Change in fair value of available-for-sale securities taken to equity . . . . .	–	–	(917)	–	–	–	(917)	3	(914)
Amortisation with respect to available-for-sale securities transferred to held-to-maturity securities . . . . .	–	–	12	–	–	(115)	(103)	–	(103)
Net impairment charges transferred to profit or loss . . . . .	–	–	289	–	–	–	289	–	289
Release of reserve upon disposal of available-for-sale securities . . . . .	–	–	17	–	–	–	17	–	17
Release (to)/from deferred tax liabilities . . . . .	–	(476)	109	–	–	–	(367)	(3)	(370)
Transfer from retained earnings . . . . .	–	–	–	509	–	(509)	–	–	–
At 31 December 2007. . . . .	<u>43,043</u>	<u>8,563</u>	<u>(605)</u>	<u>4,130</u>	<u>14</u>	<u>26,598</u>	<u>81,743</u>	<u>1,549</u>	<u>83,292</u>
Bank and subsidiaries. . . . .	43,043	8,563	(605)	4,130	14	26,553	81,698	–	–
Associates . . . . .	–	–	–	–	–	45	45	–	–
	<u>43,043</u>	<u>8,563</u>	<u>(605)</u>	<u>4,130</u>	<u>14</u>	<u>26,598</u>	<u>81,743</u>	<u>–</u>	<u>–</u>

\* 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 37 to 289 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*	Translation reserve	Retained earnings	Total equity
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
At 1 January 2006 . . . . .	43,043	3,818	(222)	2,981	—	18,571	68,191
Net profit for the year . . . . .	—	—	—	—	—	12,839	12,839
2006 interim dividend . . . . .	—	—	—	—	—	(9,298)	(9,298)
Revaluation of premises . . . . .	—	1,081	—	—	—	—	1,081
Release upon disposal of premises . . . . .	—	(53)	—	—	—	53	—
Change in fair value of available-for-sale securities taken to equity . . . . .	—	—	86	—	—	—	86
Amortisation with respect to available-for-sale securities transferred to held-to-maturity securities . . . . .	—	—	40	—	—	(222)	(182)
Release to deferred tax liabilities . . . . .	—	(183)	(14)	—	—	—	(197)
Transfer from retained earnings . . . . .	—	—	—	77	—	(77)	—
At 31 December 2006 . . . . .	<u>43,043</u>	<u>4,663</u>	<u>(110)</u>	<u>3,058</u>	<u>—</u>	<u>21,866</u>	<u>72,520</u>
At 1 January 2007 . . . . .	<b>43,043</b>	<b>4,663</b>	<b>(110)</b>	<b>3,058</b>	—	<b>21,866</b>	<b>72,520</b>
Net profit for the year . . . . .	—	—	—	—	—	<b>12,701</b>	<b>12,701</b>
Currency translation difference . . . . .	—	—	—	—	<b>4</b>	—	<b>4</b>
2007 interim dividend . . . . .	—	—	—	—	—	<b>(14,376)</b>	<b>(14,376)</b>
Revaluation of premises . . . . .	—	<b>2,336</b>	—	—	—	—	<b>2,336</b>
Release upon disposal of premises . . . . .	—	<b>(10)</b>	—	—	—	<b>10</b>	—
Change in fair value of available-for-sale securities taken to equity . . . . .	—	—	<b>(917)</b>	—	—	—	<b>(917)</b>
Amortisation with respect to available-for-sale securities transferred to held-to-maturity securities . . . . .	—	—	<b>6</b>	—	—	<b>(91)</b>	<b>(85)</b>
Net impairment charges transferred to profit or loss . . . . .	—	—	<b>289</b>	—	—	—	<b>289</b>
Release of reserve upon disposal of available-for-sale securities . . . . .	—	—	<b>19</b>	—	—	—	<b>19</b>
Release (to)/from deferred tax liabilities . . . . .	—	<b>(390)</b>	<b>110</b>	—	—	—	<b>(280)</b>
Transfer from retained earnings . . . . .	—	—	—	<b>367</b>	—	<b>(367)</b>	—
At 31 December 2007 . . . . .	<u><b>43,043</b></u>	<u><b>6,599</b></u>	<u><b>(603)</b></u>	<u><b>3,425</b></u>	<u><b>4</b></u>	<u><b>19,743</b></u>	<u><b>72,211</b></u>

\* 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 37 to 289 are an integral part of these financial statements.

# **CONSOLIDATED CASH FLOW STATEMENT**

*For the year ended 31 December*

	Notes	2007 HK\$'m	2006 HK\$'m
<b>Cash flows from operating activities</b>			
Operating cash inflow before taxation . . . . .	39(a)	<b>42,157</b>	15,614
Hong Kong profits tax paid . . . . .		<b>(2,822)</b>	(2,409)
Overseas profits tax paid . . . . .		<b>(85)</b>	(55)
<b>Net cash inflow from operating activities . . . . .</b>		<b>39,250</b>	13,150
<b>Cash flows from investing activities</b>			
Purchase of properties, plant and equipment . . . . .	29	<b>(1,145)</b>	(736)
Acquisition of an associate . . . . .	27	<b>(24)</b>	–
Proceeds from disposal of properties, plant and equipment . . . . .		<b>40</b>	34
Proceeds from disposal of investment properties . . . . .		<b>208</b>	473
Proceeds from dissolution/disposal of associates . . . . .	27	<b>1</b>	2
Dividends received from associates . . . . .	27	<b>3</b>	4
<b>Net cash outflow from investing activities . . . . .</b>		<b>(917)</b>	(223)
<b>Cash flows from financing activities</b>			
Dividends paid to equity holders of the Bank . . . . .		<b>(14,376)</b>	(4,563)
Dividends paid to minority shareholders . . . . .		<b>(157)</b>	(70)
<b>Net cash outflow from financing activities . . . . .</b>		<b>(14,533)</b>	(4,633)
Increase in cash and cash equivalents . . . . .		<b>23,800</b>	8,294
Cash and cash equivalents at 1 January . . . . .		<b>128,257</b>	119,963
<b>Cash and cash equivalents at 31 December . . . . .</b>	39(b)	<b>152,057</b>	128,257

The notes on pages 37 to 289 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 14/F, Bank of China Tower, 1 Garden Road, 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.

#### *Newly adopted HKFRSs*

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

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

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

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

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

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

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

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

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

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

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

- HKAS 1 (Revised) Presentation of Financial Statements (effective for annual periods beginning on or after 1 January 2009). HKAS 1 (Revised) affects the presentation of owner changes in equity and of comprehensive income. It does not change recognition, measurement, or disclosure of specific transaction and other events required by other HKFRSs. The expected impact is still being assessed but the probable key impact will be on the manner in which the Group presents financial statements.
- HKFRS 8 Operating Segments (effective for annual periods beginning on or after 1 January 2009). HKFRS 8 will supersede HKAS 14 Segment Reporting, under which segments were identified and reported on risk and return analysis. Items were reported on the accounting policies used for external reporting. Under HKFRS 8, which adopts the 'management approach', segments are components of an entity regularly reviewed by the entity's management. Items are presented based on internal reporting. The Group has assessed the impact of HKFRS 8 and concluded that the adoption of the new standard is unlikely to have a significant impact on the Group's results of operations and financial position.
- HK(IFRIC)-Int 13 Customer Loyalty Programmes (effective for annual periods beginning on or after 1 July 2008). HK(IFRIC)-Int 13 clarifies that when an entity provides customers with incentives to buy goods or services under a customer loyalty programme (for example, customers accumulate loyalty points to redeem free or discounted products or service), the fair value of the consideration received or receivable in respect of the initial sale shall be allocated between the award credits and the other components of the sale or service. The Group is still in the process of assessing its impact on its results of operations and financial position.

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

- HKAS 23 (Revised) Borrowing Costs (effective for annual periods beginning on or after 1 January 2009). The revised standard removes the option of recognising as an expense those borrowing costs relating to assets that take a substantial period of time to get ready for their intended use or sale (i.e. qualifying assets). This revised standard applies to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009. This revised standard is not relevant to the Group's operations because the Group does not require external borrowing to finance the development of any qualifying asset.
- HK(IFRIC)-Int 11, HKFRS 2 Group and Treasury Share Transactions (effective for annual periods beginning on or after 1 March 2007). HK(IFRIC)-Int 11 addresses how the share-based payment arrangement should be accounted for in the financial statements for the subsidiary that receives services from the employees. As the Group has not issued equity instruments for payment except those exempted under HKFRS 2, HK(IFRIC)-Int 11 is not relevant to the Group's operations.
- HK(IFRIC)-Int 12, Service Concession Arrangements (effective for annual periods beginning on or after 1 January 2008). HK(IFRIC)-Int 12 applies to companies that participate in service concession arrangements and provides guidance on the accounting by operators in public-to-private service concession arrangements. As the Group is not involved in service concession arrangements, HK(IFRIC)-Int 12 is not relevant to the Group's operations.
- HK(IFRIC)-Int 14, HKAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (effective for annual periods beginning on or after 1 January 2008). HK(IFRIC)-Int 14 provides guidance on assessing the limit in HKAS 19 on the amount of the surplus that can be recognised as an asset. It also explains how the pension asset or liability may be affected by a statutory or contractual minimum funding requirement. HK(IFRIC)-Int 14 is not relevant to the Group's operations because none of the Group's companies provide post-employment defined benefits to employees.

## **2.2 Consolidation**

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

### ***(1) Subsidiaries***

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

For acquisition of a company under common control, the merger accounting method will be applied. The principle of merger accounting is a way to combine companies under common control as though the business of the acquired company had always been carried out by the acquirer. The Group's consolidated financial statements represent the consolidated results, consolidated cash flows and consolidated financial position of the Group as if any such combination had occurred from the date when the Bank and the acquired company first came under common control (i.e. no fair value adjustment on the date of combination is required). The difference between the consideration and carrying amounts at the time of combination is treated as a merger reserve in equity. The effects of all transactions between the Group and

the acquired company, whether occurring before or after the combination, are eliminated in preparing the consolidated financial statements of the Group. The transaction costs for the combination will be expensed in the income statement.

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

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

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

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

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

## **(2) *Associates***

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The Group's investment in associates includes goodwill, net of accumulated impairment loss and any related accumulated foreign currency translation difference.

The Group's share of the post-acquisition profits or losses of associates is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the cost of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognise further losses unless the Group has incurred obligations or made payments on behalf of the associates.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred.

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



## **2.3 Segmental reporting**

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

## **2.4 Foreign currency translation**

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

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

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

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

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

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

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

## **2.5 Derivative financial instruments and hedge accounting**

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

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

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

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

The Group designates certain derivatives as hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedge). Hedge accounting is used for derivatives designated in this way.

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

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

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

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

## **2.6 Offsetting financial instruments**

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

## **2.7 Interest income and expense and fees and commission income and expense**

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

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

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

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
- 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 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.

### **(4) *Available-for-sale***

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

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

## **2.9 Financial liabilities**

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

### **(1) *Trading liabilities***

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

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

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

- eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring the financial liabilities or recognising the gains and losses on them on different bases; or
- applies to a group of financial assets, financial liabilities or both that is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the key management; or
- relates to financial liabilities containing one or more embedded derivative that significantly modifies the cash flow resulting from those financial liabilities.

Financial liabilities designated 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, debt securities in issue and other liabilities***

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

## **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.

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

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

## **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 Precious metals**

Precious metals comprise gold, silver and other precious metals. Precious metals are initially recognised at fair value and subsequently re-measured at their respective market prices as of the balance sheet date. Mark-to-market gains or losses on precious metals are included in net trading income.

## 2.13 Impairment of financial assets

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

- (i) significant financial difficulty of the issuer or obligor;
- (ii) a breach of contract, such as a default or delinquency in interest or principal payment;
- (iii) the Group granting to the borrower, for economic or legal reasons relating to the borrower’s financial difficulty, a concession that the lender would not otherwise consider;
- (iv) it becoming probable that the borrower will enter into bankruptcy or other financial reorganisation;
- (v) the disappearance of an active market or downgrading below investment grade level for that financial asset because of financial difficulties; or
- (vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
  - adverse changes in the payment status of borrowers in the group; or
  - national or local economic conditions that correlate with defaults on the assets in the group.

### *(1) Assets carried at amortised cost*

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

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

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral.

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.

## **(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.

### **2.14 Impairment of investment in subsidiaries and associates 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.

### **2.15 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.

## 2.16 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.

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

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



## **(2) *Property under development***

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

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

### **2.17 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.

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.

## **2.18 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.

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

### ***(2) Finance leases on properties***

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

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

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

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

## **2.19 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.

## **2.20 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.

## **2.21 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.

### ***(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.

## **2.22 Deferred income taxes**

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

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

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

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

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

### **2.23 Repossessed assets**

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

### **2.24 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.

### **2.25 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.

### **2.26 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.

### **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 delinquency, prepayment rate, credit enhancement, 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.

#### **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. As at 31 December 2007, the fair value of the entire portfolio of held-to-maturity investments is approximately equal to its carrying amount.

#### **4. Financial risk management**

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

##### **Financial risk management framework**

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

The Board of Directors, representing the interests of shareholders, is the highest decision making authority of the Group and has the ultimate responsibility for risk management. The Board, with the assistance of the Risk Committee, 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 Risk 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 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 Chief Risk Officer ("CRO") assists the CE in fulfilling his responsibilities for the day-to-day management of risks. The CRO 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 CRO 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.

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

##### **Product development**

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

In accordance with the strategic objectives set by the Management, the respective product management units are responsible for formulating business and product development plans, and ESPD shall ensure the plans are aligned with the Bank's overall strategies. Risk Management Department, Legal and Compliance Department and Finance Department etc. are accountable for risk assessment and review.



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

#### **4.1 Credit Risk**

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

##### ***Credit risk management framework***

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

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

A Chief Credit Officer ("CCO") has been appointed effective from February 2007. The CCO reports directly to the CRO and 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. The Risk Management Department ("RMD") has the primary responsibility for drafting, reviewing and updating credit risk management policies and procedures. The Group's principal banking subsidiaries, Nanyang and Chiyu, have also formulated their own credit risk policies that are consistent with those of the Group. These subsidiaries execute their risk management strategies independently and report to the Group's management on a regular basis.

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

##### ***Credit risk measurement and control***

###### ***Loans and advances***

Different credit approval and control procedures are adopted according to the level of risk associated with the customer, counterparty or transaction. Corporate and financial institution credit applications are independently reviewed and objectively assessed by risk management units. A small business credit scorecard 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, personal loans and credit cards. The Credit Risk Assessment Committee comprising experts from the Group's credit and other functions is responsible for making an independent assessment of all credit facilities which require the approval of Deputy Chief Executives or above.

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

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

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

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

#### *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 index on a portfolio basis. Collaterals are insured with the Group as the beneficiary. In the personal sector, the main types of collateral are real properties, cash deposits, securities and investment funds. In the commercial and industrial sector, the main types of collateral are real properties, securities, receivables, cash deposits and machinery.

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

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



## Credit exposures

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

	The Group	
	2007	2006
	HK\$'m	HK\$'m
Credit risk exposures relating to on-balance sheet assets are as follows:		
Cash and balances with banks and other financial institutions .	159,052	105,236
Placements with banks and other financial institutions maturing between 1 and 12 months . . . . .	53,154	56,373
Financial assets at fair value through profit or loss		
– debt securities . . . . .	9,881	13,133
Derivative financial instruments . . . . .	14,477	7,393
Hong Kong SAR Government certificates of indebtedness . . . .	32,770	34,750
Advances and other accounts . . . . .	420,212	352,844
Investment in securities		
– debt securities – available-for-sale . . . . .	100,073	100,339
– debt securities – held-to-maturity . . . . .	165,428	165,588
– debt securities – loans and receivables . . . . .	31,102	36,114
Other assets . . . . .	20,776	14,630
Credit risk exposures relating to off-balance sheet items are as follows:		
Letters of guarantee issued . . . . .	9,407	8,778
Loan commitment and other credit related liabilities . . . . .	221,901	179,008
	<u>1,238,233</u>	<u>1,074,186</u>

	The Bank	
	2007	2006
	HK\$'m	HK\$'m
Credit risk exposures relating to on-balance sheet assets are as follows:		
Cash and balances with banks and other financial institutions .	134,020	85,188
Placements with banks and other financial institutions maturing between 1 and 12 months . . . . .	31,887	38,044
Financial assets at fair value through profit or loss		
– debt securities . . . . .	6,042	10,529
Derivative financial instruments . . . . .	13,972	7,092
Hong Kong SAR Government certificates of indebtedness . . . .	32,770	34,750
Advances and other accounts . . . . .	341,896	293,296
Investment in securities		
– debt securities – available-for-sale . . . . .	97,330	97,475
– debt securities – held-to-maturity . . . . .	150,873	146,473
– debt securities – loans and receivables . . . . .	22,784	30,750
Other assets . . . . .	18,560	14,095
Credit risk exposures relating to off-balance sheet items are as follows:		
Letters of guarantee issued . . . . .	10,669	7,943
Loan commitment and other credit related liabilities . . . . .	145,926	110,524
	<u>1,006,729</u>	<u>876,159</u>

### *Gross loans and advances*

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

	<b>The Group</b>	
	<b>2007</b>	<b>2006</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Advances to customers		
Personal		
– Mortgages . . . . .	<b>121,663</b>	111,870
– Credit cards . . . . .	<b>5,641</b>	4,713
– Others . . . . .	<b>14,382</b>	12,779
Corporate		
– Commercial loans . . . . .	<b>247,079</b>	200,849
– Trade finance . . . . .	<b>24,275</b>	16,865
	<b>413,040</b>	347,076
Trade bills . . . . .	<b>5,334</b>	3,128
Advances to banks and other financial institutions . . . . .	<b>3,223</b>	3,743
Total . . . . .	<b>421,597</b>	353,947

	<b>The Bank</b>	
	<b>2007</b>	<b>2006</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Advances to customers		
Personal		
– Mortgages . . . . .	<b>105,275</b>	97,036
– Others . . . . .	<b>9,541</b>	9,093
Corporate		
– Commercial loans . . . . .	<b>199,665</b>	168,020
– Trade finance . . . . .	<b>20,726</b>	13,776
	<b>335,207</b>	287,925
Trade bills . . . . .	<b>4,421</b>	2,686
Advances to banks and other financial institutions . . . . .	<b>3,222</b>	3,491
Total . . . . .	<b>342,850</b>	294,102

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.

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 reorganization; 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:

	The Group			
	2007			
	Pass	Special mention	Substandard or below	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers				
Personal				
– Mortgages . . . . .	118,583	229	112	118,924
– Credit cards . . . . .	5,397	–	–	5,397
– Others . . . . .	13,715	78	20	13,813
Corporate				
– Commercial loans . . . . .	243,140	908	349	244,397
– Trade finance . . . . .	23,052	795	4	23,851
	403,887	2,010	485	406,382
Trade bills . . . . .	5,255	74	1	5,330
Advances to banks and other financial institutions . . . . .	3,223	–	–	3,223
Total . . . . .	412,365	2,084	486	414,935

	The Group			
	2006			
	Pass	Special mention	Substandard or below	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers				
Personal				
– Mortgages . . . . .	108,469	219	91	108,779
– Credit cards . . . . .	4,503	–	–	4,503
– Others . . . . .	12,043	59	41	12,143
Corporate				
– Commercial loans . . . . .	195,867	1,862	131	197,860
– Trade finance . . . . .	15,392	1,101	1	16,494
	336,274	3,241	264	339,779
Trade bills . . . . .	3,101	23	–	3,124
Advances to banks and other financial institutions . . . . .	3,743	–	–	3,743
Total . . . . .	343,118	3,264	264	346,646

The Bank				
2007				
	Pass	Special mention	Substandard or below	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers				
Personal				
– Mortgages . . . . .	102,647	193	106	102,946
– Others . . . . .	9,011	54	19	9,084
Corporate				
– Commercial loans . . . . .	196,344	713	290	197,347
– Trade finance . . . . .	19,698	680	4	20,382
	327,700	1,640	419	329,759
Trade bills . . . . .	4,344	72	1	4,417
Advances to banks and other financial institutions . . . . .	3,222	–	–	3,222
Total . . . . .	335,266	1,712	420	337,398

The Bank				
2006				
	Pass	Special mention	Substandard or below	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers				
Personal				
– Mortgages . . . . .	94,169	200	79	94,448
– Others . . . . .	8,483	52	40	8,575
Corporate				
– Commercial loans . . . . .	163,909	1,661	121	165,691
– Trade finance . . . . .	12,463	977	–	13,440
	279,024	2,890	240	282,154
Trade bills . . . . .	2,663	22	–	2,685
Advances to banks and other financial institutions . . . . .	3,491	–	–	3,491
Total . . . . .	285,178	2,912	240	288,330

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:

	The Group				
	2007				
	Overdue for 3 months or less	Overdue for 6 months or less but over 3 months	Overdue for 1 year or less but over 6 months	Overdue for over 1 year	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers					
Personal					
– Mortgages . . . . .	2,465	77	45	48	2,635
– Credit cards . . . . .	221	–	–	–	221
– Others . . . . .	428	3	12	31	474
Corporate					
– Commercial loans . . . . .	1,997	54	42	203	2,296
– Trade finance . . . . .	315	7	2	11	335
	5,426	141	101	293	5,961
Trade bills . . . . .	4	–	–	–	4
Total . . . . .	5,430	141	101	293	5,965

	The Group				
	2006				
	Overdue for 3 months or less	Overdue for 6 months or less but over 3 months	Overdue for 1 year or less but over 6 months	Overdue for over 1 year	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers					
Personal					
– Mortgages . . . . .	2,754	77	77	49	2,957
– Credit cards . . . . .	193	17	–	–	210
– Others . . . . .	467	9	22	39	537
Corporate					
– Commercial loans . . . . .	2,056	31	24	337	2,448
– Trade finance . . . . .	213	2	1	13	229
	5,683	136	124	438	6,381
Trade bills . . . . .	3	–	–	–	3
Total . . . . .	5,686	136	124	438	6,384

	The Bank				
	2007				
	Overdue for 3 months or less	Overdue for 6 months or less but over 3 months	Overdue for 1 year or less but over 6 months	Overdue for over 1 year	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers					
Personal					
– Mortgages . . . . .	2,076	73	44	47	2,240
– Others . . . . .	324	3	12	31	370
Corporate					
– Commercial loans. . . . .	1,700	45	35	200	1,980
– Trade finance. . . . .	288	6	1	11	306
	4,388	127	92	289	4,896
Trade bills . . . . .	4	–	–	–	4
Total . . . . .	4,392	127	92	289	4,900

	The Bank				
	2006				
	Overdue for 3 months or less	Overdue for 6 months or less but over 3 months	Overdue for 1 year or less but over 6 months	Overdue for over 1 year	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers					
Personal					
– Mortgages . . . . .	2,290	73	75	43	2,481
– Others . . . . .	370	5	10	39	424
Corporate					
– Commercial loans . . . . .	1,530	25	21	311	1,887
– Trade finance . . . . .	185	1	–	13	199
	4,375	104	106	406	4,991
Trade bills . . . . .	1	–	–	–	1
Total . . . . .	4,376	104	106	406	4,992

The Group		
	2007	2006
	HK\$m	HK\$m
Current market value of collateral held against the covered portion of advances to customers . . . . .	<u>11,428</u>	<u>12,461</u>
Covered portion of advances to customers . . . . .	<u>4,929</u>	<u>5,645</u>
Uncovered portion of advances to customers . . . . .	<u>1,032</u>	<u>736</u>

	The Bank	
	2007	2006
	HK\$'m	HK\$'m
Current market value of collateral held against the covered portion of advances to customers . . . . .	<u><b>9,742</b></u>	<u>10,474</u>
Covered portion of advances to customers . . . . .	<u><b>4,225</b></u>	<u>4,745</u>
Uncovered portion of advances to customers . . . . .	<u><b>671</b></u>	<u>246</u>

(c) *Impaired advances*

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

	The Group	
	2007	2006
	HK\$'m	HK\$'m
Advances to customers		
Personal		
– Mortgages . . . . .	<b>104</b>	134
– Credit cards . . . . .	<b>23</b>	–
– Others . . . . .	<b>95</b>	99
Corporate		
– Commercial loans . . . . .	<b>386</b>	541
– Trade finance . . . . .	<u><b>89</b></u>	<u>142</u>
	<b>697</b>	916
Trade bills . . . . .	<u>–</u>	<u>1</u>
Total . . . . .	<u><b>697</b></u>	<u>917</u>
Loan impairment allowances made in respect of such advances . .	<u><b>403</b></u>	<u>546</u>

	The Bank	
	2007	2006
	HK\$'m	HK\$'m
Advances to customers		
Personal		
– Mortgages . . . . .	<b>89</b>	107
– Others . . . . .	<b>87</b>	94
Corporate		
– Commercial loans . . . . .	<b>338</b>	442
– Trade finance . . . . .	<u><b>38</b></u>	<u>137</u>
	<b>552</b>	780
Trade bills . . . . .	<u>–</u>	<u>–</u>
Total . . . . .	<u><b>552</b></u>	<u>780</u>
Loan impairment allowances made in respect of such advances . .	<u><b>306</b></u>	<u>470</u>

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



	<b>The Group</b>	
	<b>2007</b>	<b>2006</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Current market value of collateral held against the covered portion of advances to customers . . . . .	<u><b>559</b></u>	<u><b>614</b></u>
Covered portion of advances to customers . . . . .	<u><b>410</b></u>	<u><b>470</b></u>
Uncovered portion of advances to customers . . . . .	<u><b>287</b></u>	<u><b>446</b></u>

	<b>The Bank</b>	
	<b>2007</b>	<b>2006</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Current market value of collateral held against the covered portion of advances to customers . . . . .	<u><b>506</b></u>	<u><b>508</b></u>
Covered portion of advances to customers . . . . .	<u><b>364</b></u>	<u><b>424</b></u>
Uncovered portion of advances to customers . . . . .	<u><b>188</b></u>	<u><b>356</b></u>

Classified or impaired advances to customers are analysed as follows:

	<b>The Group</b>	
	<b>2007</b>	<b>2006</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Gross classified or impaired advances to customers . . . . .	<u><b>1,803</b></u>	<u><b>1,988</b></u>
Gross classified or impaired advances to customers as a percentage of gross advances to customers . . . . .	<u><b>0.44%</b></u>	<u><b>0.57%</b></u>
Individually assessed loan impairment allowances made in respect of such advances . . . . .	<u><b>381</b></u>	<u><b>546</b></u>

	<b>The Bank</b>	
	<b>2007</b>	<b>2006</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Gross classified or impaired advances to customers . . . . .	<u><b>1,551</b></u>	<u><b>1,748</b></u>
Gross classified or impaired advances to customers as a percentage of gross advances to customers . . . . .	<u><b>0.46%</b></u>	<u><b>0.61%</b></u>
Individually assessed loan impairment allowances made in respect of such advances . . . . .	<u><b>306</b></u>	<u><b>470</b></u>

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

(d) *Advances overdue for more than 3 months*

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

The Group				
2007			2006	
Amount	% of gross advances to customers	Amount	% of gross advances to customers	
HK\$'m		HK\$'m		
Gross advances to customers which have been overdue for:				
– six months or less but over three months . . . . .	242	0.06%	318	0.09%
– one year or less but over six months . .	163	0.04%	202	0.06%
– over one year . . . . .	652	0.16%	838	0.24%
Advances overdue for over three months . .	1,057	0.26%	1,358	0.39%
Individually assessed loan impairment allowances made in respect of such advances . . . . .				
	305		438	

The Bank				
2007			2006	
Amount	% of gross advances to customers	Amount	% of gross advances to customers	
HK\$'m		HK\$'m		
Gross advances to customers which have been overdue for:				
– six months or less but over three months . . . . .	188	0.06%	271	0.10%
– one year or less but over six months . .	136	0.04%	181	0.06%
– over one year . . . . .	625	0.18%	784	0.27%
Advances overdue for over three months . .	949	0.28%	1,236	0.43%
Individually assessed loan impairment allowances made in respect of such advances . . . . .				
	276		428	

	The Group	
	2007	2006
	HK\$'m	HK\$'m
Current market value of collateral held against the covered portion of advances to customers . . . . .	<u>1,970</u>	<u>2,175</u>
Covered portion of advances to customers . . . . .	<u>847</u>	<u>987</u>
Uncovered portion of advances to customers . . . . .	<u>210</u>	<u>371</u>

	The Bank	
	2007	2006
	HK\$'m	HK\$'m
Current market value of collateral held against the covered portion of advances to customers . . . . .	<u>1,884</u>	<u>1,946</u>
Covered portion of advances to customers . . . . .	<u>796</u>	<u>913</u>
Uncovered portion of advances to customers . . . . .	<u>153</u>	<u>323</u>

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

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

(e) *Rescheduled advances*

	The Group			
	2007		2006	
	Amount	% of gross advances to customers	Amount	% of gross advances to customers
	HK\$'m		HK\$'m	
Rescheduled advances to customers net of amounts included in advances overdue for more than 3 months . . . . .	<u>186</u>	<u>0.05%</u>	<u>216</u>	<u>0.06%</u>

The Bank			
2007		2006	
Amount	% of gross advances to customers	Amount	% of gross advances to customers
HK\$m		HK\$m	

Rescheduled advances to customers net of  
amounts included in advances overdue  
for more than 3 months . . . . .

<u>121</u>	<u>0.04%</u>	<u>141</u>	<u>0.05%</u>
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As at 31 December 2007, the total rescheduled advances to customers during the year amounted to HK\$88 million (2006: HK\$62 million) and HK\$80 million (2006: HK\$41 million) for the Group and the Bank respectively.

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

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.

(f) *Concentration of advances to customers*

(i) Sectoral analysis of gross advances to customers

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

	The Group					
	2007					
	Gross advances	% Covered by collateral or other security	Classified or impaired	Overdue*	Individually assessed impairment allowances	Collectively assessed impairment allowances
	HK\$m		HK\$m	HK\$m	HK\$m	HK\$m
Loans for use in Hong Kong						
Industrial, commercial and financial						
– Property development . . .	17,979	33.97%	16	18	3	52
– Property investment . . . .	65,963	86.50%	343	961	14	187
– Financial concerns . . . . .	12,346	6.05%	–	14	–	43
– Stockbrokers . . . . .	242	12.10%	–	–	–	–
– Wholesale and retail trade . . . . .	13,572	65.05%	238	382	85	41
– Manufacturing . . . . .	14,468	58.08%	138	550	37	48
– Transport and transport equipment . . . . .	21,001	21.11%	3	25	1	60
– Recreational activities . .	30	93.53%	–	–	–	–
– Information technology . .	2,009	37.39%	–	2	–	6
– Others . . . . .	21,046	41.70%	90	584	16	65
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme . . . . .	13,969	99.78%	129	599	8	13
– Loans for purchase of other residential properties . . . . .	106,583	99.87%	284	2,078	18	81
– Credit card advances . . .	5,761	–	23	245	–	63
– Others . . . . .	10,686	79.57%	119	314	50	14
Total loans for use in						
Hong Kong . . . . .	305,655	73.30%	1,383	5,772	232	673
Trade finance . . . . .	24,275	40.71%	105	399	73	77
Loans for use outside						
Hong Kong . . . . .	83,110	39.76%	315	375	76	254
Gross advances to customers .	413,040	64.64%	1,803	6,546	381	1,004

The Bank						
2007						
	Gross advances	% Covered by collateral or other security	Classified or impaired	Overdue*	Individually assessed impairment allowances	Collectively assessed impairment allowances
	HK\$'m		HK\$'m	HK\$'m	HK\$'m	HK\$'m
Loans for use in Hong Kong						
Industrial, commercial and financial						
– Property development . . .	15,104	33.54%	16	17	3	36
– Property investment . . . .	55,430	86.84%	329	844	14	136
– Financial concerns . . . . .	13,986	3.52%	–	5	–	33
– Stockbrokers . . . . .	234	9.34%	–	–	–	–
– Wholesale and retail trade . . . . .	11,639	63.13%	215	315	79	31
– Manufacturing . . . . .	11,061	62.01%	115	470	33	31
– Transport and transport equipment . . . . .	17,374	23.34%	3	15	1	42
– Recreational activities . .	29	93.30%	–	–	–	–
– Information technology . .	1,550	47.87%	–	1	–	4
– Others . . . . .	15,323	35.00%	85	521	13	38
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme . . . . .	12,224	99.85%	119	502	8	12
– Loans for purchase of other residential properties . . . . .	92,284	99.91%	257	1,782	15	72
– Credit card advances . . .	–	–	–	–	–	–
– Others . . . . .	7,470	87.81%	109	241	48	6
Total loans for use in						
Hong Kong . . . . .	253,708	74.52%	1,248	4,713	214	441
Trade finance . . . . .	20,726	38.55%	54	337	23	59
Loans for use outside						
Hong Kong . . . . .	60,773	35.13%	249	315	69	148
Gross advances to customers .	335,207	65.16%	1,551	5,365	306	648

The Group						
2006						
	Gross advances	% Covered by collateral or other security	Classified or impaired	Overdue*	Individually assessed impairment allowances	Collectively assessed impairment allowances
	HK\$'m		HK\$'m	HK\$'m	HK\$'m	HK\$'m
Loans for use in Hong Kong						
Industrial, commercial and financial						
– Property development . . .	19,290	19.33%	24	281	4	37
– Property investment . . . .	55,943	85.49%	320	1,170	28	110
– Financial concerns . . . . .	10,721	8.48%	4	24	–	26
– Stockbrokers . . . . .	65	25.65%	–	–	–	–
– Wholesale and retail trade . . . . .	13,019	61.87%	248	456	61	26
– Manufacturing . . . . .	12,417	54.27%	154	402	42	26
– Transport and transport equipment . . . . .	15,548	17.55%	4	17	2	30
– Recreational activities . .	33	91.36%	–	–	–	–
– Information technology . .	1,586	57.12%	–	1	–	3
– Others . . . . .	20,158	33.13%	148	404	29	41
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme . . . . .	14,236	99.14%	141	679	20	4
– Loans for purchase of other residential properties . . . . .	96,953	99.11%	359	2,350	23	29
– Credit card advances . . .	4,806	–	17	210	–	65
– Others . . . . .	9,501	83.33%	159	435	57	9
Total loans for use in						
Hong Kong . . . . .	274,276	71.36%	1,578	6,429	266	406
Trade finance . . . . .	16,865	40.98%	157	365	98	35
Loans for use outside						
Hong Kong . . . . .	55,935	24.30%	253	329	182	116
Gross advances to customers .	<u>347,076</u>	<u>62.30%</u>	<u>1,988</u>	<u>7,123</u>	<u>546</u>	<u>557</u>

The Bank						
2006						
	Gross advances	% Covered by collateral or other security	Classified or impaired	Overdue*	Individually assessed impairment allowances	Collectively assessed impairment allowances
	HK\$m		HK\$m	HK\$m	HK\$m	HK\$m
Loans for use in Hong Kong						
Industrial, commercial and financial						
– Property development . . .	16,858	21.22%	24	176	4	28
– Property investment . . . .	47,753	88.82%	310	969	28	80
– Financial concerns . . . . .	11,167	4.92%	4	24	–	19
– Stockbrokers . . . . .	63	23.65%	–	–	–	–
– Wholesale and retail trade . . . . .	11,330	60.54%	233	389	60	19
– Manufacturing . . . . .	10,102	53.20%	132	335	39	17
– Transport and transport equipment . . . . .	13,435	19.07%	4	15	2	22
– Recreational activities . .	27	91.06%	–	–	–	–
– Information technology . .	1,574	56.72%	–	–	–	2
– Others . . . . .	15,413	31.78%	138	326	28	26
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme . . . . .	12,280	99.68%	128	536	20	4
– Loans for purchase of other residential properties . . . . .	84,253	99.87%	319	2,010	18	25
– Credit card advances . . .	–	–	–	–	–	–
– Others . . . . .	<u>7,287</u>	<u>89.37%</u>	<u>148</u>	<u>379</u>	<u>54</u>	<u>2</u>
Total loans for use in						
Hong Kong . . . . .	231,542	73.45%	1,440	5,159	253	244
Trade finance . . . . .	13,776	44.01%	152	329	95	23
Loans for use outside						
Hong Kong . . . . .	<u>42,607</u>	<u>22.59%</u>	<u>156</u>	<u>186</u>	<u>122</u>	<u>69</u>
Gross advances to customers .	<u>287,925</u>	<u>64.51%</u>	<u>1,748</u>	<u>5,674</u>	<u>470</u>	<u>336</u>

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



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

	The Group			
	2007		2006	
	New impairment allowances	Classified or impaired loans written off	New impairment allowances	Classified or impaired loans written off
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Loans for use in Hong Kong				
Industrial, commercial and financial				
– Property development . . . . .	25	–	8	–
– Property investment . . . . .	99	9	39	288
– Financial concerns . . . . .	22	–	2	–
– Stockbrokers . . . . .	–	–	–	–
– Wholesale and retail trade . . . . .	149	98	90	81
– Manufacturing . . . . .	58	18	170	207
– Transport and transport equipment . . . . .	31	–	2	–
– Recreational activities . . . . .	–	–	–	6
– Information technology . . . . .	3	–	–	–
– Others . . . . .	77	5	64	4
Individuals				
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme . . . . .	13	4	24	4
– Loans for purchase of other residential properties . . . . .	79	1	34	7
– Credit card advances . . . . .	124	126	138	116
– Others . . . . .	50	50	106	50
Total loans for use in Hong Kong . . . . .	730	311	677	763
Trade finance . . . . .	76	15	99	37
Loans for use outside Hong Kong . . . . .	149	1	65	48
Gross advances to customers . . . . .	955	327	841	848

The Bank				
	2007		2006	
	New impairment allowances	Classified or impaired loans written off	New impairment allowances	Classified or impaired loans written off
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Loans for use in Hong Kong				
Industrial, commercial and financial				
– Property development . . . . .	18	–	7	–
– Property investment . . . . .	73	7	29	288
– Financial concerns . . . . .	17	–	–	–
– Stockbrokers . . . . .	–	–	–	–
– Wholesale and retail trade . . . . .	134	97	83	33
– Manufacturing . . . . .	47	14	116	139
– Transport and transport equipment . . . . .	21	–	2	–
– Recreational activities . . . . .	–	–	–	–
– Information technology . . . . .	2	–	–	–
– Others . . . . .	24	5	53	4
Individuals				
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme . . . . .	12	4	24	4
– Loans for purchase of other residential properties . . . . .	69	–	25	7
– Credit card advances . . . . .	–	–	–	–
– Others . . . . .	19	21	78	24
Total loans for use in Hong Kong . . . . .	436	148	417	499
Trade finance . . . . .	43	–	51	–
Loans for use outside Hong Kong . . . . .	88	–	41	15
Gross advances to customers . . . . .	<u>567</u>	<u>148</u>	<u>509</u>	<u>514</u>

(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**

	<b>The Group</b>	
	<b>2007</b>	<b>2006</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Hong Kong . . . . .	<b>351,080</b>	306,897
Mainland China . . . . .	<b>39,050</b>	22,984
Others . . . . .	<b>22,910</b>	17,195
	<b><u>413,040</u></b>	<b><u>347,076</u></b>

	<b>The Bank</b>	
	<b>2007</b>	<b>2006</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Hong Kong . . . . .	<b>291,521</b>	258,407
Mainland China . . . . .	<b>25,260</b>	14,623
Others . . . . .	<b>18,426</b>	14,895
	<b><u>335,207</u></b>	<b><u>287,925</u></b>

**Collectively assessed loan impairment allowances in respect of the gross advances to customers**

	<b>The Group</b>	
	<b>2007</b>	<b>2006</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Hong Kong . . . . .	<b>827</b>	480
Mainland China . . . . .	<b>124</b>	54
Others . . . . .	<b>53</b>	23
	<b><u>1,004</u></b>	<b><u>557</u></b>

	<b>The Bank</b>	
	<b>2007</b>	<b>2006</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Hong Kong . . . . .	<b>555</b>	299
Mainland China . . . . .	<b>58</b>	20
Others . . . . .	<b>35</b>	17
	<b><u>648</u></b>	<b><u>336</u></b>

## Overdue advances

	The Group	
	2007	2006
	HK\$m	HK\$m
Hong Kong . . . . .	6,221	6,815
Mainland China . . . . .	278	230
Others . . . . .	47	78
	<u>6,546</u>	<u>7,123</u>

	The Bank	
	2007	2006
	HK\$m	HK\$m
Hong Kong . . . . .	5,149	5,577
Mainland China . . . . .	174	45
Others . . . . .	42	52
	<u>5,365</u>	<u>5,674</u>

## Individually assessed loan impairment allowances in respect of the overdue advances

	The Group	
	2007	2006
	HK\$m	HK\$m
Hong Kong . . . . .	284	449
Mainland China . . . . .	46	7
Others . . . . .	2	4
	<u>332</u>	<u>460</u>

	The Bank	
	2007	2006
	HK\$m	HK\$m
Hong Kong . . . . .	241	435
Mainland China . . . . .	35	3
Others . . . . .	2	4
	<u>278</u>	<u>442</u>

## Collectively assessed loan impairment allowances in respect of the overdue advances

	The Group	
	2007	2006
	HK\$'m	HK\$'m
Hong Kong . . . . .	<b>60</b>	47
Mainland China . . . . .	<u><b>10</b></u>	<u>9</u>
	<u><b>70</b></u>	<u><b>56</b></u>

	The Bank	
	2007	2006
	HK\$'m	HK\$'m
Hong Kong . . . . .	<b>26</b>	17
Mainland China . . . . .	<u><b>1</b></u>	<u>—</u>
	<u><b>27</b></u>	<u><b>17</b></u>

## Classified or impaired advances

	The Group	
	2007	2006
	HK\$'m	HK\$'m
Hong Kong . . . . .	<b>1,572</b>	1,909
Mainland China . . . . .	<b>223</b>	52
Others . . . . .	<u><b>8</b></u>	<u>27</u>
	<u><b>1,803</b></u>	<u><b>1,988</b></u>

	The Bank	
	2007	2006
	HK\$'m	HK\$'m
Hong Kong . . . . .	<b>1,342</b>	1,691
Mainland China . . . . .	<b>201</b>	30
Others . . . . .	<u><b>8</b></u>	<u>27</u>
	<u><b>1,551</b></u>	<u><b>1,748</b></u>

**Individually assessed loan impairment allowances in respect of the classified or impaired advances**

	<b>The Group</b>	
	<b>2007</b>	<b>2006</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Hong Kong . . . . .	<b>333</b>	526
Mainland China . . . . .	<b>46</b>	13
Others . . . . .	<b>2</b>	7
	<b><u>381</u></b>	<b><u>546</u></b>

	<b>The Bank</b>	
	<b>2007</b>	<b>2006</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Hong Kong . . . . .	<b>269</b>	454
Mainland China . . . . .	<b>35</b>	9
Others . . . . .	<b>2</b>	7
	<b><u>306</u></b>	<b><u>470</u></b>

**Collectively assessed loan impairment allowances in respect of the classified or impaired advances**

	<b>The Group</b>	
	<b>2007</b>	<b>2006</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Hong Kong . . . . .	<b>19</b>	15
Mainland China . . . . .	<b>6</b>	8
	<b><u>25</u></b>	<b><u>23</u></b>

	<b>The Bank</b>	
	<b>2007</b>	<b>2006</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>
Hong Kong . . . . .	<b>2</b>	1
Mainland China . . . . .	<b>1</b>	—
	<b><u>3</u></b>	<b><u>1</u></b>

### ***Reposessed 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:

	The Group		The Bank	
	Carrying Value		Carrying Value	
	2007	2006	2007	2006
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Commercial properties . . . . .	10	45	6	1
Residential properties . . . . .	43	140	40	81
Others . . . . .	—	1	—	—
	<u>53</u>	<u>186</u>	<u>46</u>	<u>82</u>

The estimated market value of reposessed assets held by the Group and the Bank as at 31 December 2007 amounted to HK\$116 million (2006: 309 million) and HK\$91 million (2006: HK\$163 million) respectively. They comprise properties in respect of which the Group and the Bank have 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 reposessed 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

### ***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.

	The Group				
	2007				
	Financial assets at fair value through profit or loss	Available- for-sale securities	Held-to- maturity securities	Loans and receivables	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Aaa . . . . .	733	42,166	47,912	—	90,811
Aa1 to Aa3 . . . . .	2,108	28,588	60,364	—	91,060
A1 to A3 . . . . .	1,647	10,686	16,376	—	28,709
Lower than A3 . . . . .	1,136	1,459	1,313	—	3,908
Unrated . . . . .	4,257	16,618	35,725	31,102	87,702
	<u>9,881</u>	<u>99,517</u>	<u>161,690</u>	<u>31,102</u>	<u>302,190</u>

The Group					
2006					
Financial assets at fair value through profit or loss	Available- for-sale securities	Held-to- maturity securities	Loans and receivables	Total	
HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	
Aaa . . . . .	835	49,889	58,924	–	109,648
Aa1 to Aa3 . . . . .	5,715	17,797	64,848	–	88,360
A1 to A3 . . . . .	1,351	12,955	18,685	–	32,991
Lower than A3 . . . . .	414	881	3,422	–	4,717
Unrated . . . . .	4,818	18,817	19,709	36,114	79,458
	<u>13,133</u>	<u>100,339</u>	<u>165,588</u>	<u>36,114</u>	<u>315,174</u>
The Bank					
2007					
Financial assets at fair value through profit or loss	Available- for-sale securities	Held-to- maturity securities	Loans and receivables	Total	
HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	
Aaa . . . . .	76	42,165	46,607	–	88,848
Aa1 to Aa3 . . . . .	1,381	28,588	53,265	–	83,234
A1 to A3 . . . . .	1,010	10,429	14,802	–	26,241
Lower than A3 . . . . .	181	1,301	461	–	1,943
Unrated . . . . .	3,394	14,291	32,000	22,784	72,469
	<u>6,042</u>	<u>96,774</u>	<u>147,135</u>	<u>22,784</u>	<u>272,735</u>
The Bank					
2006					
Financial assets at fair value through profit or loss	Available- for-sale securities	Held-to- maturity securities	Loans and receivables	Total	
HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	
Aaa . . . . .	470	49,687	53,028	–	103,185
Aa1 to Aa3 . . . . .	4,526	17,376	55,679	–	77,581
A1 to A3 . . . . .	1,078	12,505	16,572	–	30,155
Lower than A3 . . . . .	125	727	2,373	–	3,225
Unrated . . . . .	4,330	17,180	18,821	30,750	71,081
	<u>10,529</u>	<u>97,475</u>	<u>146,473</u>	<u>30,750</u>	<u>285,227</u>



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

The Group					
2007					
Financial assets at fair value through profit or loss	Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total	
HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	
Aaa . . . . .	29	2,486	5,859	8,572	16,946
Aa1 to Aa3 . . . . .	3,843	8,166	20,467	19,365	51,841
A1 to A3 . . . . .	20	3,818	3,765	80	7,683
Lower than A3 . . . . .	70	440	50	–	560
Unrated . . . . .	295	1,708	5,584	3,085	10,672
	<u>4,257</u>	<u>16,618</u>	<u>35,725</u>	<u>31,102</u>	<u>87,702</u>

The Group					
2006					
Financial assets at fair value through profit or loss	Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total	
HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	
Aaa . . . . .	10	3,422	1,689	3,494	8,615
Aa1 to Aa3 . . . . .	4,317	10,586	10,498	29,463	54,864
A1 to A3 . . . . .	97	3,191	4,974	3,080	11,342
Lower than A3 . . . . .	20	349	464	–	833
Unrated . . . . .	374	1,269	2,084	77	3,804
	<u>4,818</u>	<u>18,817</u>	<u>19,709</u>	<u>36,114</u>	<u>79,458</u>

The Bank					
2007					
Financial assets at fair value through profit or loss	Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total	
HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	
Aaa . . . . .	–	2,486	5,519	7,810	15,815
Aa1 to Aa3 . . . . .	3,304	6,984	17,720	11,967	39,975
A1 to A3 . . . . .	20	3,694	3,755	–	7,469
Lower than A3 . . . . .	70	440	50	–	560
Unrated . . . . .	–	687	4,956	3,007	8,650
	<u>3,394</u>	<u>14,291</u>	<u>32,000</u>	<u>22,784</u>	<u>72,469</u>

The Bank					
2006					
Financial assets at fair value through profit or loss	Available- for-sale securities	Held-to- maturity securities	Loans and receivables	Total	
HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	
Aaa . . . . .	10	3,422	1,689	3,004	8,125
Aa1 to Aa3 . . . . .	4,228	9,899	10,155	26,066	50,348
A1 to A3 . . . . .	72	3,191	4,974	1,680	9,917
Lower than A3 . . . . .	20	349	464	–	833
Unrated . . . . .	–	319	1,539	–	1,858
	<u>4,330</u>	<u>17,180</u>	<u>18,821</u>	<u>30,750</u>	<u>71,081</u>

The table below represents an analysis of the carrying value of investment in securities by credit rating and credit risk characteristic, based on Moody's ratings or their equivalent to the respective issues of the debt securities.

The Group				
2007				
US subprime mortgage related	Alt-A	Others	Total	
HK\$'m	HK\$'m	HK\$'m	HK\$'m	
Aaa . . . . .	4,118	6,567	83,687	94,372
Aa1 to Aa3 . . . . .	–	–	88,952	88,952
A1 to A3 . . . . .	–	–	27,062	27,062
Lower than A3 . . . . .	–	–	2,772	2,772
Unrated* . . . . .	–	–	83,445	83,445
	<u>4,118</u>	<u>6,567</u>	<u>285,918</u>	<u>296,603</u>

The Group				
2006				
US subprime mortgage related	Alt-A	Others	Total	
HK\$'m	HK\$'m	HK\$'m	HK\$'m	
Aaa . . . . .	15,809	8,124	84,880	108,813
Aa1 to Aa3 . . . . .	–	–	82,645	82,645
A1 to A3 . . . . .	–	–	31,640	31,640
Lower than A3 . . . . .	–	–	4,303	4,303
Unrated* . . . . .	–	389	74,251	74,640
	<u>15,809</u>	<u>8,513</u>	<u>277,719</u>	<u>302,041</u>

The Bank				
2007				
	US subprime mortgage related	Alt-A	Others	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Aaa . . . . .	4,118	6,567	82,381	93,066
Aa1 to Aa3 . . . . .	–	–	81,853	81,853
A1 to A3 . . . . .	–	–	25,231	25,231
Lower than A3 . . . . .	–	–	1,762	1,762
Unrated* . . . . .	–	–	69,075	69,075
	<u>4,118</u>	<u>6,567</u>	<u>260,302</u>	<u>270,987</u>
The Bank				
2006				
	US subprime mortgage related	Alt-A	Others	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Aaa . . . . .	15,809	8,124	78,782	102,715
Aa1 to Aa3 . . . . .	–	–	73,055	73,055
A1 to A3 . . . . .	–	–	29,077	29,077
Lower than A3 . . . . .	–	–	3,100	3,100
Unrated* . . . . .	–	389	66,362	66,751
	<u>15,809</u>	<u>8,513</u>	<u>250,376</u>	<u>274,698</u>

\* For the above debt securities with no issue rating, their issuer ratings are analysed on pages 125 to 126.

The Group defines US subprime mortgage related debt securities as those that are supported by US residential subprime mortgage loans to borrowers. As at 31 December 2007, the Group's exposure to the US subprime mortgage market was limited to investments in the US subprime mortgage related debt securities.

All US subprime mortgage related debt securities held by the Group are classified in "Investment in securities" as available-for-sale or held-to-maturity. As at 31 December 2007, the carrying values of US subprime mortgage related debt securities classified as available-for-sale and held-to-maturity held by the Group and the Bank were HK\$392 million and HK\$3,726 million respectively (2006: HK\$7,384 million and HK\$8,425 million).

With regard to risk management of the debt securities, the Group analyses important factors of its US mortgage asset-backed securities such as different vintages, delinquency rates, credit ratings and underlying mortgage pools, as well as different attachment points and timing of cash flows.

The Group's and the Bank's impairment charge on available-for-sale and held-to-maturity debt securities held at 31 December 2007 amounted to HK\$190 million and HK\$1,682 million respectively (2006: Nil). The carrying values of the available-for-sale and held-to-maturity debt securities considered impaired held by the Group and the Bank as at 31 December 2007 were HK\$556 million and HK\$3,738 million respectively (2006: Nil).

Included in the above were impairment charges on US subprime mortgage related debt securities held by the Group and the Bank at 31 December 2007 amounting to HK\$1,253 million (2006: Nil) and the carrying value of these impaired securities as at 31 December 2007 amounted to HK\$2,856 million (2006: Nil).

The Group's and the Bank's impairment charge on US Alt-A mortgage backed securities held at 31 December 2007 amounted to HK\$573 million (2006: Nil). The carrying value of these impaired securities as at 31 December 2007 was HK\$1,380 million (2006: Nil).

As at 31 December 2007 and 2006, there were no overdue debt securities.

## **4.2 Market Risk**

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

### ***Market risk management framework***

Market risk is managed within various major risk limits approved by the RC, including risk positions and/or risk factor sensitivities. Since April 2007 BOCHK also formally applied Value-at-Risk (VAR), limit as a daily risk management tool. These overall risk limits are divided into sub-limits by reference to different risk products, including interest rate, foreign exchange rate, commodity price and equity products. Transactions are classified into different risk product categories according to the prominent type of risk inherent in the transactions.

The Group's risk management objective is to enhance shareholder value by maintaining risk exposures within acceptable limits. Market risk management framework of the Group comprises three levels. The Board of Directors and the Risk Committee 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 CRO). RMD is 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 day-to-day basis to ensure that they are within established risk limits and are regularly reported to the senior management. Nanyang and Chiyu have their own independent risk monitoring units to monitor limit compliance on a daily basis.

The Group's control of market risk is based on restricting individual operations to trading within various market risk limits approved by the RC, and 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.

The Group also uses the VAR technique to measure potential losses and market risks of its trading book for reporting to the RC and senior management on a periodic basis. VAR is a statistical technique which estimates the potential losses that could occur on risk positions taken over a specified time horizon within a given level of confidence.

The Group has changed its VAR calculation from a variance/co-variance basis to historical simulation basis with effect from April 2007. The Group uses historical movements in market rates and prices, a 99% confidence level and a 1-day holding period to calculate portfolio and individual VAR. Movements in market prices are calculated by reference to market data from the last two years.

## VAR

The following table sets out the VAR for all trading market risk exposure<sup>1</sup> of BOCHK.

HK\$m		At 31 December	Minimum for the year	Maximum for the year	Average for the year
VAR for all market risk	– 2007	3.2	1.4	10.4	4.1
	– 2006	1.5	1.3	5.0	2.8
VAR for foreign exchange risk	– 2007	2.7	1.0	9.4	4.0
products	– 2006	1.7	0.7	5.3	2.8
VAR for interest rate risk products	– 2007	1.5	0.5	3.9	1.6
	– 2006	0.7	0.7	3.0	1.6
VAR for equity risk products	– 2007	0.4	0.1	1.1	0.4
	– 2006	0.5	0.1	1.0	0.3
VAR for commodity risk products	– 2007	0.0	0.0	0.4	0.1
	– 2006	0.0	0.0	0.3	0.0

In 2007, the average daily revenue<sup>2</sup> of BOCHK earned from market risk-related trading activities was HK\$3.06 million (2006: HK\$2.5 million). The standard deviation of these daily trading revenues was HK\$3.34 million (2006: HK\$1.5 million).

<sup>1</sup> Structural FX positions have been excluded.

<sup>2</sup> Revenues from structural FX positions and back to back transactions have been excluded.

Although it is a valuable guide to risk, VAR should always be viewed in the context of its limitations. For example:

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a one-day holding period assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a one-day holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99 per cent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence; and
- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

The Group recognises these limitations by augmenting its VAR limits with other position and sensitivity limit structures. Additionally, the Group applies a wide range of stress testing, both on individual portfolios and on the Group's consolidated positions. Stress testing program of the trading book includes sensitivity testing on changes in risk factors with various degrees of severity, as well as scenario analysis on historical events including the 1997 Asian Crisis and the 11 September Event in 2001. The Group's stress-testing regime provides senior management with an assessment of the financial impact of identified extreme events on the market risk exposures of the Group.

## Currency risk

The tables below summarise the Group's and the Bank'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.

	The Group							
	2007							
		US	HK		Japanese	Pound		
	Renminbi	Dollars	Dollars	EURO	Yen	Sterling	Others	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>Assets</b>								
Cash and balances with banks and other financial institutions . . . . .	30,848	49,823	71,727	1,148	160	1,815	3,531	159,052
Placements with banks and other financial institutions maturing between one and twelve months . .	375	23,854	28,750	–	–	–	175	53,154
Financial assets at fair value through profit or loss . . . . .	917	3,246	5,899	–	–	–	240	10,302
Derivative financial instruments . . .	–	773	13,703	–	–	–	1	14,477
Hong Kong SAR Government certificates of indebtedness . . . . .	–	–	32,770	–	–	–	–	32,770
Advances and other accounts . . . . .	13,335	71,309	323,473	4,202	1,667	1,006	5,220	420,212
Investment in securities								
– Available-for-sale securities . . . .	90	62,611	22,563	7,005	28	1,321	6,900	100,518
– Held-to-maturity securities . . . .	864	84,686	59,565	2,486	–	1,554	16,273	165,428
– Loans and receivables . . . . .	–	3,594	26,511	428	–	–	569	31,102
Interests in associates . . . . .	–	–	83	–	–	–	–	83
Investment properties. . . . .	–	–	8,058	–	–	–	–	8,058
Properties, plant and equipment . . . .	72	1	23,215	–	–	–	–	23,288
Other assets (including deferred tax assets) . . . . .	69	947	19,267	160	62	145	136	20,786
<b>Total assets</b> . . . . .	<u>46,570</u>	<u>300,844</u>	<u>635,584</u>	<u>15,429</u>	<u>1,917</u>	<u>5,841</u>	<u>33,045</u>	<u>1,039,230</u>
<b>Liabilities</b>								
Hong Kong SAR currency notes in circulation . . . . .	–	–	32,770	–	–	–	–	32,770
Deposits and balances of banks and other financial institutions . . . . .	27,173	19,422	9,090	147	2,141	92	2,534	60,599
Financial liabilities at fair value through profit or loss . . . . .	–	2,717	8,688	–	–	–	–	11,405
Derivative financial instruments . . . .	–	1,257	9,814	–	–	–	11	11,082
Deposits from customers . . . . .	17,360	166,467	548,813	8,432	2,492	12,284	38,399	794,247
Debt securities in issue at amortised cost . . . . .	–	667	1,422	–	–	–	–	2,089
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	575	9,751	31,932	311	31	386	760	43,746
<b>Total liabilities</b> . . . . .	<u>45,108</u>	<u>200,281</u>	<u>642,529</u>	<u>8,890</u>	<u>4,664</u>	<u>12,762</u>	<u>41,704</u>	<u>955,938</u>
Net on-balance sheet position . . . . .	<u>1,462</u>	<u>100,563</u>	<u>(6,945)</u>	<u>6,539</u>	<u>(2,747)</u>	<u>(6,921)</u>	<u>(8,659)</u>	<u>83,292</u>
Off-balance sheet net notional position* . . . . .	<u>394</u>	<u>(97,215)</u>	<u>89,481</u>	<u>(6,478)</u>	<u>2,436</u>	<u>7,050</u>	<u>8,975</u>	<u>4,643</u>
Contingent liabilities and commitments . . . . .	4,873	55,183	163,702	4,693	1,017	259	1,581	231,308

\* 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.

	The Group							
	2006							
	Renminbi	US Dollars	HK Dollars	EURO	Japanese Yen	Pound Sterling	Others	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Assets								
Cash and balances with banks and other financial institutions . . . . .	24,898	29,341	45,941	1,073	680	824	2,479	105,236
Placements with banks and other financial institutions maturing between one and twelve months . .	283	9,166	46,516	–	–	–	408	56,373
Financial assets at fair value through profit or loss . . . . .	–	4,959	6,183	1,041	–	–	1,011	13,194
Derivative financial instruments . . .	–	203	7,190	–	–	–	–	7,393
Hong Kong SAR Government certificates of indebtedness . . . . .	–	–	34,750	–	–	–	–	34,750
Advances and other accounts . . . . .	4,559	54,737	285,782	2,505	1,678	1,001	2,582	352,844
Investment in securities								
– Available-for-sale securities . . . .	–	58,627	29,012	4,200	–	2,118	6,432	100,389
– Held-to-maturity securities . . . .	–	98,960	45,780	3,815	–	1,790	15,243	165,588
– Loans and receivables . . . . .	–	2,556	32,909	–	–	302	347	36,114
Interests in associates . . . . .	–	–	60	–	–	–	–	60
Investment properties. . . . .	–	–	7,481	–	–	–	–	7,481
Properties, plant and equipment . . . .	69	1	19,665	–	–	–	–	19,735
Other assets (including deferred tax assets) . . . . .	59	294	13,773	99	122	85	200	14,632
<b>Total assets.</b> . . . .	<u>29,868</u>	<u>258,844</u>	<u>575,042</u>	<u>12,733</u>	<u>2,480</u>	<u>6,120</u>	<u>28,702</u>	<u>913,789</u>
Liabilities								
Hong Kong SAR currency notes in circulation . . . . .	–	–	34,750	–	–	–	–	34,750
Deposits and balances of banks and other financial institutions. . . . .	17,198	16,587	12,590	1,112	415	97	1,035	49,034
Financial liabilities at fair value through profit or loss . . . . .	–	4,329	10,798	–	–	–	–	15,127
Derivative financial instruments . . . .	–	450	3,602	–	–	–	–	4,052
Deposits from customers . . . . .	10,994	143,913	485,991	5,893	3,609	11,968	33,248	695,616
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	451	8,369	24,867	274	131	92	606	34,790
<b>Total liabilities.</b> . . . .	<u>28,643</u>	<u>173,648</u>	<u>572,598</u>	<u>7,279</u>	<u>4,155</u>	<u>12,157</u>	<u>34,889</u>	<u>833,369</u>
Net on-balance sheet position . . . . .	<u>1,225</u>	<u>85,196</u>	<u>2,444</u>	<u>5,454</u>	<u>(1,675)</u>	<u>(6,037)</u>	<u>(6,187)</u>	<u>80,420</u>
Off-balance sheet net notional position. . . . .	<u>54</u>	<u>(83,503)</u>	<u>77,982</u>	<u>(5,501)</u>	<u>1,817</u>	<u>6,012</u>	<u>6,433</u>	<u>3,294</u>
Contingent liabilities and commitments . . . . .	2,666	42,196	137,880	2,643	527	117	1,757	187,786

	The Bank							
	2007							
	Renminbi	US Dollars	HK Dollars	EURO	Japanese Yen	Pound Sterling	Others	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Assets								
Cash and balances with banks and other financial institutions . . . . .	29,796	44,625	55,243	382	120	1,412	2,442	134,020
Placements with banks and other financial institutions maturing between one and twelve months . .	226	15,079	16,582	–	–	–	–	31,887
Financial assets at fair value through profit or loss . . . . .	676	987	4,535	–	–	–	171	6,369
Derivative financial instruments . . .	–	748	13,224	–	–	–	–	13,972
Hong Kong SAR Government certificates of indebtedness . . . . .	–	–	32,770	–	–	–	–	32,770
Advances and other accounts . . . . .	7,987	57,672	265,976	3,914	1,477	984	3,886	341,896
Investment in securities								
– Available-for-sale securities . . . .	–	61,900	20,323	7,005	28	1,321	6,815	97,392
– Held-to-maturity securities . . . .	864	81,475	50,652	2,161	–	1,181	14,540	150,873
– Loans and receivables . . . . .	–	1,663	21,121	–	–	–	–	22,784
Interests in subsidiaries . . . . .	–	–	12,866	–	–	–	–	12,866
Interests in associates . . . . .	–	–	12	–	–	–	–	12
Investment properties. . . . .	–	–	7,595	–	–	–	–	7,595
Properties, plant and equipment . . . .	2	–	18,259	–	–	–	–	18,261
Other assets. . . . .	52	885	17,224	133	62	132	72	18,560
<b>Total assets. . . . .</b>	<b>39,603</b>	<b>265,034</b>	<b>536,382</b>	<b>13,595</b>	<b>1,687</b>	<b>5,030</b>	<b>27,926</b>	<b>889,257</b>
Liabilities								
Hong Kong SAR currency notes in circulation . . . . .	–	–	32,770	–	–	–	–	32,770
Deposits and balances of banks and other financial institutions. . . . .	23,968	19,329	9,875	128	1,623	91	1,193	56,207
Financial liabilities at fair value								
through profit or loss . . . . .	–	1,178	6,938	–	–	–	–	8,116
Derivative financial instruments . . . .	–	1,107	9,681	–	–	–	–	10,788
Deposits from customers . . . . .	14,615	138,736	466,095	6,784	2,235	11,694	33,421	673,580
Other accounts and provisions (including current and deferred tax liabilities). . . . .	426	7,226	27,076	53	16	181	607	35,585
<b>Total liabilities. . . . .</b>	<b>39,009</b>	<b>167,576</b>	<b>552,435</b>	<b>6,965</b>	<b>3,874</b>	<b>11,966</b>	<b>35,221</b>	<b>817,046</b>
Net on-balance sheet position . . . . .	<u>594</u>	<u>97,458</u>	<u>(16,053)</u>	<u>6,630</u>	<u>(2,187)</u>	<u>(6,936)</u>	<u>(7,295)</u>	<u>72,211</u>
Off-balance sheet net notional position . . . . .	<u>360</u>	<u>(94,059)</u>	<u>88,394</u>	<u>(6,580)</u>	<u>1,910</u>	<u>6,993</u>	<u>7,260</u>	<u>4,278</u>
Contingent liabilities and commitments . . . . .	2,176	42,963	107,287	2,875	847	20	427	156,595



	The Bank							
	2006							
	Renminbi	US Dollars	HK Dollars	EURO	Japanese Yen	Pound Sterling	Others	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Assets								
Cash and balances with banks and other financial institutions. . . . .	24,274	26,140	31,673	570	56	730	1,745	85,188
Placements with banks and other financial institutions maturing between one and twelve months . .	91	4,402	33,551	–	–	–	–	38,044
Financial assets at fair value through profit or loss . . . . .	–	2,916	5,580	1,041	–	–	1,011	10,548
Derivative financial instruments . . .	–	200	6,892	–	–	–	–	7,092
Hong Kong SAR Government certificates of indebtedness . . . . .	–	–	34,750	–	–	–	–	34,750
Advances and other accounts . . . . .	2,910	44,979	238,840	2,198	1,542	991	1,836	293,296
Investment in securities								
– Available-for-sale securities . . . .	–	57,986	26,856	4,200	–	2,118	6,354	97,514
– Held-to-maturity securities . . . .	–	93,338	35,033	3,791	–	1,790	12,521	146,473
– Loans and receivables . . . . .	–	379	30,371	–	–	–	–	30,750
Interests in subsidiaries . . . . .	–	–	12,857	–	–	–	–	12,857
Interests in associates . . . . .	–	–	26	–	–	–	–	26
Investment properties. . . . .	–	–	6,992	–	–	–	–	6,992
Properties, plant and equipment . . . .	–	–	15,258	–	–	–	–	15,258
Other assets. . . . .	15	237	13,686	12	1	43	101	14,095
<b>Total assets. . . . .</b>	<u>27,290</u>	<u>230,577</u>	<u>492,365</u>	<u>11,812</u>	<u>1,599</u>	<u>5,672</u>	<u>23,568</u>	<u>792,883</u>
Liabilities								
Hong Kong SAR currency notes in circulation . . . . .	–	–	34,750	–	–	–	–	34,750
Deposits and balances of banks and other financial institutions. . . . .	17,064	16,319	12,433	1,114	236	46	758	47,970
Financial liabilities at fair value								
through profit or loss . . . . .	–	2,139	9,034	–	–	–	–	11,173
Derivative financial instruments . . . .	–	438	3,416	–	–	–	–	3,854
Deposits from customers . . . . .	9,429	122,507	413,982	5,012	3,089	11,408	28,423	593,850
Other accounts and provisions (including current and deferred tax liabilities). . . . .	368	5,373	22,255	118	123	14	515	28,766
<b>Total liabilities. . . . .</b>	<u>26,861</u>	<u>146,776</u>	<u>495,870</u>	<u>6,244</u>	<u>3,448</u>	<u>11,468</u>	<u>29,696</u>	<u>720,363</u>
Net on-balance sheet position . . . . .	<u>429</u>	<u>83,801</u>	<u>(3,505)</u>	<u>5,568</u>	<u>(1,849)</u>	<u>(5,796)</u>	<u>(6,128)</u>	<u>72,520</u>
Off-balance sheet net notional position . . . . .	<u>46</u>	<u>(82,217)</u>	<u>77,393</u>	<u>(5,720)</u>	<u>1,853</u>	<u>5,721</u>	<u>5,997</u>	<u>3,073</u>
Contingent liabilities and commitments . . . . .	1,426	31,179	83,502	1,452	431	16	461	118,467

### ***Interest rate risk***

BOCHK 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 Asset and Liability Management Committee (“ALCO”) and RC are responsible for interest rate risk management. 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 daily basis. The Treasury Department manages the interest rate risk according to the established policies. The Finance Department closely monitors the related risks and reports the results to ALCO regularly. The Risk Management Department reviews the policies, guidelines and limits proposed by Treasury Department.

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 OBS 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. The key assumption in gap analysis includes the replacement of contractual maturity of mortgage-backed and asset-backed securities by weighted average life projected from prepayment modelling. 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 monthly 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.

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 BOCHK 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 Chief Financial Officer.

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

	The Group						
	2007						
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non- interest bearing	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
<b>Assets</b>							
Cash and balances with banks and other financial institutions . . . . .	152,733	–	–	–	–	6,319	159,052
Placements with banks and other financial institutions maturing between one and twelve months . .	–	42,230	10,924	–	–	–	53,154
Financial assets at fair value through profit or loss . . . . .	3,562	1,637	1,670	2,252	760	421	10,302
Derivative financial instruments . . .	–	–	–	–	–	14,477	14,477
Hong Kong SAR Government certificates of indebtedness . . . . .	–	–	–	–	–	32,770	32,770
Advances and other accounts . . . . .	328,728	58,396	19,372	9,487	643	3,586	420,212
Investment in securities							
– Available-for-sale securities . . .	11,668	21,320	6,257	19,959	40,869	445	100,518
– Held-to-maturity securities . . . .	25,562	43,920	18,534	43,022	34,390	–	165,428
– Loans and receivables . . . . .	7,459	11,444	12,199	–	–	–	31,102
Interests in associates . . . . .	–	–	–	–	–	83	83
Investment properties . . . . .	–	–	–	–	–	8,058	8,058
Properties, plant and equipment . . .	–	–	–	–	–	23,288	23,288
Other assets (including deferred tax assets) . . . . .	–	–	–	–	–	20,786	20,786
<b>Total assets . . . . .</b>	<b>529,712</b>	<b>178,947</b>	<b>68,956</b>	<b>74,720</b>	<b>76,662</b>	<b>110,233</b>	<b>1,039,230</b>
<b>Liabilities</b>							
Hong Kong SAR currency notes in circulation . . . . .	–	–	–	–	–	32,770	32,770
Deposits and balances of banks and other financial institutions . . . . .	45,728	3,428	6,897	–	–	4,546	60,599
Financial liabilities at fair value through profit or loss . . . . .	6,600	2,355	1,531	919	–	–	11,405
Derivative financial instruments . . .	–	–	–	–	–	11,082	11,082
Deposits from customers . . . . .	623,580	98,440	35,157	547	–	36,523	794,247
Debt securities in issue at amortised cost . . . . .	–	–	1,977	112	–	–	2,089
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	7,624	107	–	128	–	35,887	43,746
<b>Total liabilities . . . . .</b>	<b>683,532</b>	<b>104,330</b>	<b>45,562</b>	<b>1,706</b>	<b>–</b>	<b>120,808</b>	<b>955,938</b>
Interest sensitivity gap . . . . .	(153,820)	74,617	23,394	73,014	76,662	(10,575)	83,292

The Group							
2006							
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non- interest bearing	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>Assets</b>							
Cash and balances with banks and other financial institutions. . . . .	99,157	–	–	–	–	6,079	105,236
Placements with banks and other financial institutions maturing between one and twelve months . .	–	47,717	8,656	–	–	–	56,373
Financial assets at fair value through profit or loss . . . . .	4,623	4,729	1,570	1,921	289	62	13,194
Derivative financial instruments . . .	–	–	–	–	–	7,393	7,393
Hong Kong SAR Government certificates of indebtedness . . . . .	–	–	–	–	–	34,750	34,750
Advances and other accounts . . . . .	303,259	32,873	11,096	2,487	420	2,709	352,844
Investment in securities							
– Available-for-sale securities. . . .	5,578	14,102	5,402	27,529	47,728	50	100,389
– Held-to-maturity securities . . . .	25,050	38,721	32,265	41,105	28,447	–	165,588
– Loans and receivables . . . . .	2,429	12,753	20,932	–	–	–	36,114
Interests in associates. . . . .	–	–	–	–	–	60	60
Investment properties. . . . .	–	–	–	–	–	7,481	7,481
Properties, plant and equipment. . . .	–	–	–	–	–	19,735	19,735
Other assets (including deferred tax assets). . . . .	–	–	–	–	–	14,632	14,632
<b>Total assets</b> . . . . .	<u>440,096</u>	<u>150,895</u>	<u>79,921</u>	<u>73,042</u>	<u>76,884</u>	<u>92,951</u>	<u>913,789</u>
<b>Liabilities</b>							
Hong Kong SAR currency notes in circulation . . . . .	–	–	–	–	–	34,750	34,750
Deposits and balances of banks and other financial institutions. . . . .	44,271	955	2,692	–	–	1,116	49,034
Financial liabilities at fair value through profit or loss . . . . .	6,025	3,603	3,460	2,039	–	–	15,127
Derivative financial instruments. . . .	–	–	–	–	–	4,052	4,052
Deposits from customers . . . . .	566,616	77,894	21,891	996	18	28,201	695,616
Other accounts and provisions (including current and deferred tax liabilities). . . . .	<u>6,298</u>	<u>99</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>28,393</u>	<u>34,790</u>
<b>Total liabilities</b> . . . . .	<u>623,210</u>	<u>82,551</u>	<u>28,043</u>	<u>3,035</u>	<u>18</u>	<u>96,512</u>	<u>833,369</u>
Interest sensitivity gap . . . . .	<u>(183,114)</u>	<u>68,344</u>	<u>51,878</u>	<u>70,007</u>	<u>76,866</u>	<u>(3,561)</u>	<u>80,420</u>

The Bank							
2007							
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non- interest bearing	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>Assets</b>							
Cash and balances with banks and other financial institutions. . . . .	129,827	–	–	–	–	4,193	134,020
Placements with banks and other financial institutions maturing between one and twelve months . .	–	28,927	2,960	–	–	–	31,887
Financial assets at fair value through profit or loss . . . . .	2,261	959	1,523	1,268	31	327	6,369
Derivative financial instruments . . .	–	–	–	–	–	13,972	13,972
Hong Kong SAR Government certificates of indebtedness . . . . .	–	–	–	–	–	32,770	32,770
Advances and other accounts . . . . .	271,962	48,292	13,132	8,038	457	15	341,896
Investment in securities							
– Available-for-sale securities. . . .	11,244	19,976	5,864	19,701	40,545	62	97,392
– Held-to-maturity securities . . . .	21,599	38,905	16,411	39,568	34,390	–	150,873
– Loans and receivables . . . . .	5,696	8,025	9,063	–	–	–	22,784
Interests in subsidiaries. . . . .	–	–	–	–	–	12,866	12,866
Interests in associates. . . . .	–	–	–	–	–	12	12
Investment properties . . . . .	–	–	–	–	–	7,595	7,595
Properties, plant and equipment. . . .	–	–	–	–	–	18,261	18,261
Other assets . . . . .	–	–	–	–	–	18,560	18,560
<b>Total assets . . . . .</b>	<b>442,589</b>	<b>145,084</b>	<b>48,953</b>	<b>68,575</b>	<b>75,423</b>	<b>108,633</b>	<b>889,257</b>
<b>Liabilities</b>							
Hong Kong SAR currency notes in circulation . . . . .	–	–	–	–	–	32,770	32,770
Deposits and balances of banks and other financial institutions. . . . .	43,348	1,598	4,711	–	–	6,550	56,207
Financial liabilities at fair value through profit or loss . . . . .	4,160	2,004	1,033	919	–	–	8,116
Derivative financial instruments. . . .	–	–	–	–	–	10,788	10,788
Deposits from customers . . . . .	534,799	81,681	25,427	415	–	31,258	673,580
Other accounts and provisions (including current and deferred tax liabilities). . . . .	7,297	107	–	128	–	28,053	35,585
<b>Total liabilities . . . . .</b>	<b>589,604</b>	<b>85,390</b>	<b>31,171</b>	<b>1,462</b>	<b>–</b>	<b>109,419</b>	<b>817,046</b>
Interest sensitivity gap . . . . .	(147,015)	59,694	17,782	67,113	75,423	(786)	72,211

The Bank							
2006							
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non- interest bearing	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>Assets</b>							
Cash and balances with banks and other financial institutions. . . . .	79,891	–	–	–	–	5,297	85,188
Placements with banks and other financial institutions maturing between one and twelve months . .	–	32,475	5,569	–	–	–	38,044
Financial assets at fair value through profit or loss . . . . .	3,278	4,578	1,325	1,177	171	19	10,548
Derivative financial instruments . . .	–	–	–	–	–	7,092	7,092
Hong Kong SAR Government certificates of indebtedness . . . . .	–	–	–	–	–	34,750	34,750
Advances and other accounts . . . . .	258,962	24,115	7,679	2,203	337	–	293,296
Investment in securities							
– Available-for-sale securities. . . .	5,217	12,883	4,896	27,068	47,411	39	97,514
– Held-to-maturity securities . . . .	21,214	31,191	28,287	37,461	28,320	–	146,473
– Loans and receivables . . . . .	1,997	10,732	18,021	–	–	–	30,750
Interests in subsidiaries. . . . .	–	–	–	–	–	12,857	12,857
Interests in associates. . . . .	–	–	–	–	–	26	26
Investment properties . . . . .	–	–	–	–	–	6,992	6,992
Properties, plant and equipment. . . .	–	–	–	–	–	15,258	15,258
Other assets . . . . .	–	–	–	–	–	14,095	14,095
<b>Total assets</b> . . . . .	<u>370,559</u>	<u>115,974</u>	<u>65,777</u>	<u>67,909</u>	<u>76,239</u>	<u>96,425</u>	<u>792,883</u>
<b>Liabilities</b>							
Hong Kong SAR currency notes in circulation . . . . .	–	–	–	–	–	34,750	34,750
Deposits and balances of banks and other financial institutions. . . . .	44,059	630	2,204	–	–	1,077	47,970
Financial liabilities at fair value through profit or loss . . . . .	3,984	2,246	3,340	1,603	–	–	11,173
Derivative financial instruments. . . .	–	–	–	–	–	3,854	3,854
Deposits from customers . . . . .	489,843	62,866	17,792	266	–	23,083	593,850
Other accounts and provisions (including current and deferred tax liabilities). . . . .	<u>5,369</u>	<u>99</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>23,298</u>	<u>28,766</u>
<b>Total liabilities</b> . . . . .	<u>543,255</u>	<u>65,841</u>	<u>23,336</u>	<u>1,869</u>	<u>–</u>	<u>86,062</u>	<u>720,363</u>
Interest sensitivity gap . . . . .	<u>(172,696)</u>	<u>50,133</u>	<u>42,441</u>	<u>66,040</u>	<u>76,239</u>	<u>10,363</u>	<u>72,520</u>

### *Sensitivity analysis to market risk exposure of banking book of the Group*

The Group is principally exposed to HKD and USD in terms of interest rate risk. At 31 December 2007, if HKD and USD market interest rates had been 100 basis point higher with other variables held constant, profit after tax for the year would have been reduced by HK\$106 million (2006: HK\$468 million) because the positive interest sensitivity gaps within one year are shortened compared with 2006. Reserves would have been reduced by HK\$1,598 million (2006: HK\$1,831 million).

### *Interest rate exposures in banking book*

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

	Impact on positions at 31 December	
	2007	2006
	HK\$m	HK\$m
<b>Earnings perspective</b>		
<b>Scenarios</b>		
Down 100 basis points parallel shift in HK dollar yield curves . .	<u>(402)</u>	<u>(303)</u>
Up 100 basis points parallel shift in US dollar yield curves . . . .	<u>(562)</u>	<u>(908)</u>

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

## **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 Risk Committee 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 Chief Executive, Chief Financial Officer, Chief Risk Officer and the Asset and Liability Management Committee). Daily management of liquidity is carried out by the treasury functions, which is assisted by other functional departments, including the finance and risk management departments which monitor the liquidity risk and provide regular reports to the management and local regulatory bodies.



The liquidity management process is adopted at the Group level. The principal subsidiaries of the Group execute their risk management strategies independently, subject to risk policies that are consistent with those of the Group, and report to the Group's management on a regular basis.

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-liquifiable assets portfolio and establishment of a diversified portfolio of liabilities.

Risk management process includes:

- Perform cash-flow projection 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 asset to serve as 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 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 current risk management mechanism. Any material impact on liquidity risk noted during the risk assessment process will be reported to the Chief Financial Officer.

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

*Non-derivative cash flows*

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

	The Group					
	2007					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Hong Kong SAR currency notes in circulation . . . . .	32,770	–	–	–	–	32,770
Deposits and balances of banks and other financial institutions .	50,290	3,456	6,951	–	–	60,697
Financial liabilities at fair value through profit or loss. . . . .	2,563	1,966	4,788	1,976	364	11,657
Deposits from customers. . . . .	660,524	99,025	35,789	585	–	795,923
Debt securities in issue at amortised cost. . . . .	7	13	2,021	116	–	2,157
Other financial liabilities. . . . .	29,192	412	450	133	460	30,647
	<u>775,346</u>	<u>104,872</u>	<u>49,999</u>	<u>2,810</u>	<u>824</u>	<u>933,851</u>

	The Group					
	2006					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Hong Kong SAR currency notes in circulation . . . . .	34,750	–	–	–	–	34,750
Deposits and balances of banks and other financial institutions .	45,400	961	2,713	–	–	49,074
Financial liabilities at fair value through profit or loss. . . . .	1,937	1,849	6,159	5,492	377	15,814
Deposits from customers. . . . .	595,159	78,037	22,633	984	18	696,831
Other financial liabilities. . . . .	22,706	803	395	525	79	24,508
	<u>699,952</u>	<u>81,650</u>	<u>31,900</u>	<u>7,001</u>	<u>474</u>	<u>820,977</u>

The Bank						
2007						
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Hong Kong SAR currency notes in circulation . . . . .	32,770	–	–	–	–	32,770
Deposits and balances of banks and other financial institutions .	49,913	1,602	4,711	–	–	56,226
Financial liabilities at fair value through profit or loss. . . . .	2,188	1,275	3,732	1,039	–	8,234
Deposits from customers. . . . .	566,418	82,167	25,897	437	–	674,919
Other financial liabilities. . . . .	24,169	110	416	128	–	24,823
	<u>675,458</u>	<u>85,154</u>	<u>34,756</u>	<u>1,604</u>	<u>–</u>	<u>796,972</u>

The Bank						
2006						
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Hong Kong SAR currency notes in circulation . . . . .	34,750	–	–	–	–	34,750
Deposits and balances of banks and other financial institutions .	45,149	632	2,215	–	–	47,996
Financial liabilities at fair value through profit or loss. . . . .	1,773	1,227	5,234	3,262	–	11,496
Deposits from customers. . . . .	513,250	63,231	18,091	269	–	594,841
Other financial liabilities. . . . .	18,878	110	160	2	–	19,150
	<u>613,800</u>	<u>65,200</u>	<u>25,700</u>	<u>3,533</u>	<u>–</u>	<u>708,233</u>

#### *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, currency futures, non-deliverable currency forwards;
- Interest rate derivatives: interest rate swaps;
- Equity derivatives: exchange traded equity options; and
- Bullion derivatives: bullion margin contracts.

The table below analyses the Group's and the Bank'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.

	The Group					
	2007					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Derivatives settled on a net basis						
– Foreign exchange derivatives . . .	(7,213)	(9)	456	21	–	(6,745)
– Interest rate derivatives. . . . .	(1)	(23)	(143)	(309)	(66)	(542)
– Equity derivatives . . . . .	–	(58)	–	–	–	(58)
– Bullion derivatives . . . . .	(1,110)	–	–	–	–	(1,110)
	(8,324)	(90)	313	(288)	(66)	(8,455)

The Group						
2006						
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Derivatives settled on a net basis						
– Foreign exchange derivatives . . .	(2,515)	(1)	28	1	–	(2,487)
– Interest rate derivatives . . . . .	(7)	(28)	(96)	(103)	(8)	(242)
– Bullion derivatives . . . . .	<u>(438)</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>(438)</u>
	(2,960)	(29)	(68)	(102)	(8)	(3,167)

	The Bank					
	2007					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Derivatives settled on a net basis						
– Foreign exchange derivatives . . .	(7,097)	(9)	461	21	–	(6,624)
– Interest rate derivatives. . . . .	–	(20)	(138)	(269)	(62)	(489)
– Equity derivatives . . . . .	–	(58)	–	–	–	(58)
– Bullion derivatives . . . . .	(1,107)	–	–	–	–	(1,107)
	(8,204)	(87)	323	(248)	(62)	(8,278)

	The Bank					
	2006					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Derivatives settled on a net basis						
– Foreign exchange derivatives . . .	(2,475)	(1)	28	1	–	(2,447)
– Interest rate derivatives . . . . .	(8)	(18)	(109)	(151)	(8)	(294)
– Bullion derivatives . . . . .	<u>(438)</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>(438)</u>
	(2,921)	(19)	(81)	(150)	(8)	(3,179)

(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 cross currency interest rate swaps, OTC equity options, equity linked swaps and bullion swaps.

The table below analyses the Group's and the Bank'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.

	The Group					
	2007					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Derivatives settled on a gross basis						
– Foreign exchange derivatives:						
– Outflow . . . . .	(96,928)	(52,508)	(24,477)	(1,869)	–	(175,782)
– Inflow . . . . .	96,743	52,301	24,380	1,866	–	175,290
– Interest rate derivatives:						
– Outflow . . . . .	–	–	–	–	–	–
– Inflow . . . . .	–	316	–	–	–	316
– Equity derivatives:						
– Outflow . . . . .	(128)	(70)	(1,002)	(28)	–	(1,228)
– Inflow . . . . .	221	99	1,002	28	–	1,350
– Bullion derivatives:						
– Outflow . . . . .	(223)	(427)	(715)	–	–	(1,365)
– Inflow . . . . .	–	–	–	–	–	–
<b>Total outflow . . . . .</b>	<b><u>(97,279)</u></b>	<b><u>(53,005)</u></b>	<b><u>(26,194)</u></b>	<b><u>(1,897)</u></b>	<b><u>–</u></b>	<b><u>(178,375)</u></b>
<b>Total inflow . . . . .</b>	<b><u>96,964</u></b>	<b><u>52,716</u></b>	<b><u>25,382</u></b>	<b><u>1,894</u></b>	<b><u>–</u></b>	<b><u>176,956</u></b>

The Group						
2006						
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Derivatives settled on a gross basis						
– Foreign exchange derivatives:						
– Outflow . . . . .	(140,864)	(43,390)	(10,085)	(85)	–	(194,424)
– Inflow . . . . .	141,186	43,520	10,082	85	–	194,873
– Equity derivatives:						
– Outflow . . . . .	(14)	(1)	–	–	–	(15)
– Inflow . . . . .	12	1	–	–	–	13
– Bullion derivatives:						
– Outflow . . . . .	(103)	(371)	(638)	–	–	(1,112)
– Inflow . . . . .	–	–	–	–	–	–
<b>Total outflow . . . . .</b>	<b>(140,981)</b>	<b>(43,762)</b>	<b>(10,723)</b>	<b>(85)</b>	<b>–</b>	<b>(195,551)</b>
<b>Total inflow . . . . .</b>	<b>141,198</b>	<b>43,521</b>	<b>10,082</b>	<b>85</b>	<b>–</b>	<b>194,886</b>

The Bank						
2007						
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Derivatives settled on a gross basis						
– Foreign exchange derivatives:						
– Outflow . . . . .	(95,664)	(52,057)	(23,814)	(1,781)	–	(173,316)
– Inflow . . . . .	95,482	51,853	23,708	1,785	–	172,828
– Interest rate derivatives:						
– Outflow . . . . .	–	–	–	–	–	–
– Inflow . . . . .	–	316	–	–	–	316
– Equity derivatives:						
– Outflow . . . . .	(124)	(70)	(1,002)	(28)	–	(1,224)
– Inflow . . . . .	217	99	1,002	28	–	1,346
– Bullion derivatives:						
– Outflow . . . . .	(223)	(427)	(715)	–	–	(1,365)
– Inflow . . . . .	–	–	–	–	–	–
<b>Total outflow . . . . .</b>	<b>(96,011)</b>	<b>(52,554)</b>	<b>(25,531)</b>	<b>(1,809)</b>	<b>–</b>	<b>(175,905)</b>
<b>Total inflow . . . . .</b>	<b>95,699</b>	<b>52,268</b>	<b>24,710</b>	<b>1,813</b>	<b>–</b>	<b>174,490</b>

	The Bank					
	2006					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Derivatives settled on a gross basis						
– Foreign exchange derivatives:						
– Outflow . . . . .	(140,287)	(42,635)	(10,075)	–	–	(192,997)
– Inflow . . . . .	140,610	42,761	10,065	–	–	193,436
– Equity derivatives:						
– Outflow . . . . .	(14)	(1)	–	–	–	(15)
– Inflow . . . . .	12	1	–	–	–	13
– Bullion derivatives:						
– Outflow . . . . .	(103)	(371)	(638)	–	–	(1,112)
– Inflow . . . . .	–	–	–	–	–	–
<b>Total outflow</b> . . . . .	<u>(140,404)</u>	<u>(43,007)</u>	<u>(10,713)</u>	–	–	<u>(194,124)</u>
<b>Total inflow</b> . . . . .	140,622	42,762	10,065	–	–	193,449

*Off-balance sheet items*

Loan commitments

The contractual amounts of the Group's and the Bank's off-balance sheet financial instruments as at 31 December 2007 that commit to extend credit to customers and other facilities amounting to HK\$193,032 million and HK\$121,997 million (2006:HK\$158,409 million and HK\$93,219 million) are maturing no later than 1 year.

Financial guarantees and other financial facilities

Financial guarantees of the Group and the Bank as at 31 December 2007 amounting to HK\$38,276 million and HK\$34,598 million (2006:HK\$29,377 million and HK\$25,248 million) are maturing no later than 1 year.

**(b) Maturity analysis**

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

	The Group						
	2007						
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
<b>Assets</b>							
Cash and balances with banks and other financial institutions . . . . .	40,087	118,965	-	-	-	-	159,052
Placements with banks and other financial institutions maturing between one and twelve months . . . . .	-	-	42,230	10,924	-	-	53,154
Financial assets at fair value through profit or loss							
– debt securities held for trading							
– certificates of deposit held . . . . .	-	-	-	80	-	-	80
– others . . . . .	-	1,697	779	2,342	1,307	32	6,157
– debt securities designated at fair value through profit or loss							
– certificates of deposit held . . . . .	-	-	-	120	230	-	350
– others . . . . .	-	36	141	73	1,897	1,147	3,294
– equity securities . . . . .	-	-	-	-	-	-	421
Derivative financial instruments . . . . .	12,686	228	129	929	459	46	14,477
Hong Kong SAR Government certificates of indebtedness . . . . .	32,770	-	-	-	-	-	32,770
Advances and other accounts							
– advances to customers . . . . .	21,174	16,345	25,968	43,608	173,120	130,067	411,655
– trade bills . . . . .	12	2,815	2,227	280	-	-	5,334
– advances to banks and other financial institutions . . . . .	27	-	600	440	2,156	-	3,223
Investment in securities							
– debt securities held for available-for-sale							
– certificates of deposit held . . . . .	-	701	462	2,614	3,689	-	7,466
– others . . . . .	-	5,886	3,776	7,515	30,790	44,084	92,607
– debt securities held for held-to-maturity							
– certificates of deposit held . . . . .	-	1,097	1,490	2,426	6,351	624	11,988
– others . . . . .	-	4,278	12,309	17,166	81,918	34,031	153,440
– debt securities held for loans and receivables . . . . .	-	7,459	11,444	12,199	-	-	31,102
– equity securities . . . . .	-	-	-	-	-	-	445
Interests in associates . . . . .	-	-	-	-	-	-	83
Investment properties . . . . .	-	-	-	-	-	-	8,058
Properties, plant and equipment . . . . .	-	-	-	-	-	-	23,288
Other assets (including deferred tax assets) . . . . .	3,360	16,241	24	174	189	-	20,786
<b>Total assets</b> . . . . .	<u>110,116</u>	<u>175,748</u>	<u>101,579</u>	<u>100,890</u>	<u>302,106</u>	<u>210,031</u>	<u>1,039,230</u>
<b>Liabilities</b>							
Hong Kong SAR currency notes in circulation . . . . .	32,770	-	-	-	-	-	32,770
Deposits and balances of banks and other financial institutions . . . . .	28,200	22,074	3,428	6,897	-	-	60,599
Financial liabilities at fair value through profit or loss							
– certificates of deposit issued . . . . .	-	-	-	1,086	868	-	1,954
– others . . . . .	-	2,554	1,925	3,680	983	309	9,451
Derivative financial instruments . . . . .	8,320	411	352	954	831	214	11,082
Deposits from customers . . . . .	329,668	330,435	98,440	35,157	547	-	794,247
Debt securities in issue at amortised cost . . . . .	-	-	-	1,977	112	-	2,089
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	15,443	15,543	6,968	1,660	4,099	-	43,746
<b>Total liabilities</b> . . . . .	<u>414,401</u>	<u>371,017</u>	<u>111,113</u>	<u>51,411</u>	<u>7,440</u>	<u>523</u>	<u>955,938</u>
Net liquidity gap . . . . .	<u>(304,285)</u>	<u>(195,269)</u>	<u>(9,534)</u>	<u>49,479</u>	<u>294,666</u>	<u>209,508</u>	<u>83,292</u>



	The Group						
	2006						
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
<b>Assets</b>							
Cash and balances with banks and other financial institutions . . . . .	30,973	74,263	–	–	–	–	105,236
Placements with banks and other financial institutions maturing between one and twelve months . . . . .	–	–	47,717	8,656	–	–	56,373
Financial assets at fair value through profit or loss							
– debt securities held for trading							
– certificates of deposit held . . . . .	–	10	104	227	72	–	413
– others . . . . .	–	1,120	2,322	3,304	3,024	171	9,941
– debt securities designated at fair value through profit or loss							
– certificates of deposit held . . . . .	–	–	–	–	356	–	356
– others . . . . .	–	211	23	206	1,563	420	2,423
– equity securities . . . . .	–	–	–	–	–	61	61
Derivative financial instruments . . . . .	6,218	537	217	109	274	38	7,393
Hong Kong SAR Government certificates of indebtedness . . . . .	34,750	–	–	–	–	–	34,750
Advances and other accounts							
– advances to customers . . . . .	28,483	8,085	15,471	39,287	136,122	116,931	345,973
– trade bills . . . . .	76	1,670	1,030	350	–	–	3,128
– advances to banks and other financial institutions . . . . .	–	–	156	940	2,647	–	3,743
Investment in securities							
– debt securities held for available-for-sale							
– certificates of deposit held . . . . .	–	157	–	2,512	5,479	–	8,148
– others . . . . .	–	1,735	5,643	4,101	30,893	49,819	92,191
– debt securities held for held-to-maturity							
– certificates of deposit held . . . . .	–	1,600	1,205	3,176	3,386	–	9,367
– others . . . . .	–	3,759	7,700	35,308	79,067	30,387	156,221
– debt securities held for loans and receivables . . . . .	–	2,429	12,753	20,932	–	–	36,114
– equity securities . . . . .	–	–	–	–	–	50	50
Interests in associates . . . . .	–	–	–	–	–	60	60
Investment properties . . . . .	–	–	–	–	–	7,481	7,481
Properties, plant and equipment . . . . .	–	–	–	–	–	19,735	19,735
Other assets (including deferred tax assets). . . . .	4,185	9,773	2	246	63	163	14,632
<b>Total assets</b> . . . . .	<u>104,685</u>	<u>105,349</u>	<u>94,343</u>	<u>119,354</u>	<u>262,946</u>	<u>197,929</u>	<u>913,789</u>
<b>Liabilities</b>							
Hong Kong SAR currency notes in circulation .	34,750	–	–	–	–	–	34,750
Deposits and balances of banks and other financial institutions . . . . .	20,982	24,405	955	2,692	–	–	49,034
Financial liabilities at fair value through profit or loss							
– certificates of deposit issued. . . . .	–	–	–	514	1,984	–	2,498
– others . . . . .	–	1,922	1,810	5,443	3,152	302	12,629
Derivative financial instruments . . . . .	2,963	231	86	90	590	92	4,052
Deposits from customers . . . . .	290,241	304,550	77,585	22,272	950	18	695,616
Other accounts and provisions (including current and deferred tax liabilities). . . . .	13,918	9,615	5,961	1,253	3,963	–	34,790
<b>Total liabilities</b> . . . . .	<u>362,854</u>	<u>340,723</u>	<u>86,397</u>	<u>32,264</u>	<u>10,639</u>	<u>412</u>	<u>833,369</u>
Net liquidity gap . . . . .	<u>(258,169)</u>	<u>(235,374)</u>	<u>7,946</u>	<u>87,090</u>	<u>252,307</u>	<u>197,517</u>	<u>80,420</u>

The Bank							
2007							
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
<b>Assets</b>							
Cash and balances with banks and other financial institutions . . . . .	37,442	96,578	–	–	–	–	134,020
Placements with banks and other financial institutions maturing between one and twelve months . . . . .	–	–	28,927	2,960	–	–	31,887
Financial assets at fair value through profit or loss							
– debt securities held for trading							
– certificates of deposit held . . . . .	–	–	–	80	–	–	80
– others . . . . .	–	1,367	658	2,340	1,306	32	5,703
– debt securities designated at fair value through profit or loss							
– others . . . . .	–	–	–	–	259	–	259
– equity securities . . . . .	–	–	–	–	–	327	327
Derivative financial instruments . . . . .	12,194	226	128	942	438	44	13,972
Hong Kong SAR Government certificates of indebtedness . . . . .	32,770	–	–	–	–	–	32,770
Advances and other accounts							
– advances to customers . . . . .	18,560	9,284	20,224	34,194	140,676	110,121	334,253
– trade bills . . . . .	4	2,314	1,825	278	–	–	4,421
– advances to banks and other financial institutions . . . . .	27	–	599	440	2,156	–	3,222
Investment in securities . . . . .							
– debt securities held for available-for-sale							
– certificates of deposit held . . . . .	–	701	400	2,058	3,589	–	6,748
– others . . . . .	–	5,606	3,367	7,293	30,301	43,459	90,582
– debt securities held for held-to-maturity							
– certificates of deposit held . . . . .	–	–	207	2,234	6,340	624	9,405
– others . . . . .	–	3,009	10,902	13,722	76,539	33,558	141,468
– debt securities held for loans and receivables . . . . .	–	5,696	8,025	9,063	–	–	22,784
– equity securities . . . . .	–	–	–	–	–	62	62
Interests in subsidiaries . . . . .	–	–	–	–	–	12,866	12,866
Interests in associates . . . . .	–	–	–	–	–	12	12
Investment properties . . . . .	–	–	–	–	–	7,595	7,595
Properties, plant and equipment . . . . .	–	–	–	–	–	18,261	18,261
Other assets . . . . .	2,991	15,146	17	158	176	72	18,560
<b>Total assets</b> . . . . .	<b>103,988</b>	<b>139,927</b>	<b>75,279</b>	<b>75,762</b>	<b>261,780</b>	<b>187,838</b>	<b>889,257</b>
<b>Liabilities</b>							
Hong Kong SAR currency notes in circulation .	32,770	–	–	–	–	–	32,770
Deposits and balances of banks and other financial institutions . . . . .	29,921	19,977	1,598	4,711	–	–	56,207
Financial liabilities at fair value through profit or loss							
– certificates of deposit issued . . . . .	–	–	–	662	868	–	1,530
– others . . . . .	–	2,188	1,265	3,004	129	–	6,586
Derivative financial instruments . . . . .	8,201	405	348	942	715	177	10,788
Deposits from customers . . . . .	281,278	284,779	81,681	25,427	415	–	673,580
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	9,718	14,451	6,665	1,271	3,480	–	35,585
<b>Total liabilities</b> . . . . .	<b>361,888</b>	<b>321,800</b>	<b>91,557</b>	<b>36,017</b>	<b>5,607</b>	<b>177</b>	<b>817,046</b>
Net liquidity gap . . . . .	(257,900)	(181,873)	(16,278)	39,745	256,173	187,661	72,211

	The Bank							
	2006							
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
<b>Assets</b>								
Cash and balances with banks and other financial institutions . . . . .	29,356	55,832	–	–	–	–	–	85,188
Placements with banks and other financial institutions maturing between one and twelve months . . . . .	–	–	32,475	5,569	–	–	–	38,044
Financial assets at fair value through profit or loss								
– debt securities held for trading								
– certificates of deposit held . . . . .	–	10	104	227	72	–	–	413
– others . . . . .	–	1,120	2,242	3,305	3,022	170	–	9,859
– debt securities designated at fair value through profit or loss								
– others . . . . .	–	–	–	–	257	–	–	257
– equity securities . . . . .	–	–	–	–	–	–	19	19
Derivative financial instruments . . . . .	5,955	554	211	106	234	32	–	7,092
Hong Kong SAR Government certificates of indebtedness . . . . .	34,750	–	–	–	–	–	–	34,750
Advances and other accounts								
– advances to customers . . . . .	19,086	7,324	12,742	32,482	112,670	101,535	1,280	287,119
– trade bills . . . . .	71	1,423	866	326	–	–	–	2,686
– advances to banks and other financial institutions . . . . .	–	–	156	940	2,395	–	–	3,491
Investment in securities								
– debt securities held for available-for-sale								
– certificates of deposit held . . . . .	–	157	–	2,006	4,978	–	–	7,141
– others . . . . .	–	1,455	5,156	4,101	30,421	49,201	–	90,334
– debt securities held for held-to-maturity								
– certificates of deposit held . . . . .	–	236	–	2,043	3,317	–	–	5,596
– others . . . . .	–	3,162	4,853	31,520	71,563	29,779	–	140,877
– debt securities held for loans and receivables . . . . .	–	1,997	10,732	18,021	–	–	–	30,750
– equity securities . . . . .	–	–	–	–	–	–	39	39
Interests in subsidiaries . . . . .	–	–	–	–	–	–	12,857	12,857
Interests in associates . . . . .	–	–	–	–	–	–	26	26
Investment properties . . . . .	–	–	–	–	–	–	6,992	6,992
Properties, plant and equipment . . . . .	–	–	–	–	–	–	15,258	15,258
Other assets . . . . .	2,143	11,426	2	152	57	163	152	14,095
<b>Total assets</b> . . . . .	<u>91,361</u>	<u>84,696</u>	<u>69,539</u>	<u>100,798</u>	<u>228,986</u>	<u>180,880</u>	<u>36,623</u>	<u>792,883</u>
<b>Liabilities</b>								
Hong Kong SAR currency notes in circulation .	34,750	–	–	–	–	–	–	34,750
Deposits and balances of banks and other financial institutions . . . . .	21,410	23,726	630	2,204	–	–	–	47,970
Financial liabilities at fair value through profit or loss								
– certificates of deposit issued . . . . .	–	–	–	514	1,548	–	–	2,062
– others . . . . .	–	1,773	1,217	4,591	1,530	–	–	9,111
Derivative financial instruments . . . . .	2,923	218	80	63	486	84	–	3,854
Deposits from customers . . . . .	245,839	267,087	62,866	17,792	266	–	–	593,850
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	7,970	11,628	5,234	1,040	2,894	–	–	28,766
<b>Total liabilities</b> . . . . .	<u>312,892</u>	<u>304,432</u>	<u>70,027</u>	<u>26,204</u>	<u>6,724</u>	<u>84</u>	<u>–</u>	<u>720,363</u>
Net liquidity gap . . . . .	<u>(221,531)</u>	<u>(219,736)</u>	<u>(488)</u>	<u>74,594</u>	<u>222,262</u>	<u>180,796</u>	<u>36,623</u>	<u>72,520</u>

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 and debt securities 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.

#### 4.4 Capital Management

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

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

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

In 2007, the Group has established an 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 the capital structure in relation to the overall risk profile.

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

##### (a) Capital adequacy ratio

	2007	2006
Capital adequacy ratio . . . . .	<u>13.08%</u>	<u>13.99%</u>
Core capital ratio . . . . .	<u>12.23%</u>	<u>13.39%</u>

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

The differences between the basis of consolidation for accounting and regulatory purposes are described in "Appendix – Subsidiaries of the Bank" on page 300.

**(b) Components of capital base after deductions**

The consolidated 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:

	<u>2007</u>	<u>2006</u>
	HK\$m	HK\$m
Core capital:		
Paid up ordinary share capital . . . . .	<b>43,043</b>	43,043
Reserves . . . . .	<b>22,611</b>	20,281
Profit and loss account . . . . .	<b>207</b>	3,970
Minority interests . . . . .	<u><b>1,284</b></u>	<u>1,164</u>
	<b>67,145</b>	68,458
Deductions from core capital . . . . .	<u><b>(483)</b></u>	<u>–</u>
Core capital . . . . .	<u><b>66,662</b></u>	<u>68,458</u>
Supplementary capital:		
Reserves on revaluation of holdings of available-for-sale securities . . . . .	<b>18</b>	(115)
Reserves on revaluation of holdings of securities designated at fair value through profit or loss . . . . .	<b>9</b>	(3)
Collective loan impairment allowances . . . . .	<b>1,004</b>	557
Regulatory reserve . . . . .	<u><b>4,130</b></u>	<u>3,621</u>
	<b>5,161</b>	4,060
Deductions from supplementary capital . . . . .	<u><b>(483)</b></u>	<u>–</u>
Supplementary capital . . . . .	<u><b>4,678</b></u>	<u>4,060</u>
Deductions from total capital base . . . . .	<u><b>–</b></u>	<u>(971)</u>
Total capital base after deductions . . . . .	<u><b>71,340</b></u>	<u>71,547</u>

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

Subsidiaries which are not included in the consolidation group for the calculation of capital adequacy ratios are denoted in "Appendix – Subsidiaries of the Bank" on page 300. Investment costs in such subsidiaries are deducted from the capital base.

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

The capital adequacy ratios shown above are calculated on the consolidation 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 consolidation basis for credit, market, and operational risks. As different approaches are used to calculate the capital requirements since adoption of the Banking (Capital) Rules in 2007, presentation of the comparative quantitative information is exempted.

	2007
	HK\$m
Credit risk . . . . .	40,878
Market risk . . . . .	640
Operational risk . . . . .	3,131
	<u>44,649</u>

(i) *Capital requirements for credit risk*

	2007				
	Total exposures	Exposures after CRM*		Risk-weighted amount	
		Rated	Unrated	Rated	Unrated
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
On-balance sheet exposures					
Sovereign . . . . .	46,140	47,096	–	603	–
Public sector entity . . . . .	6,091	22,366	–	4,473	–
Multilateral development bank . . . . .	1,396	1,396	–	–	–
Bank . . . . .	357,628	349,758	12,481	90,907	4,856
Securities firm . . . . .	34	–	13	–	6
Corporate . . . . .	297,638	77,134	208,248	34,861	208,248
Cash items . . . . .	37,446	–	37,446	–	–
Regulatory retail . . . . .	29,867	–	28,232	–	21,174
Residential mortgage loans . . . . .	137,562	–	121,271	–	48,718
Other exposures which are not past due . . . . .	37,667	–	36,892	–	36,891
Past due exposures . . . . .	1,080	71	1,009	14	1,095
Total for on-balance sheet exposures . . .	<u>952,549</u>	<u>497,821</u>	<u>445,592</u>	<u>130,858</u>	<u>320,988</u>
Off-balance sheet exposures					
Off-balance sheet exposures other than OTC derivative transactions or credit derivative contracts . . . . .	54,841	8,046	46,795	4,864	42,494
OTC derivative transactions . . . . .	3,717	2,565	1,152	643	1,101
Total for off-balance sheet exposures . . .	<u>58,558</u>	<u>10,611</u>	<u>47,947</u>	<u>5,507</u>	<u>43,595</u>
Total for non-securitisation exposures . .	<u>1,011,107</u>	<u>508,432</u>	<u>493,539</u>	<u>136,365</u>	<u>364,583</u>
Securitisation exposures . . . . .	<u>50,110</u>	<u>50,110</u>	<u>–</u>	<u>10,022</u>	<u>–</u>
	<u>1,061,217</u>	<u>558,542</u>	<u>493,539</u>	<u>146,387</u>	<u>364,583</u>
Deducted from capital base . . . . .	<u>–</u>				

\* 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 Group's actual regulatory capital.

The Group used STC approach for calculation of credit risk.

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

#### Counterparty credit risk exposures

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

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

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

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

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

	2007
	HK\$m
Gross total positive fair value . . . . .	<u>1,239</u>
Credit equivalent amount . . . . .	<u>3,717</u>
Less: recognised collateral . . . . .	<u>—</u>
Net credit equivalent amount. . . . .	<u>3,717</u>
Net credit equivalent amount analysed by type of issuer:	
Sovereign . . . . .	8
Bank . . . . .	2,654
Corporate . . . . .	1,006
Others . . . . .	<u>49</u>
	<u>3,717</u>
Risk weighted amount analysed by type of issuer:	
Sovereign . . . . .	8
Bank . . . . .	685
Corporate . . . . .	1,002
Others . . . . .	<u>49</u>
	<u>1,744</u>
Notional amount of recognised credit derivative contracts which provide credit protection . . . . .	<u>—</u>

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

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

#### 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 the 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. 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.



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

	2007	
	Covered by recognised collateral	Covered by recognised guarantees
	HK\$'m	HK\$'m
On-balance sheet exposures		
Securities firm . . . . .	21	–
Corporate . . . . .	6,593	16,950
Regulatory retail . . . . .	1,590	45
Residential mortgage loans . . . . .	157	16,134
Other exposures which are not past due . . . . .	775	–
Past due exposures . . . . .	862	74
Off-balance sheet exposures . . . . .	9,069	8,612
	<u>19,067</u>	<u>41,815</u>

#### Asset securitisation

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

#### (ii) Capital charge for market risk

	2007
	HK\$'m
Interest rate exposures . . . . .	450
Equity exposures . . . . .	56
Foreign exchange exposures . . . . .	132
Commodity exposures . . . . .	2
	<u>640</u>

The Group used STM approach for calculation of market risk.

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

	2007	
	Long	Short
	HK\$'m	HK\$'m
Interest rate exposures . . . . .	208,062	207,180
Equity exposures . . . . .	333	303
Foreign exchange exposures (Net) . . . . .	1,458	–
Commodities exposures . . . . .	11	20
	<u>209,864</u>	<u>207,503</u>

## Equity exposures in banking book

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

Gains or losses related to equity exposures are summarised below:

	2007	2006
	HK\$m	HK\$m
Realised gains from sales or liquidations . . . . .	<u>1</u>	<u>7</u>
Unrealised gains on revaluation recognised in reserves but not through profit or loss. . . . .	<u>27</u>	<u>—</u>
Unrealised gains included in supplementary capital. . . . .	<u>18</u>	<u>—</u>

### (iii) Capital charge for operational risk

	2007
	HK\$m
Capital charge for operational risk. . . . .	<u>3,131</u>

The Group used STO approach for calculation of operational risk.

## 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, banks and other financial institutions*

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

### *Held-to-maturity securities*

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

### *Loans and receivables, Certificates of deposit issued and Debt securities in issue*

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.

## 5. Net interest income

	2007	2006
	HK\$m	HK\$m
<b>Interest income</b>		
Cash and due from banks and other financial institutions . . . . .	8,311	6,915
Advances to customers . . . . .	20,801	18,870
Listed investments . . . . .	2,500	2,393
Unlisted investments . . . . .	13,046	11,105
Others . . . . .	651	573
	<u>45,309</u>	<u>39,856</u>
<b>Interest expense</b>		
Due to banks, customers and other financial institutions . . . . .	(25,895)	(23,391)
Debt securities in issue . . . . .	(103)	(112)
Others . . . . .	(771)	(1,068)
	<u>(26,769)</u>	<u>(24,571)</u>
<b>Net interest income . . . . .</b>	<u><u>18,540</u></u>	<u><u>15,285</u></u>

Included within interest income is HK\$47 million (2006: HK\$88 million) of interest with respect to income recognised on advances classified as impaired for the year ended 31 December 2007. Interest accrued on impaired investment in securities amounted to HK\$1 million (2006: Nil).

Included within interest income and interest expense are HK\$44,789 million (2006: HK\$39,165 million) and HK\$26,015 million (2006: HK\$23,779 million) for financial assets and financial liabilities that are not recognised at fair value through profit or loss respectively.

## 6. Net fees and commission income

	2007	2006
	HK\$'m	HK\$'m
<b>Fees and commission income</b>		
Securities brokerage		
– Stockbroking . . . . .	3,560	1,383
– Bonds . . . . .	211	105
Credit cards . . . . .	1,027	807
Asset management . . . . .	683	317
Bills commissions . . . . .	588	537
Payment services . . . . .	464	418
Insurance . . . . .	454	343
Loan commissions . . . . .	347	273
Trust services . . . . .	153	118
Guarantees . . . . .	32	44
Others		
– currency exchange . . . . .	184	117
– safe deposit box . . . . .	182	181
– RMB business . . . . .	137	77
– information search . . . . .	42	39
– correspondent banking . . . . .	37	31
– low deposit balance accounts . . . . .	33	42
– BOC cards . . . . .	28	29
– postage and telegrams . . . . .	27	28
– agency services . . . . .	20	14
– dormant accounts . . . . .	20	24
– sundries . . . . .	251	259
	<u>8,480</u>	<u>5,186</u>
<b>Fees and commission expenses . . . . .</b>	<b>(1,897)</b>	<b>(1,259)</b>
<b>Net fees and commission income . . . . .</b>	<b><u>6,583</u></b>	<b><u>3,927</u></b>
Of which arise from		
– financial assets or financial liabilities not at fair value through profit or loss		
– Fees and commission income . . . . .	403	328
– Fees and commission expenses . . . . .	(60)	(119)
	<u>343</u>	<u>209</u>
– trust and other fiduciary activities		
– Fees and commission income . . . . .	254	183
– Fees and commission expenses . . . . .	(6)	(4)
	<u>248</u>	<u>179</u>

## 7. Net trading income

	2007	2006
	HK\$'m	HK\$'m
Net gain from:		
– foreign exchange and foreign exchange products . . . . .	800	1,113
– interest rate instruments . . . . .	30	304
– equity instruments . . . . .	181	72
– commodities. . . . .	2	78
	<u>1,013</u>	<u>1,567</u>

Comparatives for the year ended 31 December 2006 have been reclassified as a result of excluding gains and losses related to financial instruments at fair value through profit or loss other than those held for trading, which are shown as net loss on financial instruments designated at fair value through profit or loss on the consolidated income statement on page 29.

## 8. Net loss on investments in securities

	2007	2006
	HK\$'m	HK\$'m
Net loss from disposal of available-for-sale securities . . . . .	(55)	(7)
Net gain from redemption of held-to-maturity securities . . . . .	2	2
	<u>(53)</u>	<u>(5)</u>

## 9. Other operating income

	2007	2006
	HK\$'m	HK\$'m
Dividend income from investments in securities		
– unlisted investments . . . . .	15	21
Gross rental income from investment properties . . . . .	254	212
Less: Outgoings in respect of investment properties . . . . .	(52)	(56)
Others . . . . .	539	149
	<u>756</u>	<u>326</u>

Included in the “Outgoings in respect of investment properties” is HK\$3 million (2006: HK\$9 million) of direct operating expenses related to investment properties that were not let during the year.

## 10. Net (charge)/reversal of impairment allowances

	2007	2006
	HK\$'m	HK\$'m
<b>Advances to customers</b>		
Individually assessed		
– new allowances . . . . .	(330)	(647)
– releases . . . . .	299	313
– recoveries . . . . .	<u>1,311</u>	<u>2,053</u>
Net reversal of individually assessed loan impairment allowances (Note 24) . . . . .	<u>1,280</u>	<u>1,719</u>
Collectively assessed		
– new allowances . . . . .	(625)	(194)
– releases . . . . .	–	203
– recoveries . . . . .	<u>30</u>	<u>62</u>
Net (charge)/reversal of collectively assessed loan impairment allowances (Note 24) . . . . .	<u>(595)</u>	<u>71</u>
Net reversal of loan impairment allowances . . . . .	<u><u>685</u></u>	<u><u>1,790</u></u>
<b>Available-for-sale securities</b>		
Net charge of impairment losses on available-for-sale securities		
– Individually assessed . . . . .	<u>(289)</u>	<u>–</u>
<b>Held-to-maturity securities</b>		
Net charge of impairment allowances on held-to-maturity securities		
– Individually assessed (Note 25) . . . . .	<u>(1,844)</u>	<u>–</u>
<b>Properties, plant and equipment</b>		
Reversal of impairment losses on premises (Note 29) . . . . .	–	8
Impairment losses on other fixed assets (Note 29) . . . . .	<u>–</u>	<u>(4)</u>
	<u>–</u>	<u>4</u>
<b>Net (charge)/reversal of impairment allowances . . . . .</b>	<u><u>(1,448)</u></u>	<u><u>1,794</u></u>

## 11. Operating expenses

	2007	2006
	HK\$'m	HK\$'m
Staff costs (including directors' emoluments)		
– salaries and other costs . . . . .	4,281	3,679
– termination benefit . . . . .	14	15
– pension cost . . . . .	299	274
	<u>4,594</u>	<u>3,968</u>
Premises and equipment expenses (excluding depreciation)		
– rental of premises . . . . .	342	307
– information technology . . . . .	376	342
– others . . . . .	231	214
	<u>949</u>	<u>863</u>
Depreciation (Note 29) . . . . .	785	670
Auditors' remuneration		
– audit services . . . . .	31	28
– non-audit services . . . . .	5	8
Other operating expenses . . . . .	1,295	958
	<u>7,659</u>	<u>6,495</u>

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

	2007	2006
	HK\$'m	HK\$'m
Net gain on disposal of investment properties . . . . .	8	31
Net gain on fair value adjustments on investment properties (Note 28) . . . . .	1,056	574
	<u>1,064</u>	<u>605</u>

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

	2007	2006
	HK\$'m	HK\$'m
Net gain on disposal of premises . . . . .	23	9
Net loss on disposal of other fixed assets . . . . .	(16)	(24)
Net gain/(loss) on revaluation of premises (Note 29) . . . . .	21	(1)
	<u>28</u>	<u>(16)</u>

## 14. Taxation

Taxation in the income statement represents:

	<u>2007</u>	<u>2006</u>
	HK\$'m	HK\$'m
Hong Kong profits tax		
– current year taxation . . . . .	2,985	2,632
– (over)/under-provision in prior years . . . . .	(29)	3
Deferred tax charge (Note 36) . . . . .	<u>198</u>	<u>155</u>
Hong Kong profits tax . . . . .	3,154	2,790
Overseas taxation . . . . .	<u>101</u>	<u>68</u>
	<u><u>3,255</u></u>	<u><u>2,858</u></u>

Hong Kong profits tax has been provided at the rate of 17.5% (2006: 17.5%) on the estimated assessable profits arising in Hong Kong during the year. Taxation on overseas profits has been calculated on the estimated assessable profits for the year at the rates of taxation prevailing in the countries in which the Group operates.

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

	<u>2007</u>	<u>2006</u>
	HK\$'m	HK\$'m
Profit before taxation . . . . .	18,802	16,893
Calculated at a taxation rate of 17.5% (2006: 17.5%) . . . . .	3,290	2,956
Effect of different taxation rates in other countries . . . . .	5	(10)
Income not subject to taxation . . . . .	(80)	(185)
Expenses not deductible for taxation purposes . . . . .	69	93
Tax losses not recognised . . . . .	1	1
Utilisation of previously unrecognised tax losses . . . . .	(1)	–
(Over)/Under-provision in prior years . . . . .	<u>(29)</u>	<u>3</u>
Taxation charge . . . . .	<u><u>3,255</u></u>	<u><u>2,858</u></u>
Effective tax rate . . . . .	<u><u>17.3%</u></u>	<u><u>16.9%</u></u>

## 15. Profit attributable to equity holders of the Bank

The profit of the Bank for the year ended 31 December 2007 attributable to equity holders of the Bank and dealt with in the financial statements of the Bank amounted to HK\$12,701 million (2006: HK\$12,839 million).



## 16. Dividends

	2007		2006	
	Per share	Total	Per share	Total
	HK\$	HK\$m	HK\$	HK\$m
First interim dividend . . . . .	<b>0.102</b>	<b>4,390</b>	0.021	904
Second interim dividend . . . . .	<b>0.095</b>	<b>4,089</b>	0.085	3,659
Third interim dividend . . . . .	<b>0.137</b>	<b>5,897</b>	0.110	4,735
	<b><u>0.334</u></b>	<b><u>14,376</u></b>	<b><u>0.216</u></b>	<b><u>9,298</u></b>

## 17. Retirement benefit costs

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

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

The Group's total contributions made to the ORSO schemes for the year ended 31 December 2007 amounted to approximately HK\$261 million (2006: approximately HK\$240 million), after a deduction of forfeited contributions of approximately HK\$15 million (2006: approximately HK\$19 million). For the MPF Scheme, the Group contributed approximately HK\$26 million (2006: approximately HK\$20 million) for the year ended 31 December 2007.

## 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 BOCHK (Holdings) dated 10 July 2002.

The purpose of the Share Option Scheme is to provide the participants with the opportunity to acquire proprietary interests in BOCHK (Holdings). The Board of BOCHK (Holdings) may, in its absolute discretion, offer to grant options under the Share Option Scheme to any person as the Board of BOCHK (Holdings) may select. The subscription price for the shares shall be determined on the date of grant by the Board of BOCHK (Holdings) 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 Board of BOCHK (Holdings) and from time to time as specified in the offer and on or before the termination date prescribed by the Board of BOCHK (Holdings).

The purpose of the Sharesave Plan is to encourage broad-based employee ownership of the shares of BOCHK (Holdings). 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 Board of BOCHK (Holdings). When an option is exercised during an exercise period, it may be exercised in whole or in part.

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

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

On 5 July 2002, several directors together with approximately 60 senior management personnel of BOCHK (Holdings) and employees of BOC were granted options by BOC (BVI), the indirect holding company of the Bank, pursuant to a Pre-Listing Share Option Scheme to purchase from BOC (BVI) an aggregate of 31,132,600 existing issued shares of BOCHK (Holdings). 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.

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

	Directors	Senior management	Others*	Total number of share options	Average exercise price (HK\$ per share)
At 1 January 2007 . . . . .	8,459,100	3,980,450	1,446,000	13,885,550	8.5
Transfer . . . . .	(1,446,000)	–	1,446,000	–	8.5
Less: Share options exercised during the year . . . . .	(361,500)	(1,727,350)	(1,446,000)	(3,534,850)	8.5
At 31 December 2007 . . . . .	<u>6,651,600</u>	<u>2,253,100</u>	<u>1,446,000</u>	<u>10,350,700</u>	<u>8.5</u>
Exercisable at 31 December 2007 . . . . .	<u>6,651,600</u>	<u>2,253,100</u>	<u>1,446,000</u>	<u>10,350,700</u>	<u>8.5</u>
At 1 January 2006 . . . . .	8,459,100	8,302,650	1,446,000	18,207,750	8.5
Less: Share options exercised during the year . . . . .	–	(4,278,700)	–	(4,278,700)	8.5
Less: Share options lapsed during the year . . . . .	–	(43,500)	–	(43,500)	8.5
At 31 December 2006 . . . . .	<u>8,459,100</u>	<u>3,980,450</u>	<u>1,446,000</u>	<u>13,885,550</u>	<u>8.5</u>
Exercisable at 31 December 2006 . . . . .	<u>8,459,100</u>	<u>3,980,450</u>	<u>1,446,000</u>	<u>13,885,550</u>	<u>8.5</u>

\* Represented share options held by ex-directors of the Group.

Share options were exercised on a regular basis throughout the year, the weighted average share price during the year was HK\$19.38 (2006: HK\$16.50).

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.

## 19. Directors' and senior management's emoluments

### (a) 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:

	Directors' fees	Basic salaries, allowances and benefits in kind	Contributions to pension schemes	Bonus	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>For the year 2007</b>					
<i>Executive Directors</i>					
He Guangbei . . . . .	100	5,326	–	3,000	8,426
Lee Raymond Wing Hung . . . . .	259	3,044	112	1,339	4,754
Gao Yingxin . . . . .	100	2,278	–	1,120	3,498
	<u>459</u>	<u>10,648</u>	<u>112</u>	<u>5,459</u>	<u>16,678</u>
<i>Non-executive Directors</i>					
Xiao Gang . . . . .	–	–	–	–	–
Sun Changji . . . . .	300	–	–	–	300
Hua Qingshan . . . . .	137	–	–	–	137
Li Zaohang . . . . .	250	–	–	–	250
Zhou Zaiqun . . . . .	300	–	–	–	300
Zhang Yanling . . . . .	250	–	–	–	250
Fung Victor Kwok King* . . . . .	300	–	–	–	300
Koh Beng Seng* . . . . .	350	–	–	–	350
Shan Weijian* . . . . .	350	–	–	–	350
Tung Chee Chen* . . . . .	300	–	–	–	300
Tung Savio Wai-Hok* . . . . .	350	–	–	–	350
Yang Linda Tsao* . . . . .	400	–	–	–	400
	<u>3,287</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>3,287</u>
	<u>3,746</u>	<u>10,648</u>	<u>112</u>	<u>5,459</u>	<u>19,965</u>

	Directors' fees	Basic salaries, allowances and benefits in kind	Bonus	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>For the year 2006</b>				
<b><i>Executive Director</i></b>				
He Guangbei . . . . .	300	4,658	1,818	6,776
<b><i>Non-executive Directors</i></b>				
Xiao Gang . . . . .	222	—	—	222
Sun Changji . . . . .	300	—	—	300
Hua Qingshan . . . . .	300	—	—	300
Li Zaohang . . . . .	250	—	—	250
Zhou Zaiqun . . . . .	300	—	—	300
Zhang Yanling . . . . .	250	—	—	250
Fung Victor Kwok King* . . . . .	300	—	—	300
Koh Beng Seng* . . . . .	272	—	—	272
Shan Weijian* . . . . .	350	—	—	350
Tung Chee Chen* . . . . .	300	—	—	300
Tung Savio Wai-Hok* . . . . .	350	—	—	350
Yang Linda Tsao* . . . . .	400	—	—	400
	<u>3,894</u>	<u>4,658</u>	<u>1,818</u>	<u>10,370</u>

*Note:*

\* Independent Non-executive Directors

In July 2002, options were granted to several directors of the Bank by the indirect holding company, BOC (BVI), 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.

For the year ended 31 December 2007, one of the directors waived emoluments of HK\$200,000 (2006: Nil).

**(b) Five highest paid individuals**

For the year ended 31 December 2007, 2 of the five highest paid individuals in the Group were appointed as executive directors, and together with the existing director, there are 3 (2006: 1) directors whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining 2 (2006: 4) individuals during the year are as follows:

	2007	2006
	HK\$m	HK\$m
Basic salaries and allowances . . . . .	8	13
Discretionary bonuses . . . . .	4	6
Contributions to pension schemes . . . . .	1	1
	<u>13</u>	<u>20</u>

Emoluments of individuals were within the following bands:

	Number of individuals	
	2007	2006
HK\$3,500,001 – HK\$4,000,000 . . . . .	–	1
HK\$4,000,001 – HK\$4,500,000 . . . . .	–	1
HK\$5,500,001 – HK\$6,000,000 . . . . .	1	1
HK\$6,000,001 – HK\$6,500,000 . . . . .	–	1
HK\$6,500,001 – HK\$7,000,000 . . . . .	<u>1</u>	<u>–</u>

**20. Cash and balances with banks and other financial institutions**

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$m	HK\$m	HK\$m	HK\$m
Cash . . . . .	3,334	2,981	2,852	2,484
Balances with central banks . . . . .	30,627	23,745	29,814	23,270
Balances with banks and other financial institutions . . . . .	6,126	4,247	4,776	3,602
Placements with banks and other financial institutions maturing within one month . .	118,965	74,263	96,578	55,832
	<u>159,052</u>	<u>105,236</u>	<u>134,020</u>	<u>85,188</u>

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

	The Group					
	Trading securities		Financial assets designated at fair value through profit or loss		Total	
	2007	2006	2007	2006	2007	2006
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
At fair value						
Debt securities						
– Listed in Hong Kong	<b>190</b>	262	<b>727</b>	575	<b>917</b>	837
– Listed outside Hong Kong . . . . .	<u><b>537</b></u>	<u>3,683</u>	<u><b>1,002</b></u>	<u>671</u>	<u><b>1,539</b></u>	<u>4,354</u>
	<b>727</b>	3,945	<b>1,729</b>	1,246	<b>2,456</b>	5,191
– Unlisted . . . . .	<u><b>5,510</b></u>	<u>6,409</u>	<u><b>1,915</b></u>	<u>1,533</u>	<u><b>7,425</b></u>	<u>7,942</u>
	<u><b>6,237</b></u>	<u>10,354</u>	<u><b>3,644</b></u>	<u>2,779</u>	<u><b>9,881</b></u>	<u>13,133</u>
Equity securities						
– Listed in Hong Kong	<b>327</b>	19	–	–	<b>327</b>	19
– Unlisted . . . . .	<u><b>94</b></u>	<u>42</u>	<u>–</u>	<u>–</u>	<u><b>94</b></u>	<u>42</u>
	<b>421</b>	61	–	–	<b>421</b>	61
Total . . . . .	<u><b>6,658</b></u>	<u>10,415</u>	<u><b>3,644</b></u>	<u>2,779</u>	<u><b>10,302</b></u>	<u>13,194</u>

	The Bank					
	Trading securities		Financial assets designated at fair value through profit or loss		Total	
	2007	2006	2007	2006	2007	2006
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
At fair value						
Debt securities						
– Listed in Hong Kong	<b>189</b>	261	<b>101</b>	101	<b>290</b>	362
– Listed outside Hong Kong . . . . .	<u><b>537</b></u>	<u>3,683</u>	<u><b>158</b></u>	<u>156</u>	<u><b>695</b></u>	<u>3,839</u>
	<b>726</b>	3,944	<b>259</b>	257	<b>985</b>	4,201
– Unlisted . . . . .	<u><b>5,057</b></u>	<u>6,328</u>	<u>–</u>	<u>–</u>	<u><b>5,057</b></u>	<u>6,328</u>
	<u><b>5,783</b></u>	<u>10,272</u>	<u><b>259</b></u>	<u>257</u>	<u><b>6,042</b></u>	<u>10,529</u>
Equity securities						
– Listed in Hong Kong	<b>327</b>	19	–	–	<b>327</b>	19
Total . . . . .	<u><b>6,110</b></u>	<u>10,291</u>	<u><b>259</b></u>	<u>257</u>	<u><b>6,369</b></u>	<u>10,548</u>

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

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Sovereigns . . . . .	<b>3,756</b>	3,907	<b>3,261</b>	3,784
Public sector entities . . . . .	<b>413</b>	1,270	<b>299</b>	1,158
Banks and other financial institutions . . . .	<b>3,899</b>	6,912	<b>2,352</b>	5,470
Corporate entities . . . . .	<b>2,234</b>	1,105	<b>457</b>	136
	<b><u>10,302</u></b>	<b><u>13,194</u></b>	<b><u>6,369</u></b>	<b><u>10,548</u></b>

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

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Treasury bills . . . . .	<b>3,517</b>	3,616	<b>3,066</b>	3,536
Certificates of deposit held . . . . .	<b>430</b>	769	<b>80</b>	413
Other financial assets at fair value through profit or loss . . . . .	<b>6,355</b>	8,809	<b>3,223</b>	6,599
	<b><u>10,302</u></b>	<b><u>13,194</u></b>	<b><u>6,369</u></b>	<b><u>10,548</u></b>

## 22. Derivative financial instruments and hedge accounting

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

Currency forwards represent commitments to purchase and sell foreign currency on a future date. Interest rate futures are contractual obligations to receive or pay a net amount based on changes in interest rates or buy or sell interest rate financial instruments on a future date at an agreed price in the financial market under the administration of the stock exchange. Forward rate agreements are individually negotiated interest rate futures that call for a cash settlement at a future date for the difference between a contracted rate of interest and the current market rate, based on a notional principal amount.

Currency, interest rate and precious metal swaps are commitments to exchange one set of cash flows or commodity for another. Swaps result in an exchange of currencies, interest rates (for example, fixed rate for floating rate), or precious metals (for example, silver swaps) 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, equity and precious metal 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 and metal prices relative to their terms. The aggregate fair values of derivative financial instruments assets and liabilities can fluctuate significantly from time to time.

**(a) Derivative financial instruments**

The Group trades derivatives products (both exchange-traded or OTC) mainly for customer business. The Group strictly follows risk management policies in providing derivatives products to our customers and in trading of derivatives products in the interbank market.

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 derivatives transactions, and the maximum tenor of the deal and management alert limit (MAL) in profit and loss is set. Every derivative transaction must be input into relevant system for settlement, mark to market revaluation, reporting and control.

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

	The Group			
	2007			
			Not qualified for hedge accounting*	
	Trading	Hedging		Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Exchange rate contracts				
Spot and forwards . . . . .	258,556	—	—	258,556
Swaps. . . . .	156,554	—	—	156,554
Foreign currency option contracts				
– Options purchased. . . . .	5,607	—	—	5,607
– Options written. . . . .	5,875	—	—	5,875
	<u>426,592</u>	<u>—</u>	<u>—</u>	<u>426,592</u>
Interest rate contracts				
Futures . . . . .	226	—	—	226
Swaps. . . . .	36,714	6,708	3,253	46,675
Interest rate option contracts				
– Swaptions written . . . . .	780	—	—	780
– Bond options written. . . . .	780	—	—	780
	<u>38,500</u>	<u>6,708</u>	<u>3,253</u>	<u>48,461</u>
Bullion contracts . . . . .	<u>12,950</u>	<u>—</u>	<u>—</u>	<u>12,950</u>
Equity contracts . . . . .	<u>5,378</u>	<u>—</u>	<u>—</u>	<u>5,378</u>
Other contracts. . . . .	<u>172</u>	<u>—</u>	<u>—</u>	<u>172</u>
Total . . . . .	<u>483,592</u>	<u>6,708</u>	<u>3,253</u>	<u>493,553</u>



The Group				
2006				
	Trading	Hedging	Not qualified for hedge accounting*	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Exchange rate contracts				
Spot and forwards . . . . .	147,240	–	–	147,240
Swaps. . . . .	171,471	–	–	171,471
Foreign currency option contracts				
– Options purchased. . . . .	1,479	–	–	1,479
– Options written. . . . .	3,102	–	–	3,102
	<u>323,292</u>	<u>–</u>	<u>–</u>	<u>323,292</u>
Interest rate contracts				
Futures . . . . .	89	–	–	89
Swaps. . . . .	28,319	467	4,240	33,026
Interest rate option contracts				
– Swaptions written . . . . .	31	–	–	31
– Bond options written. . . . .	311	–	–	311
	<u>28,750</u>	<u>467</u>	<u>4,240</u>	<u>33,457</u>
Bullion contracts . . . . .	<u>7,330</u>	<u>–</u>	<u>–</u>	<u>7,330</u>
Equity contracts . . . . .	<u>954</u>	<u>–</u>	<u>–</u>	<u>954</u>
Other contracts. . . . .	<u>201</u>	<u>–</u>	<u>–</u>	<u>201</u>
Total . . . . .	<u>360,527</u>	<u>467</u>	<u>4,240</u>	<u>365,234</u>

\* Derivative transactions which do not qualify as hedges 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.

The Bank				
2007				
	Trading	Hedging	Not qualified for hedge accounting	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Exchange rate contracts				
Spot and forwards . . . . .	248,700	–	–	248,700
Swaps . . . . .	154,572	–	–	154,572
Foreign currency option contracts				
– Options purchased . . . . .	5,607	–	–	5,607
– Options written . . . . .	5,875	–	–	5,875
	<u>414,754</u>	<u>–</u>	<u>–</u>	<u>414,754</u>
Interest rate contracts				
Futures . . . . .	226	–	–	226
Swaps . . . . .	34,900	6,708	540	42,148
Interest rate option contracts				
– Swaptions written . . . . .	780	–	–	780
– Bond options written . . . . .	780	–	–	780
	<u>36,686</u>	<u>6,708</u>	<u>540</u>	<u>43,934</u>
Bullion contracts . . . . .	<u>12,652</u>	<u>–</u>	<u>–</u>	<u>12,652</u>
Equity contracts . . . . .	<u>5,355</u>	<u>–</u>	<u>–</u>	<u>5,355</u>
Other contracts . . . . .	<u>155</u>	<u>–</u>	<u>–</u>	<u>155</u>
Total . . . . .	<u>469,602</u>	<u>6,708</u>	<u>540</u>	<u>476,850</u>

The Bank				
2006				
	Trading	Hedging	Not qualified for hedge accounting	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Exchange rate contracts				
Spot and forwards . . . . .	141,694	–	–	141,694
Swaps . . . . .	170,279	–	–	170,279
Foreign currency option contracts				
– Options purchased . . . . .	1,479	–	–	1,479
– Options written . . . . .	3,102	–	–	3,102
	<u>316,554</u>	<u>–</u>	<u>–</u>	<u>316,554</u>
Interest rate contracts				
Futures . . . . .	89	–	–	89
Swaps . . . . .	26,888	156	539	27,583
Interest rate option contracts				
– Swaptions written . . . . .	31	–	–	31
– Bond options written . . . . .	311	–	–	311
	<u>27,319</u>	<u>156</u>	<u>539</u>	<u>28,014</u>
Bullion contracts . . . . .	<u>7,330</u>	<u>–</u>	<u>–</u>	<u>7,330</u>
Equity contracts . . . . .	<u>922</u>	<u>–</u>	<u>–</u>	<u>922</u>
Other contracts . . . . .	<u>181</u>	<u>–</u>	<u>–</u>	<u>181</u>
Total . . . . .	<u>352,306</u>	<u>156</u>	<u>539</u>	<u>353,001</u>

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

	The Group							
	2007							
	Fair value assets				Fair value liabilities			
	Trading	Hedging	Not qualified for hedge accounting	Total	Trading	Hedging	Not qualified for hedge accounting	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Exchange rate contracts								
Spot and forwards . . . . .	12,588	–	–	12,588	(7,822)	–	–	(7,822)
Swaps . . . . .	269	–	–	269	(634)	–	–	(634)
Foreign currency option contracts								
– Options purchased . . .	48	–	–	48	–	–	–	–
– Options written . . . .	–	–	–	–	(51)	–	–	(51)
	<u>12,905</u>	<u>–</u>	<u>–</u>	<u>12,905</u>	<u>(8,507)</u>	<u>–</u>	<u>–</u>	<u>(8,507)</u>
Interest rate contracts								
Swaps . . . . .	492	10	23	525	(885)	(124)	(90)	(1,099)
Interest rate option contracts								
– Swaptions written . . .	–	–	–	–	(17)	–	–	(17)
– Bond options written .	–	–	–	–	(23)	–	–	(23)
	<u>492</u>	<u>10</u>	<u>23</u>	<u>525</u>	<u>(925)</u>	<u>(124)</u>	<u>(90)</u>	<u>(1,139)</u>
Bullion contracts . . . . .	<u>774</u>	<u>–</u>	<u>–</u>	<u>774</u>	<u>(1,110)</u>	<u>–</u>	<u>–</u>	<u>(1,110)</u>
Equity contracts . . . . .	<u>273</u>	<u>–</u>	<u>–</u>	<u>273</u>	<u>(326)</u>	<u>–</u>	<u>–</u>	<u>(326)</u>
Total . . . . .	<u>14,444</u>	<u>10</u>	<u>23</u>	<u>14,477</u>	<u>(10,868)</u>	<u>(124)</u>	<u>(90)</u>	<u>(11,082)</u>

The Group								
2006								
Fair value assets					Fair value liabilities			
		Not qualified for hedge accounting	Total			Not qualified for hedge accounting	Total	
Trading	Hedging			Trading	Hedging			
HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Exchange rate contracts								
Spot and forwards . . . . .	6,033	–	–	6,033	(2,529)	–	–	(2,529)
Swaps . . . . .	775	–	–	775	(302)	–	–	(302)
Foreign currency option contracts								
– Options purchased . . .	8	–	–	8	–	–	–	–
– Options written . . . .	–	–	–	–	(12)	–	–	(12)
	<u>6,816</u>	–	–	<u>6,816</u>	<u>(2,843)</u>	–	–	<u>(2,843)</u>
Interest rate contracts								
Swaps . . . . .	313	7	34	354	(632)	(4)	(130)	(766)
Interest rate option contracts								
– Bond options written .	–	–	–	–	(3)	–	–	(3)
	<u>313</u>	<u>7</u>	<u>34</u>	<u>354</u>	<u>(635)</u>	<u>(4)</u>	<u>(130)</u>	<u>(769)</u>
Bullion contracts . . . . .	<u>219</u>	–	–	<u>219</u>	<u>(438)</u>	–	–	<u>(438)</u>
Equity contracts . . . . .	<u>4</u>	–	–	<u>4</u>	<u>(2)</u>	–	–	<u>(2)</u>
Total . . . . .	<u><u>7,352</u></u>	<u><u>7</u></u>	<u><u>34</u></u>	<u><u>7,393</u></u>	<u><u>(3,918)</u></u>	<u><u>(4)</u></u>	<u><u>(130)</u></u>	<u><u>(4,052)</u></u>

The Bank								
2007								
Fair value assets					Fair value liabilities			
Trading	Hedging	Not qualified for hedge accounting	Total		Trading	Hedging	Not qualified for hedge accounting	Total
HK\$'m	HK\$'m	HK\$'m	HK\$'m		HK\$'m	HK\$'m	HK\$'m	HK\$'m
Exchange rate contracts								
Spot and forwards . . . . .	12,100	–	–	12,100	(7,705)	–	–	(7,705)
Swaps . . . . .	265	–	–	265	(617)	–	–	(617)
Foreign currency option contracts								
– Options purchased . . .	48	–	–	48	–	–	–	–
– Options written . . . .	–	–	–	–	(51)	–	–	(51)
	<u>12,413</u>	<u>–</u>	<u>–</u>	<u>12,413</u>	<u>(8,373)</u>	<u>–</u>	<u>–</u>	<u>(8,373)</u>
Interest rate contracts								
Swaps . . . . .	502	10	3	515	(811)	(124)	(6)	(941)
Interest rate option contracts								
– Swaptions written . . .	–	–	–	–	(17)	–	–	(17)
– Bond options written .	–	–	–	–	(23)	–	–	(23)
	<u>502</u>	<u>10</u>	<u>3</u>	<u>515</u>	<u>(851)</u>	<u>(124)</u>	<u>(6)</u>	<u>(981)</u>
Bullion contracts . . . . .	772	–	–	772	(1,108)	–	–	(1,108)
Equity contracts . . . . .	272	–	–	272	(326)	–	–	(326)
Total . . . . .	<u>13,959</u>	<u>10</u>	<u>3</u>	<u>13,972</u>	<u>(10,658)</u>	<u>(124)</u>	<u>(6)</u>	<u>(10,788)</u>

The Bank								
2006								
Fair value assets					Fair value liabilities			
Trading	Hedging	Not qualified for hedge accounting	Total		Trading	Hedging	Not qualified for hedge accounting	Total
HK\$'m	HK\$'m	HK\$'m	HK\$'m		HK\$'m	HK\$'m	HK\$'m	HK\$'m
Exchange rate contracts								
Spot and forwards . . . . .	5,770	–	–	5,770	(2,489)	–	–	(2,489)
Swaps . . . . .	768	–	–	768	(296)	–	–	(296)
Foreign currency option contracts								
– Options purchased . . .	8	–	–	8	–	–	–	–
– Options written . . . .	–	–	–	–	(12)	–	–	(12)
	<u>6,546</u>	–	–	<u>6,546</u>	<u>(2,797)</u>	–	–	<u>(2,797)</u>
Interest rate contracts								
Swaps . . . . .	312	2	10	324	(601)	–	(13)	(614)
Interest rate option contracts								
– Bond options written .	–	–	–	–	(3)	–	–	(3)
	<u>312</u>	<u>2</u>	<u>10</u>	<u>324</u>	<u>(604)</u>	–	<u>(13)</u>	<u>(617)</u>
Bullion contracts . . . . .	<u>219</u>	–	–	<u>219</u>	<u>(438)</u>	–	–	<u>(438)</u>
Equity contracts . . . . .	<u>3</u>	–	–	<u>3</u>	<u>(2)</u>	–	–	<u>(2)</u>
Total . . . . .	<u>7,080</u>	<u>2</u>	<u>10</u>	<u>7,092</u>	<u>(3,841)</u>	–	<u>(13)</u>	<u>(3,854)</u>

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

The Group		
	2007	2006
	HK\$'m	HK\$'m
Exchange rate contracts		
Forwards . . . . .	<b>1,017</b>	23
Swaps . . . . .	<b>492</b>	494
Foreign currency option contracts		
– Options purchased . . . . .	<b>19</b>	8
Interest rate contracts		
Swaps . . . . .	<b>104</b>	47
Bullion contracts . . . . .	<b>63</b>	19
Equity contracts . . . . .	<b>49</b>	16
	<u><b>1,744</b></u>	<u>607</u>

	The Bank	
	2007	2006
	HK\$'m	HK\$'m
Exchange rate contracts		
Forwards . . . . .	<b>1,011</b>	23
Swaps . . . . .	<b>487</b>	491
Foreign currency option contracts		
– Options purchased . . . . .	<b>19</b>	8
Interest rate contracts		
Swaps . . . . .	<b>93</b>	33
Bullion contracts . . . . .	<b>63</b>	19
Equity contracts . . . . .	<b>52</b>	16
	<b><u>1,725</u></b>	<b><u>590</u></b>

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

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

Approximately 52% (2006: 61%) and 52% (2006: 60%) of the Group's and the Bank's transactions in derivative contracts are conducted with other financial institutions respectively.

#### (b) Hedge accounting

The Group designated all derivatives held for hedging as fair value hedges.

The Group uses interest rate swaps to hedge against change in fair value of financial assets arising from movements in market rates.

Gains or losses on fair value hedges for the year are as follows:

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Net gain/(loss) on				
– hedging instruments . . . . .	<b>(125)</b>	8	<b>(116)</b>	2
– hedged items . . . . .	<b>114</b>	(9)	<b>105</b>	(2)
	<b><u>(11)</u></b>	<b><u>(1)</u></b>	<b><u>(11)</u></b>	<b><u>–</u></b>



## 23. Advances and other accounts

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Personal loans and advances . . . . .	<b>141,686</b>	129,362	<b>114,816</b>	106,129
Corporate loans and advances . . . . .	<b>271,354</b>	217,714	<b>220,391</b>	181,796
Advances to customers . . . . .	<b>413,040</b>	347,076	<b>335,207</b>	287,925
Loan impairment allowances				
– Individually assessed . . . . .	<b>(381)</b>	(546)	<b>(306)</b>	(470)
– Collectively assessed . . . . .	<b>(1,004)</b>	(557)	<b>(648)</b>	(336)
	<b>411,655</b>	345,973	<b>334,253</b>	287,119
Trade bills . . . . .	<b>5,334</b>	3,128	<b>4,421</b>	2,686
Advances to banks and other financial institutions . . . . .	<b>3,223</b>	3,743	<b>3,222</b>	3,491
Total . . . . .	<b>420,212</b>	352,844	<b>341,896</b>	293,296

As at 31 December 2007, advances to customers of the Group and the Bank included accrued interest on gross advances of HK\$1,454 million (2006: HK\$1,236 million) and HK\$1,209 million (2006: HK\$1,042 million) respectively.

## 24. Loan impairment allowances

	The Group		
	2007		
	Individual assessment		
	Personal	Corporate	Total
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2007 . . . . .	<b>117</b>	<b>429</b>	<b>546</b>
Credited to income statement (Note 10) . . . . .	<b>(52)</b>	<b>(1,228)</b>	<b>(1,280)</b>
Loans written off during the year as uncollectible . . . . .	<b>(27)</b>	<b>(145)</b>	<b>(172)</b>
Recoveries . . . . .	<b>50</b>	<b>1,261</b>	<b>1,311</b>
Unwind of discount on allowance . . . . .	<b>(6)</b>	<b>(18)</b>	<b>(24)</b>
At 31 December 2007 . . . . .	<b>82</b>	<b>299</b>	<b>381</b>

	The Bank		
	2007		
	Individual assessment		
	Personal	Corporate	Total
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2007 . . . . .	108	362	470
Credited to income statement . . . . .	(27)	(1,068)	(1,095)
Loans written off during the year as uncollectible . . .	(25)	(123)	(148)
Recoveries . . . . .	25	1,076	1,101
Unwind of discount on allowance . . . . .	(5)	(17)	(22)
At 31 December 2007 . . . . .	<u>76</u>	<u>230</u>	<u>306</u>

	The Group		
	2006		
	Individual assessment		
	Personal	Corporate	Total
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2006 . . . . .	37	946	983
Charged/(Credited) to income statement (Note 10) . . .	63	(1,782)	(1,719)
Loans written off during the year as uncollectible . . .	(36)	(670)	(706)
Recoveries . . . . .	56	1,997	2,053
Unwind of discount on allowance . . . . .	(3)	(62)	(65)
At 31 December 2006 . . . . .	<u>117</u>	<u>429</u>	<u>546</u>

	The Bank		
	2006		
	Individual assessment		
	Personal	Corporate	Total
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2006 . . . . .	16	756	772
Charged/(Credited) to income statement . . . . .	80	(1,726)	(1,646)
Loans written off during the year as uncollectible . . .	(35)	(479)	(514)
Recoveries . . . . .	50	1,868	1,918
Unwind of discount on allowance . . . . .	(3)	(57)	(60)
At 31 December 2006 . . . . .	<u>108</u>	<u>362</u>	<u>470</u>

	The Group		
	2007		
	Collective assessment		
	Personal	Corporate	Total
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2007 . . . . .	107	450	557
Charged to income statement (Note 10) . . . . .	197	398	595
Loans written off during the year as uncollectible . . .	(155)	–	(155)
Recoveries . . . . .	30	–	30
Unwind of discount on allowance . . . . .	(6)	(17)	(23)
At 31 December 2007 . . . . .	<u>173</u>	<u>831</u>	<u>1,004</u>

	The Bank		
	2007		
	Collective assessment		
	Personal	Corporate	Total
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2007 . . . . .	31	305	336
Charged to income statement . . . . .	65	261	326
Loans written off during the year as uncollectible . . .	–	–	–
Recoveries . . . . .	–	–	–
Unwind of discount on allowance . . . . .	(5)	(9)	(14)
At 31 December 2007 . . . . .	<u>91</u>	<u>557</u>	<u>648</u>

	The Group		
	2006		
	Collective assessment		
	Personal	Corporate	Total
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2006 . . . . .	233	498	731
Credited to income statement (Note 10) . . . . .	(27)	(44)	(71)
Loans written off during the year as uncollectible . . .	(142)	–	(142)
Recoveries . . . . .	47	15	62
Unwind of discount on allowance . . . . .	(4)	(19)	(23)
At 31 December 2006 . . . . .	<u>107</u>	<u>450</u>	<u>557</u>

	The Bank		
	2006		
	Collective assessment		
	Personal	Corporate	Total
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2006 . . . . .	177	381	558
Credited to income statement . . . . .	(156)	(74)	(230)
Loans written off during the year as uncollectible . . .	–	–	–
Recoveries . . . . .	12	15	27
Unwind of discount on allowance . . . . .	(2)	(17)	(19)
At 31 December 2006 . . . . .	<u>31</u>	<u>305</u>	<u>336</u>

## 25. Investment in securities

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>(a) Available-for-sale securities</b>				
Debt securities				
– Listed in Hong Kong . . . . .	<b>3,659</b>	4,800	<b>3,500</b>	4,646
– Listed outside Hong Kong . . . . .	<b>18,455</b>	13,023	<b>18,203</b>	12,779
	<b>22,114</b>	17,823	<b>21,703</b>	17,425
– Unlisted . . . . .	<b>77,959</b>	82,516	<b>75,627</b>	80,050
	<b>100,073</b>	100,339	<b>97,330</b>	97,475
Equity securities				
– Unlisted . . . . .	<b>445</b>	50	<b>62</b>	39
	<b>100,518</b>	100,389	<b>97,392</b>	97,514
<b>(b) Held-to-maturity securities</b>				
Listed, at amortised cost				
– in Hong Kong . . . . .	<b>4,107</b>	3,935	<b>3,525</b>	3,344
– outside Hong Kong . . . . .	<b>21,078</b>	24,629	<b>19,279</b>	22,892
	<b>25,185</b>	28,564	<b>22,804</b>	26,236
Unlisted, at amortised cost . . . . .	<b>141,925</b>	137,024	<b>129,751</b>	120,237
	<b>167,110</b>	165,588	<b>152,555</b>	146,473
Impairment allowances . . . . .	<b>(1,682)</b>	–	<b>(1,682)</b>	–
	<b>165,428</b>	165,588	<b>150,873</b>	146,473
<b>(c) Loans and receivables</b>				
Unlisted, at amortised cost . . . . .	<b>31,102</b>	36,114	<b>22,784</b>	30,750
<b>Total</b>	<b>297,048</b>	302,091	<b>271,049</b>	274,737
Market value of listed held-to-maturity securities	<b>24,776</b>	28,029	<b>22,418</b>	25,757

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

The Group				
2007				
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Sovereigns . . . . .	13,402	1,814	–	15,216
Public sector entities . . . . .	9,673	20,530	–	30,203
Banks and other financial institutions . . . .	43,854	108,547	31,102	183,503
Corporate entities . . . . .	33,589	34,537	–	68,126
	<u>100,518</u>	<u>165,428</u>	<u>31,102</u>	<u>297,048</u>

The Group				
2006				
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Sovereigns . . . . .	13,180	1,768	–	14,948
Public sector entities . . . . .	6,933	21,166	–	28,099
Banks and other financial institutions . . . .	34,873	102,823	36,114	173,810
Corporate entities . . . . .	45,403	39,831	–	85,234
	<u>100,389</u>	<u>165,588</u>	<u>36,114</u>	<u>302,091</u>

The Bank				
2007				
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Sovereigns . . . . .	12,713	1,615	–	14,328
Public sector entities . . . . .	9,673	18,823	–	28,496
Banks and other financial institutions . . . .	43,047	98,225	22,784	164,056
Corporate entities . . . . .	31,959	32,210	–	64,169
	<u>97,392</u>	<u>150,873</u>	<u>22,784</u>	<u>271,049</u>

The Bank				
2006				
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Sovereigns . . . . .	12,493	1,668	–	14,161
Public sector entities . . . . .	6,934	18,632	–	25,566
Banks and other financial institutions . . . . .	33,865	88,956	30,750	153,571
Corporate entities . . . . .	44,222	37,217	–	81,439
	<u>97,514</u>	<u>146,473</u>	<u>30,750</u>	<u>274,737</u>

The movements in investment in securities are summarised as follows:

The Group			
2007			
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2007 . . . . .	100,389	165,588	36,114
Additions . . . . .	103,595	93,912	59,147
Disposals, redemptions and maturity . . . . .	(104,590)	(94,989)	(65,713)
Amortisation . . . . .	378	225	1,472
Change in fair value . . . . .	(803)	–	–
Impairment losses . . . . .	–	(1,844)	–
Exchange differences . . . . .	1,549	2,536	82
At 31 December 2007 . . . . .	<u>100,518</u>	<u>165,428</u>	<u>31,102</u>

The Group			
2006			
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2006 . . . . .	52,243	178,521	13,080
Additions . . . . .	107,789	55,135	80,872
Disposals, redemptions and maturity . . . . .	(61,732)	(69,847)	(59,046)
Amortisation . . . . .	855	(40)	1,109
Change in fair value . . . . .	90	–	–
Exchange differences . . . . .	1,144	1,819	99
At 31 December 2006 . . . . .	<u>100,389</u>	<u>165,588</u>	<u>36,114</u>

The Bank			
2007			
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2007 . . . . .	97,514	146,473	30,750
Additions . . . . .	99,422	77,610	40,692
Disposals, redemptions and maturity . . . . .	(100,624)	(73,799)	(49,841)
Amortisation . . . . .	357	157	1,184
Change in fair value . . . . .	(812)	–	–
Impairment losses . . . . .	–	(1,844)	–
Exchange differences . . . . .	1,535	2,276	(1)
At 31 December 2007 . . . . .	<u>97,392</u>	<u>150,873</u>	<u>22,784</u>

The Bank			
2006			
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables
	HK\$'m	HK\$'m	HK\$'m
At 1 January 2006 . . . . .	50,119	158,571	8,414
Additions . . . . .	103,551	31,103	62,517
Disposals, redemptions and maturity . . . . .	(58,207)	(44,586)	(41,037)
Amortisation . . . . .	831	(149)	853
Change in fair value . . . . .	84	–	–
Exchange differences . . . . .	1,136	1,534	3
At 31 December 2006 . . . . .	<u>97,514</u>	<u>146,473</u>	<u>30,750</u>

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

	The Group			
	Available-for-sale securities		Held-to-maturity securities	
	2007	2006	2007	2006
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Treasury bills . . . . .	9,396	7,566	200	100
Certificates of deposit held . . . . .	7,466	8,148	11,988	9,367
Others . . . . .	83,656	84,675	153,240	156,121
	100,518	100,389	165,428	165,588

	The Bank			
	Available-for-sale securities		Held-to-maturity securities	
	2007	2006	2007	2006
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Treasury bills . . . . .	8,708	6,879	—	—
Certificates of deposit held . . . . .	6,748	7,141	9,405	5,596
Others . . . . .	81,936	83,494	141,468	140,877
	<u>97,392</u>	<u>97,514</u>	<u>150,873</u>	<u>146,473</u>

The movements in impairment allowances on held-to-maturity securities are summarised as follows:

	The Group and the Bank	
	2007	2006
	HK\$'m	HK\$'m
At 1 January . . . . .	—	—
Debited to income statement (Note 10) . . . . .	1,844	—
Disposals . . . . .	(162)	—
At 31 December . . . . .	<u>1,682</u>	<u>—</u>

## 26. Interests in subsidiaries

	The Bank	
	2007	2006
	HK\$'m	HK\$'m
Unlisted shares, at cost . . . . .	12,423	12,353
Less: Provision for impairment in value . . . . .	(21)	(39)
	<u>12,402</u>	<u>12,314</u>
Amounts due from subsidiaries . . . . .	464	543
	<u>12,866</u>	<u>12,857</u>

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

Name	Country of incorporation & place of operation	Particulars of issued share capital	Interest held	Principal activities
Nanyang Commercial Bank, Limited	Hong Kong	6,000,000 ordinary shares of HK\$100 each	100%	Banking business
Chiyu Banking Corporation Limited	Hong Kong	3,000,000 ordinary shares of HK\$100 each	70.49%	Banking business
BOC Credit Card (International) Limited	Hong Kong	4,800,000 ordinary shares of HK\$100 each	100%	Credit card services
Po Sang Futures Limited	Hong Kong	250,000 ordinary shares of HK\$100 each	*100%	Commodities brokerage

\* Shares held indirectly by the Bank



## 27. Interests in associates

	The Group	
	2007	2006
	HK\$'m	HK\$'m
At 1 January . . . . .	<b>60</b>	61
Investment cost addition . . . . .	<b>24</b>	—
Share of result . . . . .	<b>4</b>	6
Share of tax . . . . .	<b>(1)</b>	(1)
Dividends received . . . . .	<b>(3)</b>	(4)
Dissolution of an associate . . . . .	<b>(1)</b>	—
Disposal of an associate . . . . .	<b>—</b>	(2)
At 31 December . . . . .	<b><u>83</u></b>	<u>60</u>

As at 31 December 2007, the Bank held HK\$13 million (2006: HK\$50 million) of unlisted shares in its associates with HK\$1 million (2006: HK\$24 million) of provision for impairment in value.

The Group's interests in its associates, all of which are unlisted, are as follows:

Name	CJM Insurance Brokers Limited	Joint Electronic Teller Services Limited	BOC Services Company Limited
	2007 and 2006	2007 and 2006	2007
<b>Place of incorporation</b>	<b>Hong Kong</b>	<b>Hong Kong</b>	<b>PRC</b>
<b>Particulars of issued share capital/registered capital</b>	<b>6,000,000 ordinary shares of HK\$1 each</b>	<b>100,238 ordinary shares of HK\$100 each</b>	<b>Registered capital RMB50,000,000</b>
<b>Principal activities</b>	<b>Insurance broker</b>	<b>Operation of a private inter-bank message switching network in respect of ATM services</b>	<b>Credit card back- end service support</b>
	<b>2007</b>	<b>2006</b>	<b>2007</b>
	<b>HK\$'000</b>	<b>HK\$'000</b>	<b>HK\$'000</b>
<b>Assets . . . . .</b>	<b>64,331</b>	66,807	<b>53,677</b>
<b>Liabilities . . . . .</b>	<b>51,815</b>	52,772	—
<b>Revenues . . . . .</b>	<b>10,330</b>	11,214	—
<b>Profit after taxation . . .</b>	<b>1,481</b>	2,866	—
	<b>2007</b>	<b>2006</b>	<b>2007</b>
	<b>33.33%</b>	33.33%	<b>45.00%</b>
<b>Interest held . . . . .</b>	<b>33.33%</b>	<b>19.96%</b>	—

Trilease International Limited completed winding up procedures on 7 April 2007.

BOC Services Company Limited was established in Beijing in November 2007.

## 28. Investment properties

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
At 1 January . . . . .	<b>7,481</b>	7,539	<b>6,992</b>	6,920
Disposals . . . . .	<b>(200)</b>	(442)	<b>(123)</b>	(283)
Fair value gains (Note 12) . . . . .	<b>1,056</b>	574	<b>988</b>	550
Reclassification to properties, plant and equipment (Note 29) . . . . .	<b>(279)</b>	(190)	<b>(262)</b>	(195)
At 31 December . . . . .	<b><u>8,058</u></b>	<u>7,481</u>	<b><u>7,595</u></b>	<u>6,992</u>

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

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

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Held in Hong Kong				
On long-term lease (over 50 years) . . . .	<b>7,251</b>	6,687	<b>7,051</b>	6,431
On medium-term lease (10 – 50 years) . .	<b>528</b>	545	<b>301</b>	339
On short-term lease (less than 10 years) .	<b>48</b>	40	<b>48</b>	40
Held outside Hong Kong				
On long-term lease (over 50 years) . . . .	<b>3</b>	4	<b>3</b>	4
On medium-term lease (10 – 50 years) . .	<b>224</b>	201	<b>192</b>	178
On short-term lease (less than 10 years) .	<b>4</b>	4	<b>–</b>	–
	<b><u>8,058</u></b>	<u>7,481</u>	<b><u>7,595</u></b>	<u>6,992</u>

## 29. Properties, plant and equipment

	The Group			
	Premises	Property under development	Equipment, fixtures and fittings	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Net book value at 1 January 2007 . . . . .	17,906	–	1,829	19,735
Additions . . . . .	–	–	1,145	1,145
Disposals . . . . .	(16)	–	(17)	(33)
Revaluation . . . . .	2,946	–	–	2,946
Depreciation for the year (Note 11) . . . . .	(332)	–	(453)	(785)
Reclassification from investment properties (Note 28) . . . . .	279	–	–	279
Exchange adjustments . . . . .	–	–	1	1
Net book value at 31 December 2007 . . . .	<u>20,783</u>	<u>–</u>	<u>2,505</u>	<u>23,288</u>
At 31 December 2007				
Cost or valuation . . . . .	20,783	–	5,615	26,398
Accumulated depreciation and impairment .	–	–	(3,110)	(3,110)
Net book value at 31 December 2007 . . . .	<u>20,783</u>	<u>–</u>	<u>2,505</u>	<u>23,288</u>
Net book value at 1 January 2006 . . . . .	16,820	11	1,485	18,316
Additions . . . . .	–	–	736	736
Disposals . . . . .	(17)	(7)	(25)	(49)
Revaluation . . . . .	1,208	–	–	1,208
Depreciation for the year (Note 11) . . . . .	(303)	–	(367)	(670)
Reclassification from investment properties (Note 28) . . . . .	190	–	–	190
Reversal of/(provision for) impairment losses (Note 10) . . . . .	8	(4)	–	4
Net book value at 31 December 2006 . . . .	<u>17,906</u>	<u>–</u>	<u>1,829</u>	<u>19,735</u>
At 31 December 2006				
Cost or valuation . . . . .	17,906	–	4,633	22,539
Accumulated depreciation and impairment .	–	–	(2,804)	(2,804)
Net book value at 31 December 2006 . . . .	<u>17,906</u>	<u>–</u>	<u>1,829</u>	<u>19,735</u>

	The Group			
	Premises	Property under development	Equipment, fixtures and fittings	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
The analysis of cost or valuation of the above assets is as follows:				
At 31 December 2007				
At cost. . . . .	–	–	5,615	5,615
At valuation. . . . .	<u>20,783</u>	–	–	<u>20,783</u>
	<u>20,783</u>	–	<u>5,615</u>	<u>26,398</u>
At 31 December 2006				
At cost. . . . .	–	–	4,633	4,633
At valuation. . . . .	<u>17,906</u>	–	–	<u>17,906</u>
	<u>17,906</u>	–	<u>4,633</u>	<u>22,539</u>

	The Bank		
	Premises	Equipment, fixtures and fittings	Total
	HK\$'m	HK\$'m	HK\$'m
Net book value at 1 January 2007 . . . . .	13,628	1,630	15,258
Additions . . . . .	–	1,070	1,070
Disposals . . . . .	–	(14)	(14)
Revaluation . . . . .	2,354	–	2,354
Depreciation for the year . . . . .	(270)	(399)	(669)
Reclassification from investment properties (Note 28).	<u>262</u>	–	<u>262</u>
Net book value at 31 December 2007 . . . . .	<u>15,974</u>	<u>2,287</u>	<u>18,261</u>
At 31 December 2007			
Cost or valuation . . . . .	15,974	4,959	20,933
Accumulated depreciation and impairment . . . . .	–	(2,672)	(2,672)
Net book value at 31 December 2007 . . . . .	<u>15,974</u>	<u>2,287</u>	<u>18,261</u>
Net book value at 1 January 2006 . . . . .	12,602	1,298	13,900
Additions . . . . .	–	671	671
Disposals . . . . .	(8)	(25)	(33)
Revaluation . . . . .	1,082	–	1,082
Depreciation for the year . . . . .	(243)	(314)	(557)
Reclassification from investment properties (Note 28).	<u>195</u>	–	<u>195</u>
Net book value at 31 December 2006 . . . . .	<u>13,628</u>	<u>1,630</u>	<u>15,258</u>
At 31 December 2006			
Cost or valuation . . . . .	13,628	4,000	17,628
Accumulated depreciation and impairment . . . . .	–	(2,370)	(2,370)
Net book value at 31 December 2006 . . . . .	<u>13,628</u>	<u>1,630</u>	<u>15,258</u>

	The Bank		
	Premises	Equipment, fixtures and fittings	Total
	HK\$'m	HK\$'m	HK\$'m
The analysis of cost or valuation of the above assets is as follows:			
At 31 December 2007			
At cost . . . . .	–	4,959	4,959
At valuation . . . . .	<u>15,974</u>	<u>–</u>	<u>15,974</u>
	<u>15,974</u>	<u>4,959</u>	<u>20,933</u>
At 31 December 2006			
At cost . . . . .	–	4,000	4,000
At valuation . . . . .	<u>13,628</u>	<u>–</u>	<u>13,628</u>
	<u>13,628</u>	<u>4,000</u>	<u>17,628</u>

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

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Held in Hong Kong				
On long-term lease (over 50 years) . . . .	12,955	11,224	9,562	8,207
On medium-term lease (10 – 50 years) . .	7,584	6,452	6,385	5,396
Held outside Hong Kong				
On long-term lease (over 50 years) . . . .	57	54	–	–
On medium-term lease (10 – 50 years) . .	170	160	27	25
On short-term lease (less than 10 years) .	<u>17</u>	<u>16</u>	<u>–</u>	<u>–</u>
	<u>20,783</u>	<u>17,906</u>	<u>15,974</u>	<u>13,628</u>

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

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

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$m	HK\$m	HK\$m	HK\$m
Increase in valuation credited to premises revaluation reserve . . . . .	<b>2,908</b>	1,209	<b>2,336</b>	1,081
Increase/(decrease) in valuation credited to income statement (Note 13) . . . . .	<b>21</b>	(1)	<b>18</b>	1
Increase in valuation credited to minority interests . . . . .	<b>17</b>	—	<b>—</b>	—
	<b><u>2,946</u></b>	<b><u>1,208</u></b>	<b><u>2,354</u></b>	<b><u>1,082</u></b>

As at 31 December 2007, the net book value of premises that would have been included in the Group's and Bank's balance sheets had the assets been carried at cost less accumulated depreciation and impairment losses was HK\$6,072 million (2006: HK\$5,750 million) and HK\$4,809 million (2006: HK\$4,465 million) respectively.

### 30. Other assets

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$m	HK\$m	HK\$m	HK\$m
Reposessed assets . . . . .	<b>76</b>	201	<b>64</b>	97
Precious metals . . . . .	<b>1,741</b>	1,534	<b>1,741</b>	1,534
Accounts receivable and prepayments . . . .	<b>18,959</b>	12,895	<b>16,755</b>	12,464
	<b><u>20,776</u></b>	<b><u>14,630</u></b>	<b><u>18,560</u></b>	<b><u>14,095</u></b>

### 31. Hong Kong SAR currency notes in circulation

The Hong Kong SAR currency notes in circulation are secured by deposit of funds in respect of which the Hong Kong SAR Government certificates of indebtedness are held.

### 32. Financial liabilities at fair value through profit or loss

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Trading liabilities				
– Short positions in Exchange Fund Bills (Note 35) . . . . .	<b>3,492</b>	3,544	<b>2,915</b>	3,544
Financial liabilities designated at fair value through profit or loss				
– Structured deposits (Note 33) . . . . .	<b>5,959</b>	9,085	<b>3,671</b>	5,567
– Certificates of deposit issued . . . . .	<b>1,954</b>	2,498	<b>1,530</b>	2,062
	<b>7,913</b>	11,583	<b>5,201</b>	7,629
	<b>11,405</b>	15,127	<b>8,116</b>	11,173

The amount of change in their fair values, during the year and cumulatively, attributable to changes in credit risk is insignificant. The carrying amount of financial liabilities designated at fair value through profit or loss as at 31 December 2007 is less than the amount that the Group and the Bank would be contractually required to pay at maturity to the holder by HK\$44 million (2006: HK\$96 million) and HK\$34 million (2006: HK\$20 million) respectively.

### 33. Deposits from customers

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Current, savings and other deposit accounts (per balance sheet) . . . . .	<b>794,247</b>	695,616	<b>673,580</b>	593,850
Structured deposits reported as financial liabilities at fair value through profit or loss (Note 32) . . . . .	<b>5,959</b>	9,085	<b>3,671</b>	5,567
	<b>800,206</b>	704,701	<b>677,251</b>	599,417
Analysed by:				
Demand deposits and current accounts				
– corporate customers . . . . .	<b>32,715</b>	24,650	<b>27,929</b>	19,876
– individual customers . . . . .	<b>7,854</b>	6,355	<b>6,515</b>	5,161
	<b>40,569</b>	31,005	<b>34,444</b>	25,037
Savings deposits				
– corporate customers . . . . .	<b>76,721</b>	68,371	<b>64,728</b>	58,407
– individual customers . . . . .	<b>209,985</b>	188,847	<b>180,358</b>	160,783
	<b>286,706</b>	257,218	<b>245,086</b>	219,190
Time, call and notice deposits				
– corporate customers . . . . .	<b>172,860</b>	114,373	<b>143,623</b>	98,531
– individual customers . . . . .	<b>300,071</b>	302,105	<b>254,098</b>	256,659
	<b>472,931</b>	416,478	<b>397,721</b>	355,190
	<b>800,206</b>	704,701	<b>677,251</b>	599,417

### 34. Other accounts and provisions

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Dividend payable . . . . .	<b>5,897</b>	4,735	<b>5,897</b>	4,735
Accruals and other payables . . . . .	<b>32,672</b>	25,536	<b>25,481</b>	20,260
	<b><u>38,569</u></b>	<u>30,271</u>	<b><u>31,378</u></b>	<u>24,995</u>

### 35. Assets pledged as security

As at 31 December 2007, liabilities of the Group and the Bank amounting to HK\$3,492 million and HK\$2,915 million respectively (2006 the Group and the Bank HK\$3,544 million) were secured by assets deposited with central depositories to facilitate settlement operations. The amount of assets pledged by the Group and the Bank to secure these liabilities was HK\$3,836 million and HK\$3,259 million respectively (2006 the Group and the Bank HK\$3,564 million) included in “Trading securities” and “Available-for-sale securities”.

### 36. Deferred taxation

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

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

	The Group					
	2007					
	Accelerated tax depreciation	Asset revaluation	Losses	Provisions	Other temporary differences	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
At 1 January 2007 . . . . .	<b>400</b>	<b>3,155</b>	<b>(3)</b>	<b>(89)</b>	<b>(74)</b>	<b>3,389</b>
Charged/(credited) to income statement (Note 14) . . . . .	<b>133</b>	<b>143</b>	<b>1</b>	<b>(80)</b>	<b>1</b>	<b>198</b>
Charged/(credited) to equity and minority interests . . . . .	<b>—</b>	<b>479</b>	<b>—</b>	<b>—</b>	<b>(109)</b>	<b>370</b>
At 31 December 2007 . . . . .	<b><u>533</u></b>	<b><u>3,777</u></b>	<b><u>(2)</u></b>	<b><u>(169)</u></b>	<b><u>(182)</u></b>	<b><u>3,957</u></b>



The Bank					
2007					
	Accelerated tax depreciation	Asset revaluation	Provisions	Other temporary differences	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
At 1 January 2007 . . . . .	374	2,606	(56)	(74)	2,850
Charged/(credited) to income statement . . . . .	133	137	(50)	2	222
Charged/(credited) to equity . . . . .	—	390	—	(110)	280
At 31 December 2007 . . . . .	<u>507</u>	<u>3,133</u>	<u>(106)</u>	<u>(182)</u>	<u>3,352</u>

	The Group					
	2006					
	Accelerated tax depreciation	Asset revaluation	Losses	Provisions	Other temporary differences	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
At 1 January 2006 . . . . .	357	2,941	(8)	(127)	(112)	3,051
Charged to income statement (Note 14) . . . . .	43	49	5	38	20	155
Charged to equity . . . . .	<u>—</u>	<u>165</u>	<u>—</u>	<u>—</u>	<u>18</u>	<u>183</u>
At 31 December 2006 . . . . .	<u>400</u>	<u>3,155</u>	<u>(3)</u>	<u>(89)</u>	<u>(74)</u>	<u>3,389</u>

The Bank					
2006					
	Accelerated tax depreciation	Asset revaluation	Provisions	Other temporary differences	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
At 1 January 2006 . . . . .	334	2,390	(99)	(108)	2,517
Charged to income statement . . . . .	40	33	43	20	136
Charged to equity . . . . .	—	183	—	14	197
At 31 December 2006 . . . . .	<u>374</u>	<u>2,606</u>	<u>(56)</u>	<u>(74)</u>	<u>2,850</u>

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

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$m	HK\$m	HK\$m	HK\$m
Deferred tax assets . . . . .	(10)	(2)	–	–
Deferred tax liabilities . . . . .	<u>3,967</u>	<u>3,391</u>	<u>3,352</u>	<u>2,850</u>
	<u>3,957</u>	<u>3,389</u>	<u>3,352</u>	<u>2,850</u>

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$m	HK\$m	HK\$m	HK\$m
Deferred tax assets to be recovered after more than twelve months . . . . .	(10)	(2)	–	–
Deferred tax liabilities to be settled after more than twelve months . . . . .	<u>4,115</u>	<u>3,434</u>	<u>3,500</u>	<u>2,892</u>
	<u>4,105</u>	<u>3,432</u>	<u>3,500</u>	<u>2,892</u>

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

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$m	HK\$m	HK\$m	HK\$m
Fair value reserves in shareholders' equity:				
– premises . . . . .	476	165	390	183
– available-for-sale securities . . . . .	(109)	18	(110)	14
– minority interest . . . . .	<u>3</u>	<u>–</u>	<u>–</u>	<u>–</u>
	<u>370</u>	<u>183</u>	<u>280</u>	<u>197</u>

### 37. Share capital

	2007	2006
	HK\$m	HK\$m
Authorised:		
100,000,000,000 ordinary shares of HK\$1.00 each . . . . .	<u>100,000</u>	<u>100,000</u>
Issued and fully paid:		
43,042,840,858 ordinary shares of HK\$1.00 each . . . . .	<u>43,043</u>	<u>43,043</u>

### 38. 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 34 to 35 of the financial statements respectively.

### 39. Notes to consolidated cash flow statement

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

	2007	2006
	HK\$'m	HK\$'m
Operating profit . . . . .	17,707	16,299
Depreciation . . . . .	785	670
Net charge/(reversal) of impairment allowances . . . . .	1,448	(1,794)
Unwind of discount on impairment . . . . .	(47)	(88)
Advances written off net of recoveries . . . . .	1,014	1,267
Change in cash and balances with banks and other financial institutions with original maturity over three months . . . . .	(27,873)	11,878
Change in placements with banks and other financial institutions with original maturity over three months . . . . .	(2,613)	(12,977)
Change in financial assets at fair value through profit or loss . . . . .	3,741	(1,027)
Change in derivative financial instruments . . . . .	(54)	(2,350)
Change in advances and other accounts . . . . .	(67,650)	(13,839)
Change in investment in securities . . . . .	5,039	(54,358)
Change in other assets . . . . .	(6,214)	(6,875)
Change in deposits and balances of banks and other financial institutions . . . . .	11,565	8,379
Change in financial liabilities at fair value through profit or loss . . . . .	(3,722)	3,238
Change in deposits from customers . . . . .	98,631	62,516
Change in debt securities in issue at amortised cost . . . . .	2,089	–
Change in other accounts and provisions . . . . .	8,298	4,671
Exchange difference . . . . .	13	4
Operating cash inflow before taxation . . . . .	<u>42,157</u>	<u>15,614</u>
Cash flows from operating activities included:		
– Interest received . . . . .	44,279	39,257
– Interest paid . . . . .	27,131	23,794
– Dividend received . . . . .	<u>15</u>	<u>21</u>

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

	2007	2006
	HK\$'m	HK\$'m
Cash and balances with banks and other financial institutions with original maturity within three months . . . . .	126,006	100,063
Placements with banks and other financial institutions with original maturity within three months . . . . .	13,939	19,771
Treasury bills with original maturity within three months . . . . .	10,244	6,782
Certificates of deposit held with original maturity within three months . . . . .	<u>1,868</u>	<u>1,641</u>
	<u>152,057</u>	<u>128,257</u>

#### 40. 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:

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$m	HK\$m	HK\$m	HK\$m
Direct credit substitutes . . . . .	<b>2,120</b>	1,285	<b>3,841</b>	877
Transaction-related contingencies . . . . .	<b>7,075</b>	7,150	<b>6,801</b>	6,796
Trade-related contingencies . . . . .	<b>29,081</b>	20,942	<b>23,956</b>	17,575
Commitments that are unconditionally cancellable without prior notice . . . . .	<b>50,034</b>	–	<b>1,403</b>	–
Other commitments with an original maturity of				
– under one year or which are unconditionally cancellable . . . . .	–	113,064	–	58,154
– up to one year . . . . .	<b>84,809</b>	–	<b>69,263</b>	–
– over one year . . . . .	<b>58,189</b>	45,345	<b>51,331</b>	35,065
	<b><u>231,308</u></b>	<u>187,786</u>	<b><u>156,595</u></b>	<u>118,467</u>
Credit risk weighted amount . . . . .	<b><u>47,356</u></b>	<u>30,076</u>	<b><u>42,850</u></b>	<u>24,416</u>

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

#### 41. Capital commitments

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

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$m	HK\$m	HK\$m	HK\$m
Authorised and contracted for but not provided for . . . . .	<b>165</b>	162	<b>156</b>	156
Authorised but not contracted for . . . . .	<b>1</b>	5	<b>1</b>	–
	<b><u>166</u></b>	<u>167</u>	<b><u>157</u></b>	<u>156</u>

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.

## 42. 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:

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Land and buildings				
– not later than one year . . . . .	<b>316</b>	275	<b>266</b>	234
– later than one year but not later than five years . . . . .	<b>295</b>	266	<b>236</b>	219
– later than five years . . . . .	<u>–</u>	<u>1</u>	<u>–</u>	<u>–</u>
	<b><u>611</u></b>	<b><u>542</u></b>	<b><u>502</u></b>	<b><u>453</u></b>
Computer equipment				
– not later than one year . . . . .	<u>–</u>	<u>1</u>	<u>–</u>	<u>–</u>

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:

	The Group		The Bank	
	2007	2006	2007	2006
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Land and buildings				
– not later than one year . . . . .	<b>251</b>	216	<b>235</b>	195
– later than one year but not later than five years . . . . .	<b>215</b>	219	<b>212</b>	213
	<b><u>466</u></b>	<b><u>435</u></b>	<b><u>447</u></b>	<b><u>408</u></b>

The Group and the Bank lease their investment properties (Note 28) 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.

#### **43. Litigation**

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

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

#### **44. 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 three business segments is provided in segmental reporting. They are Personal Banking, Corporate Banking and Treasury.

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. "Others" refers to those items related to the Group as a whole but independent of the other three business segments, including the Group's holdings of premises, investment properties and interests in associates.

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

	The Group						
	2007						
	Personal	Corporate	Treasury	Others	Subtotal	Eliminations	Consolidated
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Net interest (expenses)/income							
– external . . . . .	(8,552)	5,067	22,015	10	18,540	–	18,540
– inter-segment . . . . .	16,696	672	(16,146)	(1,222)	–	–	–
	8,144	5,739	5,869	(1,212)	18,540	–	18,540
Net fees and commission							
income/(expenses) . . . . .	4,983	1,778	47	(138)	6,670	(87)	6,583
Net trading income . . . . .	538	151	236	87	1,012	1	1,013
Net loss on financial instruments							
designated at fair value through profit							
or loss . . . . .	–	–	(25)	–	(25)	–	(25)
Net loss on investments in securities . .	–	–	(53)	–	(53)	–	(53)
Other operating income . . . . .	410	1	1	1,687	2,099	(1,343)	756
Net operating income before							
impairment allowances . . . . .	14,075	7,669	6,075	424	28,243	(1,429)	26,814
Net (charge)/reversal of impairment							
allowances . . . . .	(112)	797	(2,133)	–	(1,448)	–	(1,448)
Net operating income. . . . .	13,963	8,466	3,942	424	26,795	(1,429)	25,366
Operating expenses . . . . .	(5,829)	(1,940)	(627)	(692)	(9,088)	1,429	(7,659)
Operating profit/(loss) . . . . .	8,134	6,526	3,315	(268)	17,707	–	17,707
Net gain from disposal of/fair value							
adjustments on investment properties	–	–	–	1,064	1,064	–	1,064
Net (loss)/gain from disposal/							
revaluation of properties, plant and							
equipment . . . . .	(5)	–	–	33	28	–	28
Share of profits less losses of associates .	–	–	–	3	3	–	3
Profit before taxation . . . . .	8,129	6,526	3,315	832	18,802	–	18,802
Assets							
Segment assets. . . . .	162,634	281,680	566,661	33,057	1,044,032	(5,123)	1,038,909
Interests in associates . . . . .	–	–	–	83	83	–	83
Unallocated corporate assets . . . . .	–	–	–	238	238	–	238
	162,634	281,680	566,661	33,378	1,044,353	(5,123)	1,039,230
Liabilities							
Segment liabilities . . . . .	545,397	284,353	116,095	8,432	954,277	(5,123)	949,154
Unallocated corporate liabilities . . . . .	–	–	–	6,784	6,784	–	6,784
	545,397	284,353	116,095	15,216	961,061	(5,123)	955,938
Other information							
Additions of properties, plant and							
equipment . . . . .	14	8	–	1,123	1,145	–	1,145
Depreciation . . . . .	234	90	56	405	785	–	785
Amortisation of securities . . . . .	–	–	2,075	–	2,075	–	2,075

	The Group						
	2006						
	Personal	Corporate	Treasury	Others	Subtotal	Eliminations	Consolidated
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Net interest (expenses)/income							
– external . . . . .	(8,386)	4,797	18,870	4	15,285	–	15,285
– inter-segment . . . . .	15,389	212	(14,464)	(1,137)	–	–	–
	7,003	5,009	4,406	(1,133)	15,285	–	15,285
Net fees and commission							
income/(expenses). . . . .	2,413	1,530	(5)	15	3,953	(26)	3,927
Net trading income . . . . .	588	120	858	–	1,566	1	1,567
Net loss on financial instruments							
designated at fair value through profit							
or loss . . . . .	–	–	(100)	–	(100)	–	(100)
Net (loss)/gain on investments in							
securities. . . . .	–	–	(11)	6	(5)	–	(5)
Other operating income . . . . .	48	37	–	1,415	1,500	(1,174)	326
<b>Net operating income before</b>							
<b>impairment allowances . . . . .</b>	10,052	6,696	5,148	303	22,199	(1,199)	21,000
Net (charge)/reversal of impairment							
allowances . . . . .	(37)	1,827	–	4	1,794	–	1,794
<b>Net operating income. . . . .</b>	10,015	8,523	5,148	307	23,993	(1,199)	22,794
Operating expenses . . . . .	(4,853)	(1,653)	(521)	(667)	(7,694)	1,199	(6,495)
<b>Operating profit/(loss) . . . . .</b>	5,162	6,870	4,627	(360)	16,299	–	16,299
Net gain from disposal of/fair value							
adjustments on investment properties .	–	–	–	605	605	–	605
Net (loss)/gain from disposal/							
revaluation of properties, plant and							
equipment . . . . .	(18)	(3)	(2)	7	(16)	–	(16)
Share of profits less losses of associates .	–	–	–	5	5	–	5
<b>Profit before taxation . . . . .</b>	5,144	6,867	4,625	257	16,893	–	16,893
<b>Assets</b>							
Segment assets. . . . .	144,828	227,527	517,200	26,557	916,112	(2,604)	913,508
Interests in associates . . . . .	–	–	–	60	60	–	60
Unallocated corporate assets . . . . .	–	–	–	221	221	–	221
	144,828	227,527	517,200	26,838	916,393	(2,604)	913,789
<b>Liabilities</b>							
Segment liabilities . . . . .	516,848	209,363	98,532	4,906	829,649	(2,604)	827,045
Unallocated corporate liabilities . . . . .	–	–	–	6,324	6,324	–	6,324
	516,848	209,363	98,532	11,230	835,973	(2,604)	833,369
<b>Other information</b>							
Additions of properties, plant and							
equipment . . . . .	–	–	–	736	736	–	736
Depreciation . . . . .	178	78	46	368	670	–	670
Amortisation of securities . . . . .	–	–	1,924	–	1,924	–	1,924



	The Bank						
	2007						
	Personal	Corporate	Treasury	Others	Subtotal	Eliminations	Consolidated
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Net interest (expenses)/income							
– external . . . . .	(7,650)	3,221	19,208	28	14,807	–	14,807
– inter-segment . . . . .	14,060	1,391	(14,256)	(1,195)	–	–	–
	6,410	4,612	4,952	(1,167)	14,807	–	14,807
Net fees and commission							
income/(expenses). . . . .	3,797	1,313	39	(130)	5,019	–	5,019
Net trading income . . . . .	417	79	234	–	730	–	730
Net gain on financial instruments							
designated at fair value through profit							
or loss . . . . .	–	–	16	–	16	–	16
Net loss on investments in securities . . .	–	–	(53)	–	(53)	–	(53)
Other operating income . . . . .	7	1	1	2,277	2,286	(1,146)	1,140
Net operating income before							
impairment allowances . . . . .	10,631	6,005	5,189	980	22,805	(1,146)	21,659
Net (charge)/reversal of impairment							
allowances . . . . .	(4)	773	(2,133)	–	(1,364)	–	(1,364)
Net operating income. . . . .	10,627	6,778	3,056	980	21,441	(1,146)	20,295
Operating expenses . . . . .	(4,559)	(1,434)	(602)	(563)	(7,158)	1,146	(6,012)
Operating profit . . . . .	6,068	5,344	2,454	417	14,283	–	14,283
Net gain from disposal of/fair value							
adjustments on investment properties .	–	–	–	990	990	–	990
Net (loss)/gain from disposal/							
revaluation of properties, plant and							
equipment . . . . .	(5)	–	–	9	4	–	4
Profit before taxation . . . . .	6,063	5,344	2,454	1,416	15,277	–	15,277
Assets							
Segment assets. . . . .	129,876	227,466	493,569	38,110	889,021	–	889,021
Interests in associates . . . . .	–	–	–	12	12	–	12
Unallocated corporate assets . . . . .	–	–	–	224	224	–	224
	129,876	227,466	493,569	38,346	889,257	–	889,257
Liabilities							
Segment liabilities. . . . .	455,901	239,244	109,914	5,909	810,968	–	810,968
Unallocated corporate liabilities . . . . .	–	–	–	6,078	6,078	–	6,078
	455,901	239,244	109,914	11,987	817,046	–	817,046
Other information							
Additions of properties, plant and							
equipment . . . . .	–	–	–	1,070	1,070	–	1,070
Depreciation . . . . .	211	85	56	317	669	–	669
Amortisation of securities . . . . .	–	–	1,698	–	1,698	–	1,698

	The Bank						
	2006						
	Personal	Corporate	Treasury	Others	Subtotal	Eliminations	Consolidated
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Net interest (expenses)/income							
– external . . . . .	(7,476)	3,420	16,047	31	12,022	–	12,022
– inter-segment . . . . .	12,879	649	(12,414)	(1,114)	–	–	–
	5,403	4,069	3,633	(1,083)	12,022	–	12,022
Net fees and commission							
income/(expenses). . . . .	1,733	1,087	(12)	(47)	2,761	–	2,761
Net trading income . . . . .	403	83	862	–	1,348	–	1,348
Net loss on financial instruments							
designated at fair value through profit							
or loss . . . . .	–	–	(82)	–	(82)	–	(82)
Net loss on investments in securities . . .	–	–	(11)	–	(11)	–	(11)
Other operating income . . . . .	17	32	–	2,609	2,658	(895)	1,763
<b>Net operating income before</b>							
<b>impairment allowances . . . . .</b>	7,556	5,271	4,390	1,479	18,696	(895)	17,801
Net reversal of impairment allowances . .	85	1,791	–	–	1,876	–	1,876
<b>Net operating income. . . . .</b>	7,641	7,062	4,390	1,479	20,572	(895)	19,677
Operating expenses . . . . .	(3,804)	(1,188)	(498)	(484)	(5,974)	895	(5,079)
<b>Operating profit . . . . .</b>	3,837	5,874	3,892	995	14,598	–	14,598
Net gain from disposal of/fair value							
adjustments on investment properties . .	–	–	–	565	565	–	565
Net loss from disposal/ revaluation of							
properties, plant and equipment . . . .	(18)	(3)	(2)	–	(23)	–	(23)
<b>Profit before taxation . . . . .</b>	3,819	5,871	3,890	1,560	15,140	–	15,140
<b>Assets</b>							
Segment assets. . . . .	118,074	187,968	451,729	34,890	792,661	–	792,661
Interests in associates . . . . .	–	–	–	26	26	–	26
Unallocated corporate assets . . . . .	–	–	–	196	196	–	196
	118,074	187,968	451,729	35,112	792,883	–	792,883
<b>Liabilities</b>							
Segment liabilities . . . . .	432,454	179,295	98,855	4,751	715,355	–	715,355
Unallocated corporate liabilities . . . . .	–	–	–	5,008	5,008	–	5,008
	432,454	179,295	98,855	9,759	720,363	–	720,363
<b>Other information</b>							
Additions of properties, plant and							
equipment . . . . .	–	–	–	671	671	–	671
Depreciation . . . . .	155	69	46	287	557	–	557
Amortisation of securities . . . . .	–	–	1,535	–	1,535	–	1,535

#### 45. Loans to directors and officers

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

	2007	2006
	HK\$m	HK\$m
Aggregate amount of relevant loans outstanding at year end . . . .	<u>622</u>	<u>184</u>
Maximum aggregate amount of relevant loans outstanding during the year . . . . .	<u>839</u>	<u>347</u>

#### 46. 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) Advances to third parties guaranteed by BOC group companies

As at 31 December 2007, BOC, the intermediate holding company, provided guarantees for loans in favour of the Group amounting to HK\$3,693 million (2006: HK\$2,522 million) to certain third parties. BOC held equity interests of not more than 20% in these third parties.

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

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

		2007		
	Notes	Immediate and intermediate holding companies	Associates	Other related parties <sup>1</sup>
		HK\$m	HK\$m	HK\$m
Income statement items:				
Interest income . . . . .	(i)	596	–	25
Interest expense . . . . .	(ii)	(510)	(3)	(363)
(Insurance premium paid)/insurance commission received (net) . . . . .	(iii)	–	(2)	316
Administrative services fees received/receivable . . . . .	(iv)	34	–	43
Rental fees received/receivable . . . . .	(iv)	–	–	29
Credit card commission paid/payable (net) . . . . .	(v)	(96)	–	(3)
Securities brokerage commission paid/payable (net) . . . . .	(v)	–	–	(494)
Rental, property management and letting agency fees paid/payable . . . . .	(v)	–	–	(77)
Funds selling commission received . . . . .	(vi)	–	–	224
Correspondent banking fee received . . . . .	(vii)	14	–	–
Loans services fees received . . . . .		–	–	2
Net trading gains/(losses). . . . .		<u>11</u>	<u>–</u>	<u>(3)</u>

2006				
		Immediate and intermediate holding companies	Associates	Other related parties <sup>1</sup>
	Notes	HK\$'m	HK\$'m	HK\$'m
Income statement items:				
Interest income . . . . .	(i)	602	–	19
Interest expense . . . . .	(ii)	(756)	(4)	(293)
(Insurance premium paid)/insurance commission received (net) . . . . .	(iii)	–	(2)	233
Administrative services fees received/ receivable . . . . .	(iv)	33	–	21
Rental fees received/receivable . . . . .	(iv)	–	–	17
Credit card commission paid/payable (net) .	(v)	(82)	–	(2)
Securities brokerage commission paid/payable (net) . . . . .	(v)	–	–	(177)
Rental, property management and letting agency fees paid/payable . . . . .	(v)	–	–	(79)
Funds selling commission received . . . . .	(vi)	–	–	54
Correspondent banking fee received . . . . .	(vii)	10	–	–
Loans services fees received . . . . .		–	–	9
Net trading gains. . . . .		<u>68</u>	<u>–</u>	<u>2</u>
2007				
		Immediate and intermediate holding companies	Associates	Other related parties <sup>1</sup>
	Notes	HK\$'m	HK\$'m	HK\$'m
Balance sheet items:				
Cash and balances with banks and other financial institutions . . . . .	(i)	22,854	–	30
Placements with banks and other financial institutions maturing between one and twelve months . . . . .	(i)	8,917	–	–
Financial assets at fair value through profit or loss. . . . .		438	–	–
Derivative financial instruments assets . . . .	(viii)	30	–	3
Advances and other accounts . . . . .	(i)	21	–	–
Investment in securities . . . . .		347	–	–
Other assets . . . . .	(ix)	66	–	5,079
Deposits and balances of banks and other financial institutions . . . . .	(ii)	15,478	–	680
Deposits from customers . . . . .	(ii)	458	85	7,465
Derivative financial instruments liabilities .	(viii)	14	–	23
Other accounts and provisions . . . . .	(ix)	5,997	–	5,538
Off-balance sheet items:				
Contingent liabilities and commitments. . . .	(x)	2,248	–	3,727

2006				
	Notes	Immediate and intermediate holding companies	Associates	Other related parties <sup>1</sup>
		HK\$m	HK\$m	HK\$m
Balance sheet items:				
Cash and balances with banks and other financial institutions . . . . .	(i)	8,027	–	21
Placements with banks and other financial institutions maturing between one and twelve months . . . . .	(i)	5,272	–	102
Financial assets at fair value through profit or loss . . . . .		1	–	–
Derivative financial instruments assets . . . .	(viii)	15	–	–
Advances and other accounts . . . . .	(i)	64	–	–
Other assets . . . . .	(ix)	54	–	4,162
Deposits and balances of banks and other financial institutions . . . . .	(ii)	20,722	–	1,390
Deposits from customers . . . . .	(ii)	495	77	7,034
Derivative financial instruments liabilities . .	(viii)	13	–	–
Other accounts and provisions . . . . .	(ix)	4,823	–	3,853
Off-balance sheet items:				
Contingent liabilities and commitments . . .	(x)	<u>2,836</u>	<u>–</u>	<u>727</u>

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 group companies 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 BOC group companies at the relevant market rates at the time of the transactions.

**(iii) Insurance premium paid/insurance commission received (net)**

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

**(iv) Administrative services fees and rental fees received/receivable**

In the ordinary course of business, the Group receives 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 fee 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 BOC group companies. 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 BOC group company to customers of the Group at the relevant market rates at the time of the transactions.

**(vii) Correspondent banking fee received**

In the ordinary course of business, BOC provides services to the Group's customers including remittance services and advising on and collecting letters of credit issued by the Group. The Group shares the fees paid by its customers with BOC on the basis agreed between the parties from time to time.

**(viii) Derivative financial instruments assets/liabilities**

In the ordinary course of business, the Group enters into foreign exchange contracts and interest rate contracts with BOC group companies. As at 31 December 2007 the aggregate notional amount of such derivative transactions amounted to HK\$13,219 million (2006: HK\$15,918 million) whilst the corresponding derivative financial instruments assets and liabilities amounted to HK\$33 million (2006: HK\$15 million) and HK\$37 million (2006: HK\$13 million) respectively. These transactions are executed at the relevant market rates at the time of the transactions.

**(ix) 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.

**(x) 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.

**(c) *Key management personnel***

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

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

	2007	2006
	HK\$m	HK\$m
Salaries and other short-term employee benefits . . . . .	43	34
Post-employment benefits . . . . .	1	1
	<u>44</u>	<u>35</u>

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

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

	2007		2006	
	Interest income/ (expense)	Outstanding balance at end of the year	Interest income/ (expense)	Outstanding balance at end of the year
	HK\$m	HK\$m	HK\$m	HK\$m
Advances to customers/banks and other financial institutions . . . . .	8	120	10	164
Treasury bonds . . . . .	57	1,422	87	1,578
Due from banks and other financial institutions . . . . .	262	29,405	226	23,693
Due to banks and other financial institutions . . . . .	<u>(1)</u>	<u>1</u>	<u>—</u>	<u>—</u>

**(e) Transactions with Central SAFE and other companies controlled by Central SAFE**

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

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

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

	2007		2006	
	Interest income/ (expense)	Outstanding balance at end of the year	Interest income/ (expense)	Outstanding balance at end of the year
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers/banks and other				
financial institutions . . . . .	–	23	–	29
Investment in securities. . . . .	89	2,433	66	1,270
Financial assets at fair value through profit				
or loss . . . . .	–	9	–	–
Due from banks and other financial				
institutions . . . . .	85	1,443	35	854
Due to banks and other financial				
institutions . . . . .	<u>(21)</u>	<u>2,417</u>	<u>(1)</u>	<u>77</u>

*(f) Transactions with other state-controlled entities*

The state-controlled entities are those, other than BOC (the intermediate holding company 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 stated-controlled entities conducted in the ordinary course of business are set forth below:

(i) Financial assets/financial liabilities

	2007		2006	
	Interest income/ (expense)	Outstanding balance at end of the year	Interest income/ (expense)	Outstanding balance at end of the year
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Advances to customers/banks and other financial institutions (Gross) . . . . .	<b>1,899</b>	<b>39,828</b>	1,697	32,248
Individually assessed loan impairment allowances . . . . .	–	<b>28</b>	–	88
Investment in securities . . . . .	<b>323</b>	<b>7,158</b>	349	7,640
Financial assets at fair value through profit or loss . . . . .	<b>31</b>	<b>1,219</b>	14	343
Due from banks and other financial institutions . . . . .	<b>452</b>	<b>6,969</b>	270	4,745
Due to banks and other financial institutions . . . . .	<b>(286)</b>	<b>18,667</b>	(195)	10,949
Deposits from customers . . . . .	<b><u>(1,163)</u></b>	<b><u>29,927</u></b>	<b><u>(1,406)</u></b>	<b><u>26,613</u></b>

	2007	2006
	HK\$'m	HK\$'m
(ii) Contingent liabilities and commitments (including guarantees) .	<b><u>36,145</u></b>	<b><u>26,273</u></b>

	2007	2006
	HK\$'m	HK\$'m
(iii) Outstanding derivative transactions (notional amount) . . . . .	<b><u>1,686</u></b>	<b><u>618</u></b>

**47. Liquidity ratio**

	2007	2006
	50.92%	50.46%
Average liquidity ratio . . . . .		

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.

#### 48. Currency concentrations

The following is a summary of the major foreign currency exposures arising from trading, non-trading and structural positions. The net options position is calculated based on the basis of delta-weighted positions of all foreign exchange options contracts.

	2007						
	Equivalent in million of HK\$						
	US Dollars	Japanese Yen	Euro	Australian Dollars	Pound Sterling	Renminbi Yuan	Others Total
Spot assets . . . . .	321,190	2,019	15,739	27,376	6,028	44,929	7,364 424,645
Spot liabilities . . . . .	(220,339)	(4,764)	(9,215)	(24,055)	(12,951)	(44,055)	(19,615) (334,994)
Forward purchases . . . . .	159,983	22,718	25,775	22,051	25,907	26,760	43,162 326,356
Forward sales . . . . .	(257,677)	(20,215)	(32,238)	(25,426)	(18,858)	(26,322)	(30,823) (411,559)
Net options position . . . . .	107	(16)	(17)	22	(5)	–	(9) 82
Net long/(short) position . . . .	3,264	(258)	44	(32)	121	1,312	79 4,530
Net structural position . . . . .	84	–	–	–	–	459	– 543
	2006						
	Equivalent in million of HK\$						
	US Dollars	Japanese Yen	Euro	Australian Dollars	Pound Sterling	Renminbi Yuan	Others Total
Spot assets . . . . .	276,314	2,538	12,922	22,642	6,150	28,521	7,357 356,444
Spot liabilities . . . . .	(189,454)	(4,346)	(7,485)	(18,126)	(12,217)	(27,729)	(18,185) (277,542)
Forward purchases . . . . .	126,163	12,131	15,728	8,009	26,833	1,173	39,626 229,663
Forward sales . . . . .	(211,509)	(10,313)	(21,195)	(12,533)	(20,786)	(1,098)	(28,627) (306,061)
Net options position . . . . .	1,340	(12)	19	(24)	(14)	–	6 1,315
Net long/(short) position . . . .	2,854	(2)	(11)	(32)	(34)	867	177 3,819
Net structural position . . . . .	83	–	–	–	–	309	– 392

## 49. 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:

	<b>Banks</b>	<b>Public sector entities</b>	<b>Others</b>	<b>Total</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>
<b>At 31 December 2007</b>				
Asia, other than Hong Kong				
– Mainland China . . . . .	56,017	30,753	29,699	116,469
– Others . . . . .	<u>73,025</u>	<u>469</u>	<u>19,585</u>	<u>93,079</u>
	<u>129,042</u>	<u>31,222</u>	<u>49,284</u>	<u>209,548</u>
North America				
– United States . . . . .	6,200	27,179	76,783	110,162
– Others . . . . .	<u>18,081</u>	<u>–</u>	<u>68</u>	<u>18,149</u>
	<u>24,281</u>	<u>27,179</u>	<u>76,851</u>	<u>128,311</u>
Western Europe				
– Germany . . . . .	41,201	–	2,331	43,532
– Others . . . . .	<u>148,144</u>	<u>3</u>	<u>11,827</u>	<u>159,974</u>
	<u>189,345</u>	<u>3</u>	<u>14,158</u>	<u>203,506</u>
Total . . . . .	<u>342,668</u>	<u>58,404</u>	<u>140,293</u>	<u>541,365</u>

	<b>Banks</b>	<b>Public sector entities</b>	<b>Others</b>	<b>Total</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>
<b>At 31 December 2006</b>				
Asia, other than Hong Kong				
– Mainland China . . . . .	37,202	25,052	18,486	80,740
– Others . . . . .	<u>66,005</u>	<u>569</u>	<u>16,710</u>	<u>83,284</u>
	<u>103,207</u>	<u>25,621</u>	<u>35,196</u>	<u>164,024</u>
North America				
– United States . . . . .	7,080	25,232	73,900	106,212
– Others . . . . .	<u>12,391</u>	<u>101</u>	<u>39</u>	<u>12,531</u>
	<u>19,471</u>	<u>25,333</u>	<u>73,939</u>	<u>118,743</u>
Western Europe				
– Germany . . . . .	37,434	–	3,620	41,054
– Others . . . . .	<u>145,727</u>	<u>133</u>	<u>16,819</u>	<u>162,679</u>
	<u>183,161</u>	<u>133</u>	<u>20,439</u>	<u>203,733</u>
Total . . . . .	<u>305,839</u>	<u>51,087</u>	<u>129,574</u>	<u>486,500</u>

## 50. Non-bank Mainland China exposures

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

2007			
	On-balance sheet exposure	Off-balance sheet exposure	Individually assessed impairment allowances
	HK\$m	HK\$m	HK\$m
Mainland China entities . . . . .	60,275	44,698	23
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China . . . . .	23,142	17,535	13
Other non-bank Mainland China exposures	10,133	8,261	8
	<u>93,550</u>	<u>70,494</u>	<u>44</u>
2006			
	On-balance sheet exposure	Off-balance sheet exposure	Individually assessed impairment allowances
	HK\$m	HK\$m	HK\$m
Mainland China entities . . . . .	46,516	32,107	183
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China . . . . .	15,998	10,830	16
Other non-bank Mainland China exposures	9,943	4,941	18
	<u>72,457</u>	<u>47,878</u>	<u>217</u>

## 51. 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.

## 52. Comparative amounts

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

## 53. Approval of financial statements

The financial statements were approved and authorised for issue by the Board of Directors on 25 March 2008.

## UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

### RISK MANAGEMENT

#### Overview

The Group believes that sound risk management is crucial to the success of 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 all business processes and ensure various risks are properly managed and controlled in the course of conducting business. The Group has a sound 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 Audit Committee ("AC") assists the Board in fulfilling its role in overseeing the internal control system.

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 Chief Risk Officer ("CRO") assists the CE in fulfilling his responsibilities for the day-to-day management of risks. The CRO 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 CRO 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.

Various units of the Group have their respective risk management responsibilities. Business units act as the first line of defence while risk management units, which are independent from the business units, are responsible for the day-to-day management of different kinds of risks. Risk management units have the primary responsibilities for drafting, reviewing and updating various risk management policies and procedures.

The Group's principal banking subsidiaries, Nanyang and Chiyu have also formulated their own policies that are consistent with those of the Group. These subsidiaries execute their risk management strategies independently and report to the Group's management on a regular basis.

## **Reputation Risk Management**

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

In order to mitigate reputation risk, the Group has formulated its Reputation Risk Management Policy that is diligently implemented. This policy provides guidance to prevent and manage reputation risk proactively at an early stage. It requires constant 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 legal or regulatory sanctions, financial loss, or loss to reputation a bank may suffer as a result of its any failure to comply with all applicable laws and regulations. By establishing and maintaining appropriate policies and guidelines, the CRO, working through the Legal and Compliance Department, 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 Board of Directors reviews and approves the policy for the management of strategic risks. Key strategic issues have to be fully evaluated and properly endorsed by the senior management and the Board.

## **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 with the Group. It arises mainly from lending, trade finance, treasury and inter-bank transactions. For details of the Group's Credit Risk Management, please refer to Note 4 to the Financial Statements.

## **Market Risk Management**

Market risk is the risk of loss that results from movements in market rates and prices. The Group's market risk arises from trading positions taken from customer-related business and proprietary trading. For details of the Group's Market Risk Management, please refer to Note 4 to the Financial Statements.

## **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, basis risk, yield curve risk and option risk. For details of the Group's Interest Rate Risk Management, please refer to Note 4 to the Financial Statements.

## **Liquidity Risk Management**

The aim of liquidity management is to enable 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 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 (under normal condition and stress conditions respectively) and by examining deposit stability, concentration risk, liquidity ratio, mismatch ratios, loan-to-deposit ratio and liquidity profile of the investment portfolio. The ALCO maintains oversight of liquidity risk and RC sanctions the liquidity management policies formulated by ALCO. The Treasury Department ("TD") manages the liquidity risk according to the established policies. The Finance Department monitors the Group's liquidity risks and reports to ALCO regularly. The RMD reviews the policies, guidelines and limits proposed by the TD.

### **Operational Risk Management**

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

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 authorisation are the fundamental principles followed by the Group. RMD formulates corporate-level policies and procedures concerning operational risk management which are approved by RC. The management of respective business lines is responsible for managing and reporting operational risks specific to their business units by applying respective tools such as key risk indicators, self assessment and operational risk events reporting mechanism to identify, assess and control the risks inherent in their business processes, activities and products. These are followed by periodic monitoring and ongoing review of changes by RMD. Besides the current operational risk status, trends derived from historical data are served as alert on potential risks. RMD evaluates the operational risk profile, records operational risk data and reports operational risk issues to RC and senior management. The Group also takes out insurance to minimise the impact of unforeseeable operational risks.

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.

### **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 required rate of return on 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 initiated 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 for the Group's long-term growth.

### **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.

## APPENDIX

### SUBSIDIARIES OF THE BANK

The particulars of our subsidiaries are as follows:

<u>Name of company</u>	<u>Country/place and date of incorporation/operation</u>	<u>Issued and fully paid up share capital/registered capital</u>	<u>Percentage of attributable equity interest</u>	<u>Principal activities</u>
Nanyang Commercial Bank, Limited	Hong Kong 2 February 1948	Ordinary shares HK\$600,000,000	100.00%	Banking business
Chiyu Banking Corporation Limited	Hong Kong 24 April 1947	Ordinary shares HK\$300,000,000	70.49%	Banking business
BOC Credit Card (International) Limited	Hong Kong 9 September 1980	Ordinary shares HK\$480,000,000	100.00%	Credit card services
Arene Trading Limited	Hong Kong 22 August 1978	Ordinary shares HK\$500,000	100.00%	Property holding and investment
Bank of China (Hong Kong) Nominees Limited*	Hong Kong 1 October 1985	Ordinary shares HK\$2	100.00%	Nominee services
Bank of China (Hong Kong) Trustees Limited*	Hong Kong 6 November 1987	Ordinary shares HK\$3,000,000	100.00%	Trustee and agency services
BOC Group Trustee Company Limited*	Hong Kong 1 December 1997	Ordinary shares HK\$200,000,000	64.20%	Trustee services
BOC Travel Services Limited	Hong Kong 24 August 1982	Ordinary shares HK\$2,000,000	100.00%	Travel services
BOCHK Financial Products (Cayman) Limited	Cayman 10 November 2006	Ordinary shares US\$50,000	100.00%	Note issuing
BOCHK Information Technology (Shenzhen) Co., Ltd.*	PRC 16 April 1990	Registered capital HK\$70,000,000	100.00%	Property holding and investment
BOCHK Information Technology Services (Shenzhen) Ltd*	PRC 26 May 1993	Registered capital HK\$40,000,000	100.00%	Information technology services
BOCI-Prudential Trustee Limited*	Hong Kong 11 October 1999	Ordinary shares HK\$300,000,000	41.10%	Trustee services
Che Hsing (Nominees) Limited*	Hong Kong 23 April 1980	Ordinary shares HK\$10,000	100.00%	Nominee services and investment holding



<b>Name of company</b>	<b>Country/place and date of incorporation/operation</b>	<b>Issued and fully paid up share capital/registered capital</b>	<b>Percentage of attributable equity interest</b>	<b>Principal activities</b>
Chiyu Banking Corporation (Nominees) Limited*	Hong Kong 3 November 1981	Ordinary shares HK\$100,000	70.49%	Investment holding
Chung Chiat Company Limited	Hong Kong 9 April 1980	Ordinary shares HK\$200	100.00%	Property holding and investment
Dwell Bay Limited	Hong Kong 19 December 1980	Ordinary shares HK\$100,000	100.00%	Property holding and investment
Glister Company Limited*	Hong Kong 26 March 2001	Ordinary shares HK\$2	70.49%	Investment holding
Glory Cardinal Limited*	Hong Kong 4 May 2001	Ordinary shares HK\$2	70.49%	Investment holding
Grace Charter Limited*	Hong Kong 4 May 2001	Ordinary shares HK\$2	70.49%	Investment holding
G.Z.Y. Microfilm Technology (Shenzhen) Co., Ltd.*	PRC 24 September 1993	Registered capital HK\$40,000,000	100.00%	Property holding and investment
Hua Chiao Commercial (Nominees) Limited*	Hong Kong 28 October 1986	Ordinary shares HK\$10,000	100.00%	Nominee services
Kincheng Finance (H.K.) Limited	Hong Kong 30 March 1979	Ordinary shares HK\$225,000,000	100.00%	Loan financing
Kincheng Investments & Developments (H.K.) Limited	Hong Kong 15 May 1981	Ordinary shares HK\$6,000	100.00%	Property holding and investment
Kincheng (Nominees) Limited*	Hong Kong 12 December 1980	Ordinary shares HK\$100,000	100.00%	Nominee services
Kiu Nam Investment Corporation Limited	Hong Kong 9 November 1963	Ordinary shares HK\$2,000,000	100.00%	Property holding and investment
Kwong Li Nam Investment Agency Limited*	Hong Kong 25 May 1984	Ordinary shares HK\$3,050,000	100.00%	Investment agency
Nan Song Company, Limited*	Hong Kong 13 April 1965	Ordinary shares HK\$1,000,000	100.00%	Property investment and investment holding
Nanyang Commercial Bank (China) Limited	PRC 14 December 2007	Registered capital RMB2,500,000,000	100.00%	Banking business

<b>Name of company</b>	<b>Country/place and date of incorporation/operation</b>	<b>Issued and fully paid up share capital/registered capital</b>	<b>Percentage of attributable equity interest</b>	<b>Principal activities</b>
Nanyang Commercial Bank (Nominees) Limited*	Hong Kong 22 August 1980	Ordinary shares HK\$50,000	100.00%	Nominee services
Nanyang Commercial Bank Trustee Limited*	Hong Kong 22 October 1976	Ordinary shares HK\$3,000,000	100.00%	Trustee services
Nanyang Finance Company Limited	Hong Kong 16 March 1979	Ordinary shares HK\$50,000,000	100.00%	Financial services
Pacific Trend Profits Corporation*	British Virgin Islands 20 April 2001	Registered shares US\$1	70.49%	Investment holding
Patson (HK) Limited*	Hong Kong 18 August 1970	Ordinary shares HK\$1,000,000	100.00%	Property investment
Perento Limited	Hong Kong 27 September 1983	Ordinary shares HK\$10,000	100.00%	Property holding and investment
Po Hay Enterprises Limited	Hong Kong 2 October 1979	Ordinary shares HK\$100,000	100.00%	Property holding and investment
Po Sang Financial Investment Services Company Limited*	Hong Kong 23 September 1980	Ordinary shares HK\$25,000,000	100.00%	Gold trading and investment holding
Po Sang Futures Limited*	Hong Kong 19 October 1993	Ordinary shares HK\$25,000,000	100.00%	Commodities brokerage
Po Sang (Nominees) Limited*	Hong Kong 29 April 1993	Ordinary shares HK\$10,000	100.00%	Nominee services
Rams City (Nominees) Limited*	Hong Kong 2 May 1986	Ordinary shares HK\$2,000,000	100.00%	Nominee services and investment holding
Sanicon Investment Limited	Hong Kong 24 January 2000	Ordinary shares HK\$2	100.00%	Property holding and investment
Seng Sun Development Company, Limited*	Hong Kong 11 December 1961	Ordinary shares HK\$2,800,000	70.49%	Investment holding
Shenstone Limited	Hong Kong 4 September 1979	Ordinary shares HK\$2	100.00%	Property holding and investment
Sin Chiao Enterprises Corporation, Limited*	Hong Kong 13 September 1961	Ordinary shares HK\$3,000,000	100.00%	Property holding and investment

<b>Name of company</b>	<b>Country/place and date of incorporation/operation</b>	<b>Issued and fully paid up share capital/registered capital</b>	<b>Percentage of attributable equity interest</b>	<b>Principal activities</b>
Sin Hua Trustee Limited*	Hong Kong 27 October 1978	Ordinary shares HK\$3,000,000	100.00%	Trustee services
Sin Mei (Nominee) Limited*	Hong Kong 27 April 1982	Ordinary shares HK\$100,000	100.00%	Nominee services and investment holding
Sin Yeh Shing Company Limited	Hong Kong 28 November 1980	Ordinary shares HK\$100,000	100.00%	Property holding and investment
Sino Information Services Company Limited	Hong Kong 11 February 1993	Ordinary shares HK\$7,000,000	100.00%	Information services
The China-South Sea (Nominees) Services Limited*	Hong Kong 13 February 1981	Ordinary shares HK\$100,000	100.00%	Nominee services
The China State (Nominees) Limited*	Hong Kong 14 May 1982	Ordinary shares HK\$100,000	100.00%	Nominee services and investment holding
The China State Trustee Limited*	Hong Kong 17 July 1981	Ordinary shares HK\$3,000,000	100.00%	Trustee services
Track Link Investment Limited	Hong Kong 8 February 1994	Ordinary shares HK\$2	100.00%	Property holding and investment
Yien Yieh (Nominee) Limited*	Hong Kong 26 June 2001	Ordinary shares HK\$2,000	100.00%	Nominee services and investment holding

Champion Leader International Limited completed winding up procedures on 8 April 2007.

Excellent Way Properties Limited completed winding up procedures on 12 May 2007.

**Remarks:**

Name of subsidiaries which are not included in the consolidation group for regulatory purposes in respect of capital adequacy is marked with \* in the above table. BOCHK and its subsidiaries specified by the HKMA form the basis of consolidation 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.

## DEFINITIONS

In this Annual Report, unless the context otherwise requires, the following terms shall have the meanings set out below:

Terms	Meanings
“AC” . . . . .	The Audit Committee
“ALCO” . . . . .	The Asset and Liability Management Committee
“ATM” . . . . .	Automated Teller Machine
“Board” or “Board of Directors” . . . . .	The Board of Directors of BOCHK
“Board of BOCHK (Holdings)” . . . . .	The Board of Directors of BOCHK (Holdings)
“BOC” . . . . .	Bank of China Limited, a joint stock commercial bank with limited liability established under the laws of the PRC, the H shares and A shares of which are listed on the Hong Kong Stock Exchange and the Shanghai Stock Exchange respectively
“BOC (BVI)” . . . . .	BOC Hong Kong (BVI) Limited, a company incorporated under the laws of the British Virgin Islands and a wholly owned subsidiary of BOC Hong Kong (Group) Limited
“BOC-CC” . . . . .	BOC Credit Card (International) Limited, a company incorporated under the laws of Hong Kong and a wholly owned subsidiary of BOCHK
“BOCHK” or “the Bank” . . . . .	Bank of China (Hong Kong) Limited, a company incorporated under the laws of Hong Kong and a wholly owned subsidiary of BOCHK (Holdings)
“BOCHK (Holdings)” . . . . .	BOC Hong Kong (Holdings) Limited, a company incorporated under the laws of Hong Kong
“BOCI-Prudential Manager” . . . . .	BOCI-Prudential Asset Management Limited, a company incorporated under the laws of Hong Kong, in which BOCI Asset Management Limited, a wholly owned subsidiary of BOC International Holdings Limited, and Prudential Corporation Holdings Limited hold equity interests of 64% and 36% respectively
“BOCI-Prudential Trustee” . . . . .	BOCI-Prudential Trustee Limited, a company incorporated under the laws of Hong Kong, in which BOC Group Trustee Company Limited and Prudential Corporation Holdings Limited hold equity interests of 64% and 36% respectively
“CAR” . . . . .	Capital Adequacy Ratio, computed on the consolidated basis that comprises the positions of BOCHK and certain subsidiaries specified by the HKMA for its regulatory purposes and in accordance with the Banking (Capital) Rules

Terms	Meanings
“CCO” . . . . .	Chief Credit Officer
“CE” . . . . .	Chief Executive
“CRO” . . . . .	Chief Risk Officer
“Central SAFE” . . . . .	Central SAFE Investments Limited
“Chiyu” . . . . .	Chiyu Banking Corporation Limited, a company incorporated under the laws of Hong Kong, in which BOCHK holds an equity interest of 70.49%
“ECAI(s)” . . . . .	External Credit Assessment Institution(s)
“ESPD” . . . . .	The Economics & Strategic Planning Department
“Fitch” . . . . .	Fitch Ratings
“Group” . . . . .	The Bank and its subsidiaries collectively referred as the Group
“HK GAAP” . . . . .	Generally Accepted Accounting Principles in Hong Kong
“HKAS(s)” . . . . .	Hong Kong Accounting Standard(s)
“HKAS-Int” . . . . .	HKAS Interpretation
“HKFRS(s)” . . . . .	Hong Kong Financial Reporting Standard(s)
“HKICPA” . . . . .	Hong Kong Institute of Certified Public Accountants
“HKMA” . . . . .	Hong Kong Monetary Authority
“Hong Kong” or “Hong Kong SAR” . .	Hong Kong Special Administrative Region
“Listing Rules” . . . . .	The Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited
“Mainland China” . . . . .	The mainland of the PRC
“MPF” . . . . .	Mandatory Provident Fund
“MPF Schemes Ordinance” . . . . .	The Mandatory Provident Fund Schemes Ordinance, Chapter 485 of the Laws of Hong Kong, as amended
“Moody’s” . . . . .	Moody’s Investors Service
“Nanyang” . . . . .	Nanyang Commercial Bank, Limited, a company incorporated under the laws of Hong Kong and a wholly owned subsidiary of BOCHK
“ORSO schemes” . . . . .	The Occupational Retirement Schemes under Occupational Retirement Schemes Ordinance, Chapter 426 of the Laws of Hong Kong

Terms	Meanings
“PRC” . . . . .	The People’s Republic of China
“RC” . . . . .	The Risk Committee
“RMB” or “Renminbi” . . . . .	Renminbi, the lawful currency of the PRC
“RMD” . . . . .	The Risk Management Department
“STC approach” . . . . .	Standardised (Credit Risk) Approach
“STM approach” . . . . .	Standardised (Market Risk) Approach
“STO approach” . . . . .	Standardised (Operational Risk) Approach
“Share Option Scheme” . . . . .	The Share Option Scheme conditionally approved and adopted by the shareholders of the Bank on 10 July 2002
“Sharesave Plan” . . . . .	The Sharesave Plan conditionally approved and adopted by the shareholders of the Bank on 10 July 2002
“Standard & Poor’s” . . . . .	Standard & Poor’s Ratings Services
“Stock Exchange” . . . . .	The Stock Exchange of Hong Kong Limited
“TD” . . . . .	The Treasury Department
“US” . . . . .	The United States of America
“VAR” . . . . .	Value at Risk

# CONDENSED CONSOLIDATED INCOME STATEMENT

		(Unaudited)	(Unaudited)
		Nine months ended	Nine months ended
	Notes	30 September 2009	30 September 2008
		HK\$'m	HK\$'m
Interest income . . . . .		16,553	25,890
Interest expense . . . . .		(4,174)	(11,980)
<b>Net interest income</b> . . . . .	4	<b>12,379</b>	13,910
Fees and commission income . . . . .		6,474	5,688
Fees and commission expenses . . . . .		(1,431)	(1,433)
<b>Net fees and commission income</b> . . . . .	5	<b>5,043</b>	4,255
Net trading income . . . . .	6	1,313	1,661
Net gain/(loss) on financial instruments designated at fair value through profit or loss . . . . .		255	(117)
Net gain on investment in securities . . . . .	7	73	40
Other operating income . . . . .	8	339	317
<b>Net operating income before impairment allowances</b> . . . . .		<b>19,402</b>	20,066
Net charge of impairment allowances . . . . .	9	(21)	(5,870)
<b>Net operating income</b> . . . . .		<b>19,381</b>	14,196
Operating expenses . . . . .	10	(9,165)	(6,166)
<b>Operating profit</b> . . . . .		<b>10,216</b>	8,030
Net gain from disposal of/fair value adjustments on investment properties . . . . .	11	1,266	475
Net gain from disposal/revaluation of properties, plant and equipment . . . . .	12	24	5
Share of profits less losses of associates . . . . .		4	9
<b>Profit before taxation</b> . . . . .		<b>11,510</b>	8,519
Taxation . . . . .	13	(1,912)	(1,331)
<b>Profit for the period</b> . . . . .		<b>9,598</b>	7,188
<b>Profit attributable to:</b>			
Equity holders of the Bank . . . . .		9,474	6,989
Minority interests . . . . .		124	199
		<b>9,598</b>	7,188
<b>Dividends</b> . . . . .	14	<b>3,469</b>	3,960

The notes on pages A-6 to A-59 are an integral part of this financial information.

# CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

		(Unaudited)	(Unaudited)
		Nine months ended	Nine months ended
	Notes	30 September 2009	30 September 2008
		HK\$'m	HK\$'m
<b>Profit for the period</b> . . . . .		<b>9,598</b>	<b>7,188</b>
Net change in fair value of available-for-sale securities . . . . .		<b>5,448</b>	(6,494)
Revaluation of premises . . . . .		<b>3,199</b>	1,208
Currency translation difference . . . . .		<b>(5)</b>	194
Net deferred tax on items taken directly to equity . . .		<b>(1,389)</b>	498
Reclassification adjustments			
Release upon disposal of available-for-sale securities . . . . .		<b>(69)</b>	23
Net impairment charges on available-for-sale securities transferred to profit or loss . . . . .	9	<b>206</b>	2,959
Amortisation with respect to available-for-sale securities transferred to held-to-maturity securities . . . . .		<b>(50)</b>	(67)
<b>Other comprehensive income for the period, net of tax</b> . . . . .		<b>7,340</b>	<b>(1,679)</b>
<b>Total comprehensive income for the period</b> . . . . .		<b>16,938</b>	<b>5,509</b>
<b>Total comprehensive income attributable to:</b> . . . . .			
Equity holders of the Bank . . . . .		<b>16,810</b>	5,285
Minority interests . . . . .		<b>128</b>	224
		<b>16,938</b>	<b>5,509</b>

The notes on pages A-6 to A-59 are an integral part of this financial information.



# CONDENSED CONSOLIDATED BALANCE SHEET

	Notes	(Unaudited)	(Audited)
		At	At
		30 September 2009	31 December 2008
		HK\$'m	HK\$'m
<b>ASSETS</b>			
Cash and balances with banks and other financial institutions . . . . .	15	168,551	153,268
Placements with banks and other financial institutions maturing between one and twelve months . . . . .		98,486	89,718
Financial assets at fair value through profit or loss . . . . .	16	12,072	16,404
Derivative financial instruments . . . . .	17	18,722	19,628
Hong Kong SAR Government certificates of indebtedness . . . . .		37,560	34,200
Advances and other accounts . . . . .	18	517,791	470,220
Investment in securities . . . . .	19	293,655	289,353
Interests in associates . . . . .		89	88
Investment properties . . . . .	20	9,024	7,727
Properties, plant and equipment . . . . .	21	25,301	22,788
Deferred tax assets . . . . .		73	47
Other assets . . . . .		16,001	14,555
Total assets . . . . .		<u>1,197,325</u>	<u>1,117,996</u>
<b>LIABILITIES</b>			
Hong Kong SAR currency notes in circulation . . . . .		37,560	34,200
Deposits and balances of banks and other financial institutions . . . . .		81,871	88,779
Financial liabilities at fair value through profit or loss . . . . .	22	9,988	21,938
Derivative financial instruments . . . . .	17	15,557	20,450
Deposits from customers . . . . .	23	888,967	805,866
Debt securities in issue at amortised cost . . . . .		78	1,042
Other accounts and provisions . . . . .	24	34,393	33,662
Current tax liabilities . . . . .		1,929	441
Deferred tax liabilities . . . . .		4,402	2,799
Subordinated liabilities . . . . .	25	27,076	26,604
Total liabilities . . . . .		<u>1,101,821</u>	<u>1,035,781</u>
<b>EQUITY</b>			
Share capital . . . . .	26	43,043	43,043
Reserves . . . . .	27	51,055	37,714
Capital and reserves attributable to the equity holders of the Bank . . . . .		94,098	80,757
Minority interests . . . . .		1,406	1,458
Total equity . . . . .		<u>95,504</u>	<u>82,215</u>
Total liabilities and equity . . . . .		<u>1,197,325</u>	<u>1,117,996</u>

The notes on pages A-6 to A-59 are an integral part of this financial information.

# CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(Unaudited)

	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	Minority interests	Total equity
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
At 1 January 2008 . . . . .	43,043	8,563	(605)	4,130	14	26,598	81,743	1,549	83,292
Comprehensive income . . . . .	–	1,083	(2,913)	–	191	6,924	5,285	224	5,509
Release upon disposal of premises . . . . .	–	(42)	–	–	–	42	–	–	–
Transfer from retained earnings . . . . .	–	–	–	544	–	(544)	–	–	–
2007 final dividend paid . . . . .	–	–	–	–	–	–	–	(107)	(107)
2008 interim dividend paid . . . . .	–	–	–	–	–	(3,960)	(3,960)	(200)	(4,160)
At 30 September 2008 . . . . .	<u>43,043</u>	<u>9,604</u>	<u>(3,518)</u>	<u>4,674</u>	<u>205</u>	<u>29,060</u>	<u>83,068</u>	<u>1,466</u>	<u>84,534</u>
Bank and subsidiaries . . . . .	43,043	9,604	(3,518)	4,674	205	29,007	83,015		
Associates . . . . .	–	–	–	–	–	53	53		
	<u>43,043</u>	<u>9,604</u>	<u>(3,518)</u>	<u>4,674</u>	<u>205</u>	<u>29,060</u>	<u>83,068</u>		
At 1 October 2008 . . . . .	43,043	9,604	(3,518)	4,674	205	29,060	83,068	1,466	84,534
Comprehensive income . . . . .	–	(1,230)	(607)	–	21	(495)	(2,311)	9	(2,302)
Release upon disposal of premises . . . . .	–	(61)	–	–	–	61	–	–	–
Transfer from retained earnings . . . . .	–	–	–	(171)	–	171	–	–	–
2008 interim dividend paid . . . . .	–	–	–	–	–	–	–	(17)	(17)
At 31 December 2008 . . . . .	<u>43,043</u>	<u>8,313</u>	<u>(4,125)</u>	<u>4,503</u>	<u>226</u>	<u>28,797</u>	<u>80,757</u>	<u>1,458</u>	<u>82,215</u>
Bank and subsidiaries . . . . .	43,043	8,313	(4,125)	4,503	226	28,747	80,707		
Associates . . . . .	–	–	–	–	–	50	50		
	<u>43,043</u>	<u>8,313</u>	<u>(4,125)</u>	<u>4,503</u>	<u>226</u>	<u>28,797</u>	<u>80,757</u>		
At 1 January 2009 . . . . .	<b>43,043</b>	<b>8,313</b>	<b>(4,125)</b>	<b>4,503</b>	<b>226</b>	<b>28,797</b>	<b>80,757</b>	<b>1,458</b>	<b>82,215</b>
Comprehensive income . . . . .	–	<b>2,719</b>	<b>4,671</b>	–	(5)	<b>9,425</b>	<b>16,810</b>	<b>128</b>	<b>16,938</b>
Release upon disposal of premises . . . . .	–	(91)	–	–	–	<b>91</b>	–	–	–
Transfer from retained earnings . . . . .	–	–	–	<b>358</b>	–	(358)	–	–	–
2008 final dividend paid . . . . .	–	–	–	–	–	–	–	(180)	(180)
2009 interim dividend paid . . . . .	–	–	–	–	–	(3,469)	(3,469)	–	(3,469)
At 30 September 2009 . . . . .	<u>43,043</u>	<u>10,941</u>	<u>546</u>	<u>4,861</u>	<u>221</u>	<u>34,486</u>	<u>94,098</u>	<u>1,406</u>	<u>95,504</u>
Bank and subsidiaries . . . . .	43,043	10,941	546	4,861	221	34,435	94,047		
Associates . . . . .	–	–	–	–	–	51	51		
	<u>43,043</u>	<u>10,941</u>	<u>546</u>	<u>4,861</u>	<u>221</u>	<u>34,486</u>	<u>94,098</u>		

\* 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 A-6 to A-59 are an integral part of this financial information.

# CONDENSED CONSOLIDATED CASH FLOW STATEMENT

		(Unaudited)	(Unaudited)
	Notes	Nine months ended 30 September 2009	Nine months ended 30 September 2008
		HK\$'m	HK\$'m
<b>Cash flows from operating activities</b>			
Operating cash inflow before taxation . . . . .	28(a)	22,885	65,513
Hong Kong profits tax paid . . . . .		(126)	(645)
Overseas profits tax paid . . . . .		(110)	(100)
<b>Net cash inflow from operating activities . . . . .</b>		<b>22,649</b>	<b>64,768</b>
<b>Cash flows from investing activities</b>			
Purchase of properties, plant and equipment . . . . .		(257)	(371)
Proceeds from disposal of properties, plant and equipment . . . . .		125	1
Proceeds from disposal of investment properties . . .		56	178
Dividends received from associates . . . . .		3	2
<b>Net cash outflow from investing activities . . . . .</b>		<b>(73)</b>	<b>(190)</b>
<b>Cash flows from financing activities</b>			
Dividends paid to equity holders of the Bank . . . . .		(3,469)	(3,960)
Dividends paid to minority shareholders . . . . .		(180)	(307)
Proceeds from subordinated liabilities . . . . .		–	8,144
Interest paid for subordinated loans . . . . .		(539)	–
<b>Net cash (outflow)/inflow from financing activities .</b>		<b>(4,188)</b>	<b>3,877</b>
Increase in cash and cash equivalents . . . . .		18,388	68,455
Cash and cash equivalents at 1 January . . . . .		174,925	152,057
<b>Cash and cash equivalents at 30 September . . . . .</b>	28(b)	<b>193,313</b>	<b>220,512</b>

The notes on pages A-6 to A-59 are an integral part of this financial information.

## NOTES TO THE FINANCIAL INFORMATION

### 1. Basis of preparation and accounting policies

#### Basis of preparation

The unaudited financial information has been prepared in accordance with HKAS 34 “Interim Financial Reporting” issued by the HKICPA.

#### Accounting policies

Except as described below, the accounting policies and methods of computation used in the preparation of the unaudited financial information are consistent with those used in the Group’s financial statements for the year ended 31 December 2008 and should be read in conjunction with the Group’s Annual Report for 2008.

The following new standard, revised standard, amendment to standard, and interpretation are mandatory for the first time for the financial year beginning 1 January 2009.

- HKAS 1 (Revised), ‘Presentation of financial statements’. The revised standard prohibits 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’ are required to be shown in a performance statement.

The Group has elected to present the performance in two separate statements: an income statement and a statement of comprehensive income. The financial information has been prepared under the revised disclosure requirements. The adoption of this revised standard affects the presentation of the Group’s financial statements.

- HKFRS 7 (Amendment), ‘Financial instruments: disclosures’. The amendment increases the disclosure requirements about fair value measurement and reinforces existing principles for disclosure about liquidity risk. The amendment introduces a three-level hierarchy for fair value measurement disclosures and requires some specific quantitative disclosures for financial instruments on the lowest level in the hierarchy. It also requires entities to provide additional disclosures about the relative reliability of fair value measurements. These disclosures will help to improve comparability between entities about the effects of fair value measurements. In addition, the amendment clarifies and enhances the existing requirements for the disclosure of liquidity risk primarily requiring a separate liquidity risk analysis for derivative and non-derivative financial liabilities. The Group will make additional relevant disclosures in its financial statements ending 31 December 2009. It is not required to provide comparative disclosures in the first year of application.
- HKFRS 8, ‘Operating Segments’. HKFRS 8 replaces HKAS 14 ‘Segment Reporting’. It requires a ‘management approach’ under which segment information, that reflects the operating result of segments reviewed regularly by the management for operation decisions making and performance assessment, is presented on the same basis and in the same manner as that used for internal reporting to the management. The adoption of HKFRS 8 has no change in the number of reportable segments presented. However, there is a change in inter-segment funding, details of which are disclosed in Notes 31. As the impact is not significant, no restatement of prior year figure has been made.
- HK(IFRIC)-Int 13, ‘Customer Loyalty Programmes’. 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 interpretation does not have significant impact on the Group’s results of operations and financial position.

## 2. Critical accounting estimates and judgements in applying accounting policies

Except as described below, the Group makes estimates and assumptions that are consistent with those used in the Group's financial statements for the year ended 31 December 2008.

### *Amount recoverable from the Lehman Brothers minibonds*

In determining the Group's charge to the income statement in respect of the Lehman Brothers minibonds ("Minibonds") (Note 10), the Group took into account the estimated aggregate amount paid and payable under the Repurchase Scheme and the voluntary offer, the provision made prior to the date of the Repurchase Scheme and the amount recoverable from the Minibonds.

The amount recoverable from the Minibonds is uncertain and dependent on a number of factors including resolution of certain legal matters, which may result in a wide range of recovery outcomes. The Group has made an assessment of the amount recoverable taking into account such uncertainties. The final amount recovered by the Group could be different from the assessment and may result in a significant credit being recognised in the income statement in the period when it is realised.

## 3. 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 and interest rate risk) and liquidity risk. This note summarises the Group's exposures to these risks.

### 3.1 Credit Risk

#### *A. Gross loans and advances*

##### *(a) Impaired advances*

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.

	At 30 September 2009 HK\$m	At 31 December 2008 HK\$m
Gross impaired advances to customers . . . . .	<u>794</u>	<u>1,326</u>
Individually assessed loan impairment allowances made in respect of such advances . . . . .	<u>573</u>	<u>800</u>
Current market value of collateral held against the covered portion of advances to customers . . . . .	<u>360</u>	<u>710</u>
Covered portion of advances to customers . . . . .	<u>286</u>	<u>628</u>
Uncovered portion of advances to customers . . . . .	<u>508</u>	<u>698</u>
Gross impaired advances to customers as a percentage of gross advances to customers . . . . .	<u>0.16%</u>	<u>0.29%</u>

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

Classified or impaired advances to customers are analysed as follows:

	At 30 September 2009	At 31 December 2008
	HK\$m	HK\$m
Gross classified or impaired advances to customers . . . . .	<u>1,495</u>	<u>2,138</u>
Gross classified or impaired advances to customers as a percentage of gross advances to customers . . . . .	<u>0.29%</u>	<u>0.46%</u>

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.

*(b) Advances overdue for more than 3 months*

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.

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

	At 30 September 2009		At 31 December 2008	
	Amount	% of gross advances to customers	Amount	% of gross advances to customers
	HK\$m		HK\$m	
Gross advances to customers which have been overdue for:				
– six months or less but over three months . . . . .	156	0.03%	339	0.07%
– one year or less but over six months . .	268	0.06%	66	0.02%
– over one year . . . . .	616	0.12%	571	0.12%
Advances overdue for over three months . .	<u>1,040</u>	<u>0.21%</u>	<u>976</u>	<u>0.21%</u>
Individually assessed loan impairment allowances made in respect of such advances . . . . .	<u>520</u>		<u>439</u>	

	At 30 September 2009	At 31 December 2008
	HK\$m	HK\$m
Current market value of collateral held against the covered portion of advances to customers . . . . .	<u>1,334</u>	<u>1,436</u>
Covered portion of advances to customers . . . . .	<u>668</u>	<u>604</u>
Uncovered portion of advances to customers . . . . .	<u>372</u>	<u>372</u>

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 30 September 2009 and 31 December 2008, there were no advances to banks and other financial institutions that were overdue for more than three months.

(c) *Rescheduled advances*

	At 30 September 2009		At 31 December 2008	
	Amount	% of gross advances to customers	Amount	% of gross advances to customers
	HK\$m		HK\$m	
Rescheduled advances to customers net of amounts included in advances overdue for more than 3 months . . . . .	<u>240</u>	<u>0.05%</u>	<u>127</u>	<u>0.03%</u>

As at 30 September 2009 and 31 December 2008, there were no rescheduled advances to banks and other financial institutions.

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.

(d) *Concentration of advances to customers*

(i) Sectoral analysis of gross advances to customers

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

At 30 September 2009						
	Gross advances	% Covered by collateral or other security	Classified or impaired	Overdue*	Individually assessed impairment allowances	Collectively assessed impairment allowances
	HK\$'m		HK\$'m	HK\$'m	HK\$'m	HK\$'m
Loans for use in Hong Kong						
Industrial, commercial and financial						
– Property development . . . .	26,667	30.90%	3	18	2	58
– Property investment . . . . .	72,009	84.73%	232	453	22	331
– Financial concerns . . . . .	11,524	8.27%	–	4	–	37
– Stockbrokers . . . . .	5,314	96.43%	–	–	–	23
– Wholesale and retail trade.	20,066	54.16%	173	221	70	86
– Manufacturing . . . . .	23,223	44.70%	127	252	59	116
– Transport and transport equipment. . . . .	27,879	12.44%	96	8	4	64
– Recreational activities. . . .	309	14.17%	–	–	–	1
– Information technology. . . .	4,978	2.71%	–	–	–	13
– Others . . . . .	34,859	28.20%	53	182	16	79
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme . . . . .	12,332	99.97%	77	465	2	7
– Loans for purchase of other residential properties . . . . .	124,902	99.96%	137	1,302	2	38
– Credit card advances . . . .	6,703	–	29	199	–	73
– Others . . . . .	10,333	75.62%	93	273	56	16
Total loans for use in						
Hong Kong . . . . .	381,098	66.93%	1,020	3,377	233	942
Trade finance . . . . .	27,514	22.59%	259	286	209	116
Loans for use outside						
Hong Kong . . . . .	98,346	22.99%	216	195	131	362
Gross advances to customers . .	<u>506,958</u>	<u>56.00%</u>	<u>1,495</u>	<u>3,858</u>	<u>573</u>	<u>1,420</u>



	Gross advances	% Covered by collateral or other security	Classified or impaired	Overdue*	Individually assessed impairment allowances	Collectively assessed impairment allowances
	HK\$'m		HK\$'m	HK\$'m	HK\$'m	HK\$'m
Loans for use in Hong Kong						
Industrial, commercial and financial						
– Property development . . . .	19,856	40.49%	2	14	1	66
– Property investment . . . . .	71,374	88.00%	294	585	30	312
– Financial concerns . . . . .	12,312	8.14%	–	–	1	56
– Stockbrokers . . . . .	124	10.33%	–	–	–	–
– Wholesale and retail trade.	18,156	52.85%	218	300	71	98
– Manufacturing . . . . .	16,410	53.67%	234	298	138	80
– Transport and transport equipment. . . . .	21,590	13.82%	2	9	1	81
– Recreational activities. . . .	139	46.87%	–	–	–	–
– Information technology. . . .	6,049	2.21%	–	3	–	19
– Others . . . . .	23,529	26.91%	68	213	13	83
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme . . . . .	13,477	99.91%	98	510	4	12
– Loans for purchase of other residential properties . . . . .	116,303	99.97%	153	1,650	7	74
– Credit card advances . . . .	6,553	–	30	273	–	71
– Others . . . . .	11,452	77.84%	107	333	57	20
Total loans for use in Hong Kong . . . . .	337,324	70.68%	1,206	4,188	323	972
Trade finance . . . . .	24,555	30.36%	560	494	355	108
Loans for use outside Hong Kong . . . . .	99,295	22.38%	372	235	122	421
Gross advances to customers . .	<u>461,174</u>	<u>58.14%</u>	<u>2,138</u>	<u>4,917</u>	<u>800</u>	<u>1,501</u>

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

(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**

	At 30 September 2009	At 31 December 2008
	HK\$'m	HK\$'m
Hong Kong . . . . .	406,206	375,233
Mainland China . . . . .	71,332	55,318
Others . . . . .	29,420	30,623
	<u>506,958</u>	<u>461,174</u>

*Collectively assessed loan impairment allowances in respect of the gross advances to customers*

	At 30 September 2009	At 31 December 2008
	HK\$'m	HK\$'m
Hong Kong . . . . .	1,040	1,172
Mainland China . . . . .	305	221
Others . . . . .	75	108
	<u>1,420</u>	<u>1,501</u>

**Overdue advances**

	At 30 September 2009	At 31 December 2008
	HK\$'m	HK\$'m
Hong Kong . . . . .	3,525	4,622
Mainland China . . . . .	295	266
Others . . . . .	38	29
	<u>3,858</u>	<u>4,917</u>

*Individually assessed loan impairment allowances in respect of the overdue advances*

	At 30 September 2009	At 31 December 2008
	HK\$'m	HK\$'m
Hong Kong . . . . .	357	554
Mainland China . . . . .	158	99
Others . . . . .	22	21
	<u>537</u>	<u>674</u>

*Collectively assessed loan impairment allowances in respect of the overdue advances*

	At 30 September 2009	At 31 December 2008
	HK\$'m	HK\$'m
Hong Kong . . . . .	59	50
Mainland China . . . . .	6	6
	<u>65</u>	<u>56</u>

**Classified or impaired advances**

	At 30 September 2009	At 31 December 2008
	HK\$'m	HK\$'m
Hong Kong . . . . .	1,229	1,792
Mainland China . . . . .	242	323
Others . . . . .	24	23
	<u>1,495</u>	<u>2,138</u>

*Individually assessed loan impairment allowances in respect of the classified or impaired advances*

	At 30 September 2009	At 31 December 2008
	HK\$'m	HK\$'m
Hong Kong . . . . .	391	677
Mainland China . . . . .	158	100
Others . . . . .	24	23
	<u>573</u>	<u>800</u>

*Collectively assessed loan impairment allowances in respect of the classified or impaired advances*

	At 30 September 2009	At 31 December 2008
	HK\$'m	HK\$'m
Hong Kong . . . . .	28	26
Mainland China . . . . .	4	7
	<u>32</u>	<u>33</u>

***Reposessed assets***

The estimated market value of reposessed assets held by the Group as at 30 September 2009 amounted to HK\$106 million (31 December 2008: HK\$173 million). 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.

## B. Debt securities

The table below represents an analysis of the carrying value of debt securities by credit rating and credit risk characteristic, based on Moody's ratings or their equivalent to the respective issues of the debt securities.

At 30 September 2009							
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated		
					Hong Kong government and government bodies	Other governments and government agencies	Other
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
<b>Investment in securities</b>							
US non-agency residential mortgage-backed							
– Subprime. . . . .	563	15	15	106	–	–	699
– Alt-A. . . . .	190	187	41	410	–	–	828
– Prime . . . . .	1,100	272	857	7,024	–	–	9,253
Fannie Mae							
– issued debt securities. .	1,349	–	–	–	–	–	1,349
– mortgage-backed securities. . . . .	–	–	–	–	–	60	60
Freddie Mac							
– issued debt securities. .	78	158	–	–	–	–	236
– mortgage-backed securities. . . . .	–	–	–	–	–	1,249	1,249
Other MBS/ABS . . . . .	4,847	429	33	–	–	2,757	8,066
Other debt securities . . .	66,620	68,503	35,260	5,458	19,172	29,736	271,396
Subtotal . . . . .	74,747	69,564	36,206	12,998	19,172	33,802	293,136
<b>Financial assets at fair value through profit or loss</b>							
Other MBS/ABS . . . . .	24	–	–	–	–	–	24
Other debt securities . . .	50	568	1,200	1,150	8,527	155	11,921
Subtotal . . . . .	74	568	1,200	1,150	8,527	155	11,945
Total . . . . .	74,821	70,132	37,406	14,148	27,699	33,957	305,081

	Unrated							
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Hong Kong	Other governments	Other	Total
					government and	and government		
					government bodies	agencies		
HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	
Investment in securities								
US non-agency residential mortgage-backed								
– Subprime. . . . .	913	–	30	104	–	–	–	1,047
– Alt-A. . . . .	1,245	383	274	432	–	–	–	2,334
– Prime . . . . .	9,549	1,558	2,878	1,950	–	–	–	15,935
Fannie Mae								
– issued debt securities. .	1,504	–	–	–	–	–	–	1,504
– mortgage-backed securities. . . . .	–	–	–	–	–	88	–	88
Freddie Mac								
– issued debt securities. .	864	162	–	–	–	–	–	1,026
– mortgage-backed securities. . . . .	–	–	–	–	–	1,633	–	1,633
Other MBS/ABS . . . . .	6,874	24	63	–	–	3,807	–	10,768
Other debt securities . . . .	40,537	83,827	26,437	4,371	12,175	51,368	35,873	254,588
Subtotal . . . . .	61,486	85,954	29,682	6,857	12,175	56,896	35,873	288,923
Financial assets at fair value through profit or loss								
Other MBS/ABS . . . . .	27	–	–	–	–	–	–	27
Other debt securities . . . .	243	1,814	1,800	729	11,358	–	351	16,295
Subtotal . . . . .	270	1,814	1,800	729	11,358	–	351	16,322
Total . . . . .	61,756	87,768	31,482	7,586	23,533	56,896	36,224	305,245

The total amount of unrated issues amounted to HK\$108,574 million (31 December 2008: HK\$116,653 million) as at 30 September 2009, of which only HK\$6,620 million (31 December 2008: HK\$8,971 million) were without issuer ratings. For details, please refer to page A-18.

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

At 30 September 2009						
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Available-for-sale securities . . . . .	17,341	38,302	7,091	2,076	5,464	70,274
Held-to-maturity securities . . . . .	711	10,451	2,685	155	1,078	15,080
Loans and receivables . . .	1,716	10,275	2,276	–	–	14,267
Financial assets at fair value through profit or loss . . . . .	155	8,528	192	–	78	8,953
Total . . . . .	<u>19,923</u>	<u>67,556</u>	<u>12,244</u>	<u>2,231</u>	<u>6,620</u>	<u>108,574</u>

At 31 December 2008						
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Available-for-sale securities . . . . .	18,180	49,408	3,293	35	5,481	76,397
Held-to-maturity securities . . . . .	624	10,140	2,037	–	3,151	15,952
Loans and receivables . . .	3,386	8,768	397	–	44	12,595
Financial assets at fair value through profit or loss . . . . .	1	11,413	–	–	295	11,709
Total . . . . .	<u>22,191</u>	<u>79,729</u>	<u>5,727</u>	<u>35</u>	<u>8,971</u>	<u>116,653</u>

The impaired debt securities by credit rating are analysed as follows:

At 30 September 2009							
	Carrying values						Of which accumulated impairment allowances
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total	
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>Investment in securities</b>							
US non-agency residential mortgage-backed							
– Subprime . . . . .	480	–	15	106	–	601	294
– Alt-A . . . . .	18	97	41	410	–	566	264
– Prime . . . . .	375	233	441	6,202	–	7,251	3,336
Other MBS/ABS . . . .	–	72	–	–	–	72	54
Other debt securities . .	–	–	33	386	60	479	675
Total . . . . .	<u>873</u>	<u>402</u>	<u>530</u>	<u>7,104</u>	<u>60</u>	<u>8,969</u>	<u>4,623</u>
Of which accumulated impairment allowances . . . . .	<u>201</u>	<u>149</u>	<u>219</u>	<u>3,447</u>	<u>607</u>	<u>4,623</u>	
At 31 December 2008							
	Carrying values						Of which accumulated impairment allowances
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total	
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>Investment in securities</b>							
US non-agency residential mortgage-backed							
– Subprime . . . . .	695	–	30	104	–	829	339
– Alt-A . . . . .	662	383	274	431	–	1,750	1,302
– Prime . . . . .	5,162	1,295	1,312	1,825	–	9,594	6,479
Other MBS/ABS . . . .	69	–	–	–	–	69	27
Other debt securities . .	–	–	185	591	35	811	854
Total . . . . .	<u>6,588</u>	<u>1,678</u>	<u>1,801</u>	<u>2,951</u>	<u>35</u>	<u>13,053</u>	<u>9,001</u>
Of which accumulated impairment allowances . . . . .	<u>4,195</u>	<u>1,400</u>	<u>976</u>	<u>2,078</u>	<u>352</u>	<u>9,001</u>	

Debt securities overdue for more than 3 months are analysed as follows:

	At 30 September 2009
	Available-for-sale securities
	HK\$m
Overdue for over 1 year . . . . .	<u>68</u>

	At 31 December 2008
	Available-for-sale securities
	HK\$m
Overdue for 6 months or less but over 3 months . . . . .	<u>35</u>

#### MBS/ABS

The table below represents an analysis of the Group's exposure to MBS/ABS by geographical location.

	At 30 September 2009		
	Carrying values		Of which
	Total	Impaired securities	accumulated impairment allowances
	HK\$m	HK\$m	HK\$m
<b>US MBS/ABS</b>			
Non-agency residential mortgage-backed			
– Subprime . . . . .	699	601	294
– Alt-A . . . . .	828	566	264
– Prime . . . . .	9,253	7,251	3,336
Ginnie Mae . . . . .	2,757	–	–
Fannie Mae . . . . .	60	–	–
Freddie Mac . . . . .	1,249	–	–
Commercial mortgage-backed . . . . .	911	–	–
Others . . . . .	<u>1,789</u>	<u>–</u>	<u>–</u>
	<u>17,546</u>	<u>8,418</u>	<u>3,894</u>
<b>Other countries MBS/ABS</b>			
Residential mortgage-backed . . . . .	2,396	72	54
Commercial mortgage-backed . . . . .	160	–	–
Others . . . . .	<u>77</u>	<u>–</u>	<u>–</u>
	<u>2,633</u>	<u>72</u>	<u>54</u>
Total MBS/ABS . . . . .	<u>20,179</u>	<u>8,490</u>	<u>3,948</u>



At 31 December 2008			
	Carrying values		Of which
	Total	Impaired securities	accumulated
			impairment allowances
	HK\$m	HK\$m	HK\$m
<b>US MBS/ABS</b>			
Non-agency residential mortgage-backed			
– Subprime . . . . .	1,047	829	339
– Alt-A . . . . .	2,334	1,750	1,302
– Prime . . . . .	15,935	9,594	6,479
Ginnie Mae . . . . .	3,807	–	–
Fannie Mae . . . . .	88	–	–
Freddie Mac . . . . .	1,633	–	–
Commercial mortgage-backed . . . . .	929	–	–
Others . . . . .	2,806	–	–
	<u>28,579</u>	<u>12,173</u>	<u>8,120</u>
<b>Other countries MBS/ABS</b>			
Residential mortgage-backed . . . . .	2,649	69	27
Commercial mortgage-backed . . . . .	454	–	–
Others . . . . .	150	–	–
	<u>3,253</u>	<u>69</u>	<u>27</u>
Total MBS/ABS . . . . .	<u>31,832</u>	<u>12,242</u>	<u>8,147</u>

	At	At
	30 September 2009	31 December 2008
	HK\$m	HK\$m
Increase/(decrease) in fair value taken to available-for-sale securities reserve on MBS/ABS for the period/year (net of impairment charges taken to income statement excluding deferred tax impact) . . . . .	<u>1,899</u>	<u>(1,340)</u>
Closing balance of available-for-sale securities reserve relating to MBS/ABS (excluding deferred tax impact) . . . . .	<u>192</u>	<u>(1,707)</u>

The table below represents an analysis of impairment charges/(releases) for the period/year for MBS/ABS held as at 30 September 2009 and 31 December 2008.

At 30 September 2009					
Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total
HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
<b>US MBS/ABS</b>					
Non-agency residential mortgage-backed					
– Subprime . . . . .	(14)	–	(2)	16	–
– Alt-A. . . . .	(10)	12	21	(1)	–
– Prime . . . . .	61	28	85	799	–
	37	40	104	814	–
<b>Other countries</b>					
<b>MBS/ABS</b>					
Residential mortgage-backed . . . . .					
	–	24	–	–	–
Total MBS/ABS . . . . .	37	64	104	814	–

At 31 December 2008					
Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total
HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
<b>US MBS/ABS</b>					
Non-agency residential mortgage-backed					
– Subprime . . . . .	(90)	–	27	27	–
– Alt-A. . . . .	394	299	157	359	–
– Prime . . . . .	3,725	1,055	658	1,094	–
	4,029	1,354	842	1,480	–
<b>Other countries</b>					
<b>MBS/ABS</b>					
Residential mortgage-backed . . . . .					
	27	–	–	–	–
Total MBS/ABS . . . . .	4,056	1,354	842	1,480	–

*Note:* The impairment charges/(releases) for MBS/ABS disposed during the period/year are excluded.

## 3.2 Market Risk

### A. VAR

The Group uses VAR technique to measure potential losses and market risks of its trading book for reporting to the RC and senior management on a periodic basis. VAR is a statistical technique which estimates the potential losses that could occur on risk positions taken over a specified time horizon within a given level of confidence. BOCHK, being the banking entity within the Group with the major trading positions, which are mainly foreign currency positions in major currencies, uses VAR technique to monitor and control market risk on a daily basis.

The Group uses a historical simulation approach, a 99% confidence level and a 1-day holding period to calculate portfolio and individual VAR. Historical movements in market prices are calculated by reference to market data from the last two years.

The following table sets out the VAR for all trading market risk exposure<sup>1</sup> of BOCHK.

HK\$m		At 30 September	Minimum for the first three quarters	Maximum for the first three quarters	Average for the first three quarters
VAR for all market risk	– 2009	14.9	9.0	16.3	12.3
	– 2008	9.1	3.0	9.1	5.1
VAR for foreign exchange risk products	– 2009	10.0	9.2	15.8	12.0
	– 2008	9.2	2.5	9.2	4.4
VAR for interest rate risk products	– 2009	9.6	2.1	9.7	4.6
	– 2008	5.1	1.0	5.6	2.6
VAR for equity risk products	– 2009	0.1	0.1	2.5	0.3
	– 2008	0.3	0.2	2.8	0.5
VAR for commodity risk products	– 2009	0.0	0.0	0.1	0.0
	– 2008	0.0	0.0	0.5	0.0

In the first three quarters of 2009, the average daily revenue<sup>2</sup> of BOCHK earned from market risk-related trading activities was HK\$3.7 million (first three quarters of 2008: HK\$5.4 million).

<sup>1</sup> Structural FX positions have been excluded.

<sup>2</sup> Revenues from structural FX positions and back to back transactions have been excluded.

## B. Currency risk

The tables below summarise the Group's exposure to foreign currency exchange rate risk as at 30 September 2009 and 31 December 2008. Included in the tables are the Group's assets and liabilities at carrying amounts in HK\$ equivalent, categorised by the original currency.

	At 30 September 2009							
	Renminbi	US Dollars	HK Dollars	Euro	Japanese Yen	Pound Sterling	Others	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>Assets</b>								
Cash and balances with banks and other financial institutions . . . .	54,202	42,309	66,939	397	314	1,630	2,760	168,551
Placements with banks and other financial institutions maturing between one and twelve months . . . . .	406	55,011	31,232	4,250	–	3,163	4,424	98,486
Financial assets at fair value through profit or loss . . . . .	617	1,981	9,414	–	–	–	60	12,072
Derivative financial instruments . .	–	845	17,689	84	2	–	102	18,722
Hong Kong SAR Government certificates of indebtedness. . . .	–	–	37,560	–	–	–	–	37,560
Advances and other accounts . . . .	15,723	106,712	381,517	4,368	1,218	42	8,211	517,791
Investment in securities								
– Available-for-sale securities . .	2,123	94,185	40,834	22,115	17,675	1,670	28,241	206,843
– Held-to-maturity securities . . .	1,745	30,351	24,045	6,587	1,839	355	7,623	72,545
– Loans and receivables . . . . .	–	2,887	10,475	905	–	–	–	14,267
Interests in associates. . . . .	–	–	89	–	–	–	–	89
Investment properties. . . . .	30	–	8,994	–	–	–	–	9,024
Properties, plant and equipment . .	365	–	24,936	–	–	–	–	25,301
Other assets (including deferred tax assets) . . . . .	185	641	14,845	127	58	148	70	16,074
<b>Total assets</b> . . . . .	<u>75,396</u>	<u>334,922</u>	<u>668,569</u>	<u>38,833</u>	<u>21,106</u>	<u>7,008</u>	<u>51,491</u>	<u>1,197,325</u>
<b>Liabilities</b>								
Hong Kong SAR currency notes in circulation . . . . .	–	–	37,560	–	–	–	–	37,560
Deposits and balances of banks and other financial institutions . . . .	36,781	30,421	9,731	3,006	1,150	69	713	81,871
Financial liabilities at fair value through profit or loss. . . . .	–	698	8,886	–	–	–	404	9,988
Derivative financial instruments . .	–	1,964	12,598	885	5	–	105	15,557
Deposits from customers . . . . .	33,693	165,175	610,993	14,868	1,874	15,394	46,970	888,967
Debt securities in issue at amortised cost . . . . .	–	78	–	–	–	–	–	78
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	1,085	11,061	26,198	525	75	810	970	40,724
Subordinated liabilities . . . . .	–	19,547	–	7,529	–	–	–	27,076
<b>Total liabilities.</b> . . . .	<u>71,559</u>	<u>228,944</u>	<u>705,966</u>	<u>26,813</u>	<u>3,104</u>	<u>16,273</u>	<u>49,162</u>	<u>1,101,821</u>
Net on-balance sheet position . . .	<u>3,837</u>	<u>105,978</u>	<u>(37,397)</u>	<u>12,020</u>	<u>18,002</u>	<u>(9,265)</u>	<u>2,329</u>	<u>95,504</u>
Off-balance sheet net notional position*. . . . .	<u>132</u>	<u>(94,037)</u>	<u>123,094</u>	<u>(12,362)</u>	<u>(18,025)</u>	<u>9,199</u>	<u>(2,955)</u>	<u>5,046</u>
Contingent liabilities and commitments . . . . .	5,310	69,890	168,374	5,412	947	1,197	1,969	253,099

\* 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.

At 31 December 2008

	Renminbi	US Dollars	HK Dollars	Euro	Japanese Yen	Pound Sterling	Others	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>Assets</b>								
Cash and balances with banks and other financial institutions . . . .	53,381	36,592	53,719	2,662	1,425	3,163	2,326	153,268
Placements with banks and other financial institutions maturing between one and twelve months .	504	31,441	38,728	5,924	–	6,487	6,634	89,718
Financial assets at fair value through profit or loss . . . . .	1,274	1,614	13,465	–	–	–	51	16,404
Derivative financial instruments . .	–	485	19,032	99	1	–	11	19,628
Hong Kong SAR Government certificates of indebtedness. . . .	–	–	34,200	–	–	–	–	34,200
Advances and other accounts . . . .	15,056	97,002	347,976	2,915	1,622	1,002	4,647	470,220
Investment in securities								
– Available-for-sale securities . .	828	71,882	24,141	21,160	40,652	1,651	11,051	171,365
– Held-to-maturity securities . . .	2,165	52,352	32,580	6,132	1,823	791	9,550	105,393
– Loans and receivables . . . . .	–	2,243	9,039	108	–	110	1,095	12,595
Interests in associates. . . . .	–	–	88	–	–	–	–	88
Investment properties. . . . .	63	–	7,664	–	–	–	–	7,727
Properties, plant and equipment . .	98	–	22,690	–	–	–	–	22,788
Other assets (including deferred tax assets) . . . . .	121	244	13,314	596	220	19	88	14,602
<b>Total assets</b> . . . . .	<u>73,490</u>	<u>293,855</u>	<u>616,636</u>	<u>39,596</u>	<u>45,743</u>	<u>13,223</u>	<u>35,453</u>	<u>1,117,996</u>
<b>Liabilities</b>								
Hong Kong SAR currency notes in circulation . . . . .	–	–	34,200	–	–	–	–	34,200
Deposits and balances of banks and other financial institutions . . . .	38,131	24,191	18,558	2,251	693	2,494	2,461	88,779
Financial liabilities at fair value through profit or loss. . . . .	–	1,852	19,890	–	–	–	196	21,938
Derivative financial instruments . .	–	513	19,622	297	1	–	17	20,450
Deposits from customers . . . . .	30,518	194,358	505,082	15,584	2,135	13,445	44,744	805,866
Debt securities in issue at amortised cost . . . . .	–	148	845	–	–	–	49	1,042
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	1,331	9,672	16,673	325	7,907	348	646	36,902
Subordinated liabilities . . . . .	–	19,394	–	7,210	–	–	–	26,604
<b>Total liabilities</b> . . . . .	<u>69,980</u>	<u>250,128</u>	<u>614,870</u>	<u>25,667</u>	<u>10,736</u>	<u>16,287</u>	<u>48,113</u>	<u>1,035,781</u>
Net on-balance sheet position . . .	<u>3,510</u>	<u>43,727</u>	<u>1,766</u>	<u>13,929</u>	<u>35,007</u>	<u>(3,064)</u>	<u>(12,660)</u>	<u>82,215</u>
Off-balance sheet net notional position . . . . .	<u>(4)</u>	<u>(33,929)</u>	<u>68,465</u>	<u>(13,826)</u>	<u>(34,817)</u>	<u>3,043</u>	<u>12,542</u>	<u>1,474</u>
Contingent liabilities and commitments . . . . .	<u>9,132</u>	<u>62,401</u>	<u>176,097</u>	<u>3,032</u>	<u>551</u>	<u>303</u>	<u>1,878</u>	<u>253,394</u>

### C. Interest rate risk

The tables below summarise the Group's exposure to interest rate risk as at 30 September 2009 and 31 December 2008. Included in the tables are the Group's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

At 30 September 2009							
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non- interest bearing	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>Assets</b>							
Cash and balances with banks and other financial institutions . . . . .	147,675	–	–	–	–	20,876	168,551
Placements with banks and other financial institutions maturing between one and twelve months . . . . .	–	60,454	38,032	–	–	–	98,486
Financial assets at fair value through profit or loss . . . . .	4,781	3,028	1,754	1,946	436	127	12,072
Derivative financial instruments . . . . .	–	–	–	–	–	18,722	18,722
Hong Kong SAR Government certificates of indebtedness . . . . .	–	–	–	–	–	37,560	37,560
Advances and other accounts . . . . .	422,136	72,865	17,389	1,786	190	3,425	517,791
Investment in securities							
– Available-for-sale securities . . . . .	25,405	50,112	13,687	95,100	22,020	519	206,843
– Held-to-maturity securities . . . . .	22,235	29,063	9,021	7,900	4,326	–	72,545
– Loans and receivables . . . . .	3,718	7,914	2,635	–	–	–	14,267
Interests in associates . . . . .	–	–	–	–	–	89	89
Investment properties . . . . .	–	–	–	–	–	9,024	9,024
Properties, plant and equipment . . . . .	–	–	–	–	–	25,301	25,301
Other assets (including deferred tax assets) . . . . .	–	–	–	–	–	16,074	16,074
<b>Total assets</b> . . . . .	<u>625,950</u>	<u>223,436</u>	<u>82,518</u>	<u>106,732</u>	<u>26,972</u>	<u>131,717</u>	<u>1,197,325</u>
<b>Liabilities</b>							
Hong Kong SAR currency notes in circulation . . . . .	–	–	–	–	–	37,560	37,560
Deposits and balances of banks and other financial institutions . . . . .	74,473	1,960	3,938	–	–	1,500	81,871
Financial liabilities at fair value through profit or loss . . . . .	5,414	2,862	1,619	93	–	–	9,988
Derivative financial instruments . . . . .	–	–	–	–	–	15,557	15,557
Deposits from customers . . . . .	729,958	73,236	39,303	519	–	45,951	888,967
Debt securities in issue at amortised cost . . . . .	–	78	–	–	–	–	78
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	9,619	94	324	301	–	30,386	40,724
Subordinated liabilities . . . . .	–	27,076	–	–	–	–	27,076
<b>Total liabilities</b> . . . . .	<u>819,464</u>	<u>105,306</u>	<u>45,184</u>	<u>913</u>	<u>–</u>	<u>130,954</u>	<u>1,101,821</u>
Interest sensitivity gap . . . . .	<u>(193,514)</u>	<u>118,130</u>	<u>37,334</u>	<u>105,819</u>	<u>26,972</u>	<u>763</u>	<u>95,504</u>

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non- interest bearing	Total
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
<b>Assets</b>							
Cash and balances with banks and other financial institutions . . . .	134,722	–	–	–	–	18,546	153,268
Placements with banks and other financial institutions maturing between one and twelve months .	–	38,622	51,096	–	–	–	89,718
Financial assets at fair value through profit or loss . . . . .	5,103	7,076	2,311	1,416	415	83	16,404
Derivative financial instruments . .	–	–	–	–	–	19,628	19,628
Hong Kong SAR Government certificates of indebtedness . . . .	–	–	–	–	–	34,200	34,200
Advances and other accounts . . . .	366,581	77,143	20,873	1,258	159	4,206	470,220
Investment in securities							
– Available-for-sale securities . .	31,282	28,066	42,437	47,155	21,995	430	171,365
– Held-to-maturity securities . . .	23,765	38,406	12,514	17,371	13,337	–	105,393
– Loans and receivables . . . . .	1,755	2,675	8,165	–	–	–	12,595
Interests in associates . . . . .	–	–	–	–	–	88	88
Investment properties . . . . .	–	–	–	–	–	7,727	7,727
Properties, plant and equipment . .	–	–	–	–	–	22,788	22,788
Other assets (including deferred tax assets) . . . . .	–	–	–	–	–	14,602	14,602
<b>Total assets</b> . . . . .	<u>563,208</u>	<u>191,988</u>	<u>137,396</u>	<u>67,200</u>	<u>35,906</u>	<u>122,298</u>	<u>1,117,996</u>
<b>Liabilities</b>							
Hong Kong SAR currency notes in circulation . . . . .	–	–	–	–	–	34,200	34,200
Deposits and balances of banks and other financial institutions . . . .	55,274	10,655	3,272	–	–	19,578	88,779
Financial liabilities at fair value through profit or loss . . . . .	6,769	13,412	1,749	8	–	–	21,938
Derivative financial instruments . .	–	–	–	–	–	20,450	20,450
Deposits from customers . . . . .	631,968	103,266	32,532	253	–	37,847	805,866
Debt securities in issue at amortised cost . . . . .	459	148	435	–	–	–	1,042
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	8,036	116	493	136	–	28,121	36,902
Subordinated liabilities . . . . .	–	–	26,604	–	–	–	26,604
<b>Total liabilities</b> . . . . .	<u>702,506</u>	<u>127,597</u>	<u>65,085</u>	<u>397</u>	<u>–</u>	<u>140,196</u>	<u>1,035,781</u>
Interest sensitivity gap . . . . .	<u>(139,298)</u>	<u>64,391</u>	<u>72,311</u>	<u>66,803</u>	<u>35,906</u>	<u>(17,898)</u>	<u>82,215</u>

### 3.3 Liquidity Risk

#### A. Liquidity ratio

	Nine months ended 30 September 2009	Nine months ended 30 September 2008
Average liquidity ratio . . . . .	<u>40.01%</u>	<u>42.02%</u>

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

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

## B. Maturity analysis

Tables below analyse assets and liabilities of the Group as at 30 September 2009 and 31 December 2008 into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date.

	At 30 September 2009							Total HK\$'m
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	
<b>Assets</b>								
Cash and balances with banks and other financial institutions . . . .	78,295	90,256	–	–	–	–	–	168,551
Placements with banks and other financial institutions maturing between one and twelve months .	–	–	60,454	38,032	–	–	–	98,486
Financial assets at fair value through profit or loss								
– debt securities held for trading								
– certificates of deposit held . .	–	–	–	–	–	–	–	–
– others . . . . .	–	4,781	2,600	1,548	810	41	–	9,780
– debt securities designated at fair value through profit or loss								
– certificates of deposit held . .	–	–	–	–	–	–	–	–
– others . . . . .	–	–	–	282	1,464	419	–	2,165
– equity securities . . . . .	–	–	–	–	–	–	127	127
Derivative financial instruments . .	14,024	129	2,246	1,207	995	121	–	18,722
Hong Kong SAR Government certificates of indebtedness . . . .	37,560	–	–	–	–	–	–	37,560
Advances and other accounts								
– advances to customers . . . . .	31,737	12,607	30,015	65,346	221,420	142,988	852	504,965
– trade bills . . . . .	46	4,074	4,669	222	–	–	–	9,011
– advances to banks and other financial institutions . . . . .	15	77	500	396	2,827	–	–	3,815
Investment in securities								
– debt securities held for available-for-sale								
– certificates of deposit held . .	–	1,000	4,814	5,107	6,675	–	–	17,596
– others . . . . .	–	10,798	25,700	14,837	107,496	24,286	5,611	188,728
– debt securities held for held-to-maturity								
– certificates of deposit held . .	–	784	876	2,681	4,224	–	–	8,565
– others . . . . .	–	1,819	2,708	17,873	31,369	6,853	3,358	63,980
– debt securities held for loans and receivables . . . . .	–	3,718	7,914	2,635	–	–	–	14,267
– equity securities . . . . .	–	–	–	–	–	–	519	519
Interests in associates . . . . .	–	–	–	–	–	–	89	89
Investment properties . . . . .	–	–	–	–	–	–	9,024	9,024
Properties, plant and equipment . .	–	–	–	–	–	–	25,301	25,301
Other assets (including deferred tax assets) . . . . .	2,953	12,532	235	173	83	–	98	16,074
<b>Total assets</b> . . . . .	<u>164,630</u>	<u>142,575</u>	<u>142,731</u>	<u>150,339</u>	<u>377,363</u>	<u>174,708</u>	<u>44,979</u>	<u>1,197,325</u>
<b>Liabilities</b>								
Hong Kong SAR currency notes in circulation . . . . .	37,560	–	–	–	–	–	–	37,560
Deposits and balances of banks and other financial institutions . . . .	47,511	28,462	1,960	3,938	–	–	–	81,871
Financial liabilities at fair value through profit or loss								
– certificates of deposit issued . .	–	–	–	–	–	–	–	–
– others . . . . .	–	5,170	2,137	2,544	93	44	–	9,988
Derivative financial instruments . .	9,345	894	1,188	666	2,592	872	–	15,557
Deposits from customers . . . . .	610,460	166,104	71,535	40,260	608	–	–	888,967
Debt securities in issue at amortised cost . . . . .	–	–	78	–	–	–	–	78
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	14,316	18,556	121	3,011	4,706	–	14	40,724
Subordinated liabilities . . . . .	–	–	215	–	–	26,861	–	27,076
<b>Total liabilities</b> . . . . .	<u>719,192</u>	<u>219,186</u>	<u>77,234</u>	<u>50,419</u>	<u>7,999</u>	<u>27,777</u>	<u>14</u>	<u>1,101,821</u>
Net liquidity gap . . . . .	<u>(554,562)</u>	<u>(76,611)</u>	<u>65,497</u>	<u>99,920</u>	<u>369,364</u>	<u>146,931</u>	<u>44,965</u>	<u>95,504</u>



	At 31 December 2008							
	On demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
<b>Assets</b>								
Cash and balances with banks and other financial institutions . . . .	77,935	75,333	–	–	–	–	–	153,268
Placements with banks and other financial institutions maturing between one and twelve months .	–	–	38,622	51,096	–	–	–	89,718
Financial assets at fair value through profit or loss								
– debt securities held for trading								
– certificates of deposit held . .	–	–	–	–	–	–	–	–
– others . . . . .	–	4,628	6,685	1,927	685	6	–	13,931
– debt securities designated at fair value through profit or loss								
– certificates of deposit held . .	–	25	–	–	–	–	–	25
– others . . . . .	–	226	30	384	1,066	660	–	2,366
– equity securities . . . . .	–	–	–	–	–	–	82	82
Derivative financial instruments . .	14,844	756	1,253	1,439	1,216	120	–	19,628
Hong Kong SAR Government certificates of indebtedness . . . .	34,200	–	–	–	–	–	–	34,200
Advances and other accounts								
– advances to customers . . . . .	21,941	17,656	31,084	51,336	198,165	137,684	1,007	458,873
– trade bills . . . . .	–	2,910	4,022	677	–	–	–	7,609
– advances to banks and other financial institutions . . . . .	27	–	–	885	2,826	–	–	3,738
Investment in securities								
– debt securities held for available-for-sale								
– certificates of deposit held . .	–	–	23	5,236	2,096	–	–	7,355
– others . . . . .	–	19,849	13,349	40,054	58,135	26,164	6,029	163,580
– debt securities held for held-to-maturity								
– certificates of deposit held . .	–	968	2,173	2,162	6,073	–	–	11,376
– others . . . . .	–	2,115	4,933	14,560	49,480	15,905	7,024	94,017
– debt securities held for loans and receivables . . . . .	–	1,755	2,675	8,165	–	–	–	12,595
– equity securities . . . . .	–	–	–	–	–	–	430	430
Interests in associates . . . . .	–	–	–	–	–	–	88	88
Investment properties . . . . .	–	–	–	–	–	–	7,727	7,727
Properties, plant and equipment . . .	–	–	–	–	–	–	22,788	22,788
Other assets (including deferred tax assets) . . . . .	2,185	12,050	11	112	65	–	179	14,602
<b>Total assets</b> . . . . .	<u>151,132</u>	<u>138,271</u>	<u>104,860</u>	<u>178,033</u>	<u>319,807</u>	<u>180,539</u>	<u>45,354</u>	<u>1,117,996</u>
<b>Liabilities</b>								
Hong Kong SAR currency notes in circulation . . . . .	34,200	–	–	–	–	–	–	34,200
Deposits and balances of banks and other financial institutions . . . .	61,206	13,646	10,655	3,272	–	–	–	88,779
Financial liabilities at fair value through profit or loss								
– certificates of deposit issued . .	–	–	–	858	–	–	–	858
– others . . . . .	–	6,111	6,363	8,170	166	270	–	21,080
Derivative financial instruments . .	10,556	2,137	1,689	1,967	2,822	1,279	–	20,450
Deposits from customers . . . . .	429,288	240,523	101,987	32,696	1,372	–	–	805,866
Debt securities in issue at amortised cost . . . . .	–	459	148	435	–	–	–	1,042
Other accounts and provisions (including current and deferred tax liabilities) . . . . .	15,270	15,994	204	2,341	2,857	232	4	36,902
Subordinated liabilities . . . . .	–	–	–	21	–	26,583	–	26,604
<b>Total liabilities</b> . . . . .	<u>550,520</u>	<u>278,870</u>	<u>121,046</u>	<u>49,760</u>	<u>7,217</u>	<u>28,364</u>	<u>4</u>	<u>1,035,781</u>
Net liquidity gap . . . . .	<u>(399,388)</u>	<u>(140,599)</u>	<u>(16,186)</u>	<u>128,273</u>	<u>312,590</u>	<u>152,175</u>	<u>45,350</u>	<u>82,215</u>

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 and debt securities 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 accordance with relevant provisions under the Banking (Disclosure) Rules. The disclosure does not imply that the securities will be held to maturity.

### 3.4 Capital Management

#### (a) Capital adequacy ratio

	At 30 September 2009	At 31 December 2008
Capital adequacy ratio . . . . .	<u>16.22%</u>	<u>16.17%</u>
Core capital ratio . . . . .	<u>11.44%</u>	<u>10.86%</u>

The capital ratios are computed on the consolidated basis that comprises the positions of BOCHK and certain subsidiaries 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 “Additional Information – Subsidiaries of the Bank” on page A-65 and A-69.

**(b) Components of capital base after deductions**

The consolidated capital base after deductions used in the calculation of the above capital adequacy ratio as at 30 September 2009 and 31 December 2008 and reported to the HKMA is analysed as follows:

	At 30 September 2009 HK\$m	At 31 December 2008 HK\$m
Core capital:		
Paid up ordinary share capital . . . . .	43,043	43,043
Reserves . . . . .	25,427	18,049
Profit and loss account . . . . .	4,933	2,956
Minority interests . . . . .	1,214	1,124
	<u>74,617</u>	<u>65,172</u>
Deductions from core capital . . . . .	<u>(3,914)</u>	<u>(1,536)</u>
Core capital . . . . .	<u>70,703</u>	<u>63,636</u>
Supplementary capital:		
Fair value gains arising from holdings of available-for-sale securities . . . . .	295	87
Collective loan impairment allowances . . . . .	1,420	1,502
Regulatory reserve . . . . .	4,861	4,503
Term subordinated debt . . . . .	26,861	26,583
	<u>33,437</u>	<u>32,675</u>
Deductions from supplementary capital . . . . .	<u>(3,914)</u>	<u>(1,536)</u>
Supplementary capital . . . . .	<u>29,523</u>	<u>31,139</u>
Total capital base after deductions . . . . .	<u>100,226</u>	<u>94,775</u>

Subsidiaries which are not included in the consolidation group for the calculation of capital adequacy ratios are denoted in “Additional Information – Subsidiaries of the Bank” on A-62 to A-65 and A-66 to A-69. Investment costs in such subsidiaries are deducted from the capital base.

Term subordinated debt represents subordinated loans qualified as Tier 2 Capital of BOCHK pursuant to the regulatory requirements of the HKMA.

#### 4. Net interest income

	Nine months ended 30 September 2009	Nine months ended 30 September 2008
	HK\$'m	HK\$'m
<b>Interest income</b>		
Cash and due from banks and other financial institutions . . . . .	2,365	3,944
Advances to customers . . . . .	7,957	12,179
Listed investments . . . . .	1,678	2,279
Unlisted investments . . . . .	3,173	7,174
Others . . . . .	1,380	314
	<u>16,553</u>	<u>25,890</u>
<b>Interest expense</b>		
Due to banks, customers and other financial institutions . . . . .	(2,290)	(11,149)
Debt securities in issue . . . . .	(20)	(99)
Subordinated liabilities . . . . .	(732)	(118)
Others . . . . .	(1,132)	(614)
	<u>(4,174)</u>	<u>(11,980)</u>
<b>Net interest income</b> . . . . .	<u>12,379</u>	<u>13,910</u>

#### 5. Net fees and commission income

	Nine months ended 30 September 2009	Nine months ended 30 September 2008
	HK\$'m	HK\$'m
<b>Fees and commission income</b>		
Securities brokerage		
– Stockbroking . . . . .	2,620	1,729
– Bonds . . . . .	19	259
Credit cards . . . . .	1,119	1,025
Loan commissions . . . . .	758	423
Bills commissions . . . . .	465	512
Payment services . . . . .	359	365
Insurance . . . . .	369	386
Safe deposit box . . . . .	147	145
Currency exchange . . . . .	145	160
Trust services . . . . .	127	128
Funds distribution . . . . .	66	198
Others . . . . .	280	358
	<u>6,474</u>	<u>5,688</u>
<b>Fees and commission expenses</b>		
Credit cards . . . . .	(760)	(675)
Securities brokerage . . . . .	(413)	(276)
Payment services . . . . .	(60)	(58)
Others . . . . .	(198)	(424)
	<u>(1,431)</u>	<u>(1,433)</u>
<b>Net fees and commission income</b> . . . . .	<u>5,043</u>	<u>4,255</u>

## 6. Net trading income

	<b>Nine months ended 30 September 2009</b>	Nine months ended 30 September 2008
	<b>HK\$'m</b>	HK\$'m
Net gain from:		
– foreign exchange and foreign exchange products . . . . .	<b>1,061</b>	1,231
– interest rate instruments . . . . .	<b>154</b>	234
– equity instruments . . . . .	<b>20</b>	126
– commodities. . . . .	<b>78</b>	70
	<b><u>1,313</u></b>	<u>1,661</u>

## 7. Net gain on investment in securities

	<b>Nine months ended 30 September 2009</b>	Nine months ended 30 September 2008
	<b>HK\$'m</b>	HK\$'m
Net gain from disposal of available-for-sale securities . . . . .	<b>69</b>	41
Net gain from redemption of held-to-maturity securities . . . . .	<b>4</b>	–
Net loss from disposal of loans and receivables . . . . .	<b>–</b>	(1)
	<b><u>73</u></b>	<u>40</u>

## 8. Other operating income

	<b>Nine months ended 30 September 2009</b>	Nine months ended 30 September 2008
	<b>HK\$'m</b>	HK\$'m
Dividend income from investment in securities		
– unlisted investments . . . . .	<b>11</b>	9
Gross rental income from investment properties . . . . .	<b>267</b>	232
Less: Outgoings in respect of investment properties . . . . .	<b>(35)</b>	(38)
Others . . . . .	<b>96</b>	114
	<b><u>339</u></b>	<u>317</u>

## 9. Net charge of impairment allowances

	Nine months ended 30 September 2009	Nine months ended 30 September 2008
	HK\$m	HK\$m
<b>Advances to customers</b>		
Individually assessed		
– new allowances . . . . .	183	438
– releases . . . . .	(119)	(77)
– recoveries . . . . .	(248)	(224)
Net (reversal)/charge of individually assessed loan impairment allowances . . . . .	(184)	137
Collectively assessed		
– new allowances . . . . .	282	434
– releases . . . . .	(167)	(35)
– recoveries . . . . .	(26)	(21)
Net charge of collectively assessed loan impairment allowances . . . . .	89	378
Net (reversal)/charge of loan impairment allowances . . . . .	(95)	515
<b>Available-for-sale securities</b>		
Net charge of impairment losses on available-for-sale securities		
– Individually assessed . . . . .	206	2,959
<b>Held-to-maturity securities</b>		
Net (reversal)/charge of impairment allowances on held-to-maturity securities		
– Individually assessed . . . . .	(99)	2,389
<b>Others . . . . .</b>	9	7
<b>Net charge of impairment allowances . . . . .</b>	<u>21</u>	<u>5,870</u>

## 10. Operating expenses

	Nine months ended 30 September 2009	Nine months ended 30 September 2008
	HK\$'m	HK\$'m
Staff costs (including directors' emoluments)		
– salaries and other costs . . . . .	3,006	3,438
– termination benefit . . . . .	8	3
– pension cost . . . . .	287	272
	<u>3,301</u>	<u>3,713</u>
Premises and equipment expenses (excluding depreciation)		
– rental of premises . . . . .	357	293
– information technology . . . . .	245	284
– others . . . . .	204	176
	<u>806</u>	<u>753</u>
Depreciation . . . . .	755	733
Auditor's remuneration		
– audit services . . . . .	21	21
– non-audit services . . . . .	3	3
Lehman Brothers related products* . . . . .	3,242	–
Other operating expenses . . . . .	1,037	943
	<u>9,165</u>	<u>6,166</u>

\* Expenses incurred on Lehman Brothers related products were primarily in relation to the Lehman Brothers minibonds (“Minibonds”) repurchase arrangements announced on 22 July 2009 as summarised below.

On 22 July 2009, the Group agreed with the Securities and Futures Commission, the Hong Kong Monetary Authority and thirteen other distributing banks to make an offer to eligible customers to repurchase their holdings in all outstanding Minibonds subscribed through the Group (“the Repurchase Scheme”).

Under the Repurchase Scheme, the Group has, without admission of liability, made an offer to repurchase at a price equivalent to 60% of the nominal value of the principal invested for eligible customers below the age of 65 as at 1 July 2009 or at 70% of the nominal value of the principal invested for eligible customers aged 65 or above as at 1 July 2009. If any recovery is made from the Minibonds, the Group will make further payments to eligible customers who have accepted the Repurchase Scheme according to the terms set out in the scheme. The Group has also made a voluntary offer to pay an ex gratia amount to customers who would have qualified as eligible customers but for their previous settlements with the Group, to bring them in line with the Repurchase Scheme offer. The Group has further made available an amount equivalent to the total commission income received as a Minibonds distributor of approximately HK\$160 million to the trustee of the Minibonds to fund the trustee's expenses in realising the value of the underlying collateral in respect of the outstanding Minibonds.

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

	<b>Nine months ended 30 September 2009</b>	Nine months ended 30 September 2008
	<b>HK\$'m</b>	HK\$'m
Net gain on disposal of investment properties . . . . .	<b>3</b>	10
Net gain on fair value adjustments on investment properties . . . .	<b><u>1,263</u></b>	<u>465</u>
	<b><u>1,266</u></b>	<u>475</u>

## 12. Net gain from disposal/revaluation of properties, plant and equipment

	<b>Nine months ended 30 September 2009</b>	Nine months ended 30 September 2008
	<b>HK\$'m</b>	HK\$'m
Net gain on disposal of premises . . . . .	<b>25</b>	–
Net loss on disposal of other fixed assets. . . . .	<b>(7)</b>	(1)
Net gain on revaluation of premises . . . . .	<b><u>6</u></b>	<u>6</u>
	<b><u>24</u></b>	<u>5</u>

## 13. Taxation

Taxation in the condensed consolidated income statement represents:

	<b>Nine months ended 30 September 2009</b>	Nine months ended 30 September 2008
	<b>HK\$'m</b>	HK\$'m
Hong Kong profits tax		
– current period taxation . . . . .	<b>1,622</b>	1,345
Deferred tax charge/(credit) . . . . .	<b><u>188</u></b>	<u>(108)</u>
Hong Kong profits tax . . . . .	<b>1,810</b>	1,237
Overseas taxation . . . . .	<b><u>102</u></b>	<u>94</u>
	<b><u>1,912</u></b>	<u>1,331</u>

Hong Kong profits tax has been provided at the rate of 16.5% (2008: 16.5%) on the estimated assessable profits arising in Hong Kong for the first three quarters of 2009. Taxation on overseas profits has been calculated on the estimated assessable profits for the first three quarters of 2009 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:

	Nine months ended 30 September 2009	Nine months ended 30 September 2008
	HK\$'m	HK\$'m
Profit before taxation . . . . .	<b>11,510</b>	8,519
Calculated at a taxation rate of 16.5% (2008: 16.5%) . . . . .	<b>1,899</b>	1,406
Effect of different taxation rates in other countries . . . . .	<b>16</b>	48
Income not subject to taxation . . . . .	<b>(27)</b>	(200)
Expenses not deductible for taxation purposes . . . . .	<b>24</b>	77
Taxation charge . . . . .	<b><u>1,912</u></b>	<u>1,331</u>
Effective tax rate . . . . .	<b><u>16.6%</u></b>	<u>15.6%</u>

#### 14. Dividends

	Nine months ended 30 September 2009		Nine months ended 30 September 2008	
	Per share	Total	Per share	Total
	HK\$	HK\$'m	HK\$	HK\$'m
First interim dividend . . . . .	<b>0.0110</b>	<b>473</b>	0.0920	3,960
Second interim dividend . . . . .	<b>0.0696</b>	<b>2,996</b>	—	—
	<b><u>0.0806</u></b>	<b><u>3,469</u></b>	<u>0.0920</u>	<u>3,960</u>

#### 15. Cash and balances with banks and other financial institutions

	At 30 September 2009	At 31 December 2008
	HK\$'m	HK\$'m
Cash . . . . .	<b>3,660</b>	4,232
Balances with central banks . . . . .	<b>71,265</b>	66,158
Balances with banks and other financial institutions . . . . .	<b>3,370</b>	7,544
Placements with central banks maturing within one month . . . . .	<b>15,000</b>	—
Placements with banks and other financial institutions maturing within one month . . . . .	<b><u>75,256</u></b>	<u>75,334</u>
	<b><u>168,551</u></b>	<u>153,268</u>

## 16. Financial assets at fair value through profit or loss

	Trading securities		Financial assets designated at fair value through profit or loss		Total	
	At	At	At	At	At	At
	30 September	31 December	30 September	31 December	30 September	31 December
	2009	2008	2009	2008	2009	2008
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
At fair value						
Debt securities						
– Listed in Hong Kong . . . .	369	412	475	358	844	770
– Listed outside Hong Kong . . . . .	–	35	1,261	890	1,261	925
	369	447	1,736	1,248	2,105	1,695
– Unlisted. . . . .	9,411	13,484	429	1,143	9,840	14,627
	9,780	13,931	2,165	2,391	11,945	16,322
Equity securities						
– Listed in Hong Kong . . . .	40	20	–	–	40	20
– Unlisted. . . . .	87	62	–	–	87	62
	127	82	–	–	127	82
Total . . . . .	9,907	14,013	2,165	2,391	12,072	16,404

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

	At 30 September 2009	At 31 December 2008
	HK\$'m	HK\$'m
Sovereigns . . . . .	8,989	12,709
Public sector entities. . . . .	233	272
Banks and other financial institutions . . . . .	1,064	1,915
Corporate entities . . . . .	1,786	1,508
	12,072	16,404

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

	At 30 September 2009	At 31 December 2008
	HK\$'m	HK\$'m
Treasury bills . . . . .	8,440	12,458
Certificates of deposit held . . . . .	–	25
Other financial assets at fair value through profit or loss . . . . .	3,632	3,921
	12,072	16,404

## 17. Derivative financial instruments

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

Currency forwards represent commitments to purchase and sell foreign currency on a future date. Interest rate futures are contractual obligations to receive or pay a net amount based on changes in interest rates or buy or sell interest rate financial instruments on a future date at an agreed price in the financial market under the administration of the stock exchange. Forward rate agreements are individually negotiated interest rate futures that call for a cash settlement at a future date for the difference between a contracted rate of interest and the current market rate, based on a notional principal amount.

Currency, interest rate and precious metal swaps are commitments to exchange one set of cash flows or commodity for another. Swaps result in an exchange of currencies, interest rates (for example, fixed rate for floating rate), or precious metals (for example, silver swaps) 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, equity and precious metal 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 condensed 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 and metal prices relative to their terms. The aggregate fair values of derivative financial instruments assets and liabilities can fluctuate significantly from time to time.

The following tables summarise the contract/notional amounts of each significant type of derivative financial instrument as at 30 September 2009 and 31 December 2008:

At 30 September 2009				
	Trading	Hedging	Not qualified for hedge accounting*	Total
	HK\$m	HK\$m	HK\$m	HK\$m
Exchange rate contracts				
Spot and forwards . . . . .	228,275	–	–	228,275
Swaps. . . . .	281,614	–	68	281,682
Foreign currency option contracts				
– Options purchased. . . . .	1,753	–	–	1,753
– Options written. . . . .	2,009	–	–	2,009
	<u>513,651</u>	<u>–</u>	<u>68</u>	<u>513,719</u>
Interest rate contracts				
Futures . . . . .	1,706	–	–	1,706
Swaps. . . . .	126,424	13,407	22,220	162,051
Interest rate option contracts				
– Swaptions written . . . . .	155	–	–	155
– Bond options written. . . . .	4,495	–	–	4,495
	<u>132,780</u>	<u>13,407</u>	<u>22,220</u>	<u>168,407</u>
Bullion contracts . . . . .	<u>7,331</u>	<u>–</u>	<u>–</u>	<u>7,331</u>
Equity contracts . . . . .	<u>370</u>	<u>–</u>	<u>–</u>	<u>370</u>
Other contracts. . . . .	<u>123</u>	<u>–</u>	<u>–</u>	<u>123</u>
Total . . . . .	<u>654,255</u>	<u>13,407</u>	<u>22,288</u>	<u>689,950</u>

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

At 31 December 2008

	Trading	Hedging	Not qualified for hedge accounting	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Exchange rate contracts				
Spot and forwards . . . . .	182,624	–	–	182,624
Swaps. . . . .	248,956	–	68	249,024
Foreign currency option contracts				
– Options purchased. . . . .	2,518	–	–	2,518
– Options written. . . . .	2,754	–	–	2,754
	<u>436,852</u>	<u>–</u>	<u>68</u>	<u>436,920</u>
Interest rate contracts				
Futures . . . . .	4,290	–	–	4,290
Swaps. . . . .	68,392	19,931	10,045	98,368
Interest rate option contracts				
– Bond options written. . . . .	775	–	–	775
	<u>73,457</u>	<u>19,931</u>	<u>10,045</u>	<u>103,433</u>
Bullion contracts . . . . .	<u>3,880</u>	<u>–</u>	<u>–</u>	<u>3,880</u>
Equity contracts . . . . .	<u>5,070</u>	<u>–</u>	<u>–</u>	<u>5,070</u>
Other contracts. . . . .	<u>144</u>	<u>–</u>	<u>–</u>	<u>144</u>
Total . . . . .	<u>519,403</u>	<u>19,931</u>	<u>10,113</u>	<u>549,447</u>

The following tables summarise the fair values of each class of derivative financial instrument as at 30 September 2009 and 31 December 2008:

At 30 September 2009								
	Fair value assets				Fair value liabilities			
	Trading	Hedging	Not qualified for hedge accounting	Total	Trading	Hedging	Not qualified for hedge accounting	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Exchange rate contracts								
Spot and forwards . . . . .	13,806	–	–	13,806	(9,331)	–	–	(9,331)
Swaps . . . . .	3,199	–	–	3,199	(2,297)	–	(2)	(2,299)
Foreign currency option contracts								
– Options purchased . . .	9	–	–	9	–	–	–	–
– Options written . . . .	–	–	–	–	(8)	–	–	(8)
	<u>17,014</u>	<u>–</u>	<u>–</u>	<u>17,014</u>	<u>(11,636)</u>	<u>–</u>	<u>(2)</u>	<u>(11,638)</u>
Interest rate contracts								
Futures . . . . .	1	–	–	1	(3)	–	–	(3)
Swaps . . . . .	1,254	25	10	1,289	(2,755)	(832)	(120)	(3,707)
Interest rate option contracts								
– Bond options written .	–	–	–	–	(15)	–	–	(15)
	<u>1,255</u>	<u>25</u>	<u>10</u>	<u>1,290</u>	<u>(2,773)</u>	<u>(832)</u>	<u>(120)</u>	<u>(3,725)</u>
Bullion contracts . . . . .	397	–	–	397	(175)	–	–	(175)
Equity contracts . . . . .	21	–	–	21	(19)	–	–	(19)
Total . . . . .	<u>18,687</u>	<u>25</u>	<u>10</u>	<u>18,722</u>	<u>(14,603)</u>	<u>(832)</u>	<u>(122)</u>	<u>(15,557)</u>

At 31 December 2008

	Fair value assets				Fair value liabilities			
	Trading	Hedging	Not qualified for hedge accounting	Total	Trading	Hedging	Not qualified for hedge accounting	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Exchange rate contracts								
Spot and forwards . . . . .	15,152	–	–	15,152	(10,962)	–	–	(10,962)
Swaps . . . . .	1,624	–	1	1,625	(3,933)	–	(3)	(3,936)
Foreign currency option contracts								
– Options purchased . . .	21	–	–	21	–	–	–	–
– Options written . . . .	–	–	–	–	(24)	–	–	(24)
	<u>16,797</u>	–	<u>1</u>	<u>16,798</u>	<u>(14,919)</u>	–	<u>(3)</u>	<u>(14,922)</u>
Interest rate contracts								
Futures . . . . .	2	–	–	2	(6)	–	–	(6)
Swaps . . . . .	1,420	–	18	1,438	(2,329)	(1,769)	(166)	(4,264)
Interest rate option contracts								
– Bond options written .	–	–	–	–	(25)	–	–	(25)
	<u>1,422</u>	–	<u>18</u>	<u>1,440</u>	<u>(2,360)</u>	<u>(1,769)</u>	<u>(166)</u>	<u>(4,295)</u>
Bullion contracts . . . . .	<u>248</u>	–	–	<u>248</u>	<u>(91)</u>	–	–	<u>(91)</u>
Equity contracts . . . . .	<u>1,142</u>	–	–	<u>1,142</u>	<u>(1,142)</u>	–	–	<u>(1,142)</u>
Total . . . . .	<u>19,609</u>	–	<u>19</u>	<u>19,628</u>	<u>(18,512)</u>	<u>(1,769)</u>	<u>(169)</u>	<u>(20,450)</u>

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

	At 30 September 2009	At 31 December 2008
	HK\$'m	HK\$'m
Exchange rate contracts . . . . .	2,335	1,699
Interest rate contracts . . . . .	674	579
Bullion contracts . . . . .	1	5
Equity contracts . . . . .	<u>1</u>	<u>37</u>
	<u>3,011</u>	<u>2,320</u>

The credit risk weighted amounts are calculated in accordance with the Banking (Capital) Rules. The amounts are dependent upon the status of the counterparty and the maturity characteristics of each type of contract.

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

Approximately 72% (31 December 2008: 69%) of the Group's transactions in derivative contracts are conducted with other financial institutions.

## 18. Advances and other accounts

	At 30 September 2009	At 31 December 2008
	HK\$'m	HK\$'m
Personal loans and advances . . . . .	161,478	151,746
Corporate loans and advances . . . . .	345,480	309,428
Advances to customers . . . . .	506,958	461,174
Loan impairment allowances		
– Individually assessed . . . . .	(573)	(800)
– Collectively assessed . . . . .	(1,420)	(1,501)
	504,965	458,873
Trade bills . . . . .	9,011	7,609
Advances to banks and other financial institutions . . . . .	3,815	3,738
Total . . . . .	<u>517,791</u>	<u>470,220</u>

As at 30 September 2009, advances to customers included accrued interest on gross advances of HK\$688 million (31 December 2008: HK\$1,293 million).

As at 30 September 2009 and 31 December 2008, no impairment allowance was made in respect of trade bills and advances to banks and other financial institutions.

## 19. Investment in securities

	At 30 September 2009	At 31 December 2008
	HK\$'m	HK\$'m
<b>(a) Available-for-sale securities</b>		
Debt securities, at fair value		
– Listed in Hong Kong . . . . .	8,372	4,588
– Listed outside Hong Kong . . . . .	71,532	44,692
	79,904	49,280
– Unlisted . . . . .	126,420	121,655
	<u>206,324</u>	<u>170,935</u>
Equity securities, at fair value		
– Unlisted . . . . .	519	430
	<u>206,843</u>	<u>171,365</u>
<b>(b) Held-to-maturity securities</b>		
Listed, at amortised cost		
– in Hong Kong . . . . .	2,330	4,082
– outside Hong Kong . . . . .	18,916	21,302
	21,246	25,384
Unlisted, at amortised cost . . . . .	52,968	84,449
	74,214	109,833
Impairment allowances . . . . .	(1,669)	(4,440)
	<u>72,545</u>	<u>105,393</u>
<b>(c) Loans and receivables</b>		
Unlisted, at amortised cost . . . . .	14,267	12,595
<b>Total</b>	<u>293,655</u>	<u>289,353</u>
Market value of listed held-to-maturity securities	<u>20,942</u>	<u>24,354</u>



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

At 30 September 2009			
Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total
HK\$'m	HK\$'m	HK\$'m	HK\$'m
Sovereigns . . . . .	56,757	1,304	58,061
Public sector entities . . . . .	21,851	3,481	25,332
Banks and other financial institutions . . . .	111,932	56,770	182,969
Corporate entities . . . . .	16,303	10,990	27,293
	<u>206,843</u>	<u>72,545</u>	<u>293,655</u>

At 31 December 2008			
Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total
HK\$'m	HK\$'m	HK\$'m	HK\$'m
Sovereigns . . . . .	70,274	1,079	71,353
Public sector entities . . . . .	9,202	12,481	21,683
Banks and other financial institutions . . . .	70,576	71,426	154,597
Corporate entities . . . . .	21,313	20,407	41,720
	<u>171,365</u>	<u>105,393</u>	<u>289,353</u>

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

Available-for-sale securities		Held-to-maturity securities	
At	At	At	At
30 September 2009	31 December 2008	30 September 2009	31 December 2008
HK\$'m	HK\$'m	HK\$'m	HK\$'m
Treasury bills . . . . .	34,487	60,980	400
Certificates of deposit held . . . . .	17,596	7,355	8,565
Others . . . . .	154,760	103,030	63,580
	<u>206,843</u>	<u>171,365</u>	<u>72,545</u>
			<u>105,393</u>

## 20. Investment properties

	At 30 September 2009	At 31 December 2008
	HK\$m	HK\$m
At 1 January . . . . .	7,727	8,058
Disposals . . . . .	(53)	(186)
Fair value gains/(losses) . . . . .	1,263	(132)
Reclassification from/(to) properties, plant and equipment (Note 21) . . . . .	87	(13)
At period/year end . . . . .	<u>9,024</u>	<u>7,727</u>

## 21. Properties, plant and equipment

	Premises	Equipment, fixtures and fittings	Total
	HK\$m	HK\$m	HK\$m
Net book value at 1 January 2009 . . . . .	20,105	2,683	22,788
Additions . . . . .	–	257	257
Disposals . . . . .	(100)	(7)	(107)
Revaluation . . . . .	3,205	–	3,205
Depreciation for the period (Note 10) . . . . .	(287)	(468)	(755)
Transfer . . . . .	18	(18)	–
Reclassification to investment properties (Note 20). . .	(84)	(3)	(87)
Net book value at 30 September 2009 . . . . .	<u>22,857</u>	<u>2,444</u>	<u>25,301</u>
At 30 September 2009 . . . . .			
Cost or valuation . . . . .	22,857	6,305	29,162
Accumulated depreciation and impairment . . . . .	–	(3,861)	(3,861)
Net book value at 30 September 2009 . . . . .	<u>22,857</u>	<u>2,444</u>	<u>25,301</u>
Net book value at 1 January 2008 . . . . .	20,783	2,505	23,288
Additions . . . . .	42	772	814
Disposals . . . . .	(68)	(5)	(73)
Revaluation . . . . .	(265)	–	(265)
Depreciation for the year . . . . .	(400)	(590)	(990)
Reclassification from investment properties (Note 20). .	13	–	13
Exchange difference . . . . .	–	1	1
Net book value at 31 December 2008 . . . . .	<u>20,105</u>	<u>2,683</u>	<u>22,788</u>
At 31 December 2008 . . . . .			
Cost or valuation . . . . .	20,105	6,209	26,314
Accumulated depreciation and impairment . . . . .	–	(3,526)	(3,526)
Net book value at 31 December 2008 . . . . .	<u>20,105</u>	<u>2,683</u>	<u>22,788</u>

	<u>Premises</u>	<u>Equipment, fixtures and fittings</u>	<u>Total</u>
	<u>HK\$m</u>	<u>HK\$m</u>	<u>HK\$m</u>
The analysis of cost or valuation of the above assets is as follows:			
At 30 September 2009			
At cost. . . . .	–	6,305	6,305
At valuation. . . . .	<u>22,857</u>	<u>–</u>	<u>22,857</u>
	<u>22,857</u>	<u>6,305</u>	<u>29,162</u>
At 31 December 2008			
At cost. . . . .	–	6,209	6,209
At valuation. . . . .	<u>20,105</u>	<u>–</u>	<u>20,105</u>
	<u>20,105</u>	<u>6,209</u>	<u>26,314</u>

## 22. Financial liabilities at fair value through profit or loss

	<u>At 30 September 2009</u>	<u>At 31 December 2008</u>
	<u>HK\$m</u>	<u>HK\$m</u>
Trading liabilities		
– Short positions in Exchange Fund Bills . . . . .	7,541	12,141
Financial liabilities designated at fair value through profit or loss		
– Structured deposits (Note 23) . . . . .	2,447	8,939
– Certificates of deposit issued . . . . .	<u>–</u>	<u>858</u>
	<u>2,447</u>	<u>9,797</u>
	<u>9,988</u>	<u>21,938</u>

The carrying amount of financial liabilities designated at fair value through profit or loss as at 30 September 2009 is less than the amount that the Group would be contractually required to pay at maturity to the holders by HK\$2 million, and it was more than the amount that the Group would be contractually required to pay at maturity to the holders by HK\$5 million as at 31 December 2008. The amount of change in the fair values of financial liabilities at fair value through profit or loss, during the period and cumulatively, attributable to changes in credit risk is insignificant.

## 23. Deposits from customers

	At 30 September 2009	At 31 December 2008
	HK\$'m	HK\$'m
Current, savings and other deposit accounts (per condensed consolidated balance sheet) . . . . .	888,967	805,866
Structured deposits reported as financial liabilities at fair value through profit or loss (Note 22) . . . . .	<u>2,447</u>	<u>8,939</u>
	<u><b>891,414</b></u>	<u><b>814,805</b></u>
Analysed by:		
Demand deposits and current accounts . . . . .		
– corporate customers . . . . .	96,029	35,946
– individual customers . . . . .	<u>13,882</u>	<u>10,175</u>
	<u><b>109,911</b></u>	<u><b>46,121</b></u>
Savings deposits		
– corporate customers . . . . .	142,341	116,278
– individual customers . . . . .	<u>352,292</u>	<u>261,355</u>
	<u><b>494,633</b></u>	<u><b>377,633</b></u>
Time, call and notice deposits		
– corporate customers . . . . .	109,056	153,376
– individual customers . . . . .	<u>177,814</u>	<u>237,675</u>
	<u><b>286,870</b></u>	<u><b>391,051</b></u>
	<u><b>891,414</b></u>	<u><b>814,805</b></u>

## 24. Other accounts and provisions

	At 30 September 2009	At 31 December 2008
	HK\$'m	HK\$'m
Other accounts payable . . . . .	33,805	33,086
Provisions . . . . .	<u>588</u>	<u>576</u>
	<u><b>34,393</b></u>	<u><b>33,662</b></u>

## 25. Subordinated liabilities

	At 30 September 2009	At 31 December 2008
	HK\$'m	HK\$'m
<b>Subordinated loans</b>		
EUR 660m* . . . . .	7,529	7,210
USD 2,500m** . . . . .	<u>19,547</u>	<u>19,394</u>
	<u><b>27,076</b></u>	<u><b>26,604</b></u>

BOCHK obtained floating-rate subordinated loans from BOC, the intermediate holding company. The subordinated loans are repayable prior to maturity after the first 5-year tenure at the option of the borrower. Amounts qualified as supplementary capital for regulatory purposes as shown in Note 3.4.

\* Interest rate at 6-month EURIBOR plus 0.85% for the first 5 years, 6-month EURIBOR plus 1.35% for the remaining tenure payable semi-annually, due June 2018.

\*\* Interest rate at 6-month LIBOR plus 2.00% for the first 5 years, 6-month LIBOR plus 2.50% for the remaining tenure payable semi-annually, due December 2018.

## 26. Share capital

	At 30 September 2009 HK\$'m	At 31 December 2008 HK\$'m
Authorised:		
100,000,000,000 ordinary shares of HK\$1.00 each . . . . .	<u>100,000</u>	<u>100,000</u>
Issued and fully paid:		
43,042,840,858 ordinary shares of HK\$1.00 each . . . . .	<u>43,043</u>	<u>43,043</u>

## 27. Reserves

The Group's reserves and the movements therein for the current and prior periods are presented in the condensed consolidated statement of changes in equity on pages A-4.

## 28. Notes to condensed consolidated cash flow statement

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

	Nine months ended 30 September 2009 HK\$'m	Nine months ended 30 September 2008 HK\$'m
Operating profit . . . . .	10,216	8,030
Depreciation. . . . .	755	733
Net charge of impairment allowances . . . . .	21	5,870
Unwind of discount on impairment . . . . .	(9)	(9)
Advances written off net of recoveries. . . . .	(205)	81
Interest expense on subordinated liabilities. . . . .	732	118
Change in cash and balances with banks and other financial institutions with original maturity over three months. . . . .	14,426	25,381
Change in placements with banks and other financial institutions with original maturity over three months . . . . .	(17,360)	(34)
Change in financial assets at fair value through profit or loss . . . . .	1,711	2,357
Change in derivative financial instruments . . . . .	(3,987)	130
Change in advances and other accounts . . . . .	(47,263)	(74,199)
Change in investment in securities. . . . .	1,018	50,285
Change in other assets . . . . .	(1,454)	7,536
Change in deposits and balances of banks and other financial institutions . . . . .	(6,908)	7,029
Change in financial liabilities at fair value through profit or loss. . . . .	(11,950)	990
Change in deposits from customers . . . . .	83,101	41,321
Change in debt securities in issue at amortised cost . . . . .	(964)	686
Change in other accounts and provisions . . . . .	731	(10,211)
Exchange difference . . . . .	274	(581)
Operating cash inflow before taxation . . . . .	<u>22,885</u>	<u>65,513</u>
Cash flows from operating activities included		
– Interest received. . . . .	18,344	27,476
– Interest paid. . . . .	5,615	11,716
– Dividend received . . . . .	<u>11</u>	<u>9</u>

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

	At 30 September 2009 HK\$'m	At 30 September 2008 HK\$'m
Cash and balances with banks and other financial institutions		
with original maturity within three months . . . . .	<b>157,712</b>	196,512
Placements with banks and other financial institutions with		
original maturity within three months . . . . .	<b>15,018</b>	12,868
Treasury bills with original maturity within three months . . . . .	<b>18,799</b>	10,544
Certificates of deposit held with original maturity within		
three months . . . . .	<b>1,784</b>	588
	<b><u>193,313</u></b>	<b><u>220,512</u></b>

**29. 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:

	At 30 September 2009 HK\$'m	At 31 December 2008 HK\$'m
Direct credit substitutes . . . . .	<b>2,003</b>	1,419
Transaction-related contingencies . . . . .	<b>9,669</b>	10,153
Trade-related contingencies . . . . .	<b>28,228</b>	22,481
Commitments that are unconditionally cancellable		
without prior notice . . . . .	<b>150,723</b>	103,684
Other commitments with an original maturity of		
– up to one year . . . . .	<b>19,224</b>	63,257
– over one year . . . . .	<b>43,252</b>	52,400
	<b><u>253,099</u></b>	<b><u>253,394</u></b>
Credit risk weighted amount . . . . .	<b><u>30,237</u></b>	<b><u>40,252</u></b>

The credit risk weighted amount is calculated in accordance with the Banking (Capital) Rules. The amount is dependent upon the status of the counterparty and the maturity characteristics of each type of contract.

**30. Capital commitments**

The Group has the following outstanding capital commitments not provided for in this financial information:

	At 30 September 2009 HK\$'m	At 31 December 2008 HK\$'m
Authorised and contracted for but not provided for . . . . .	<b>161</b>	121
Authorised but not contracted for . . . . .	<b>–</b>	15
	<b><u>161</u></b>	<b><u>136</u></b>

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

### 31. Segmental reporting

The Group has adopted the new HKFRS 8 “Operating Segments” effective this year. After assessing the internal financial reporting process, it was concluded that the original segments classification has already complied with the new standard. However, consistent with internal management reporting, the charge on inter-segment funding has changed from the corresponding money market rates to money market rates adjusted with pre-determined margins. These margins reflect differentiation based on product features. Since the impact of this change on prior year figures is immaterial, no restatement has been made.

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 the three business segments is provided in segmental reporting. They are Personal Banking, Corporate Banking and Treasury. The classification of the Group’s operating segments is based on customer segment and product type, which is aligned with the RPC (relationship, product and channel) management model of the Group.

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. “Others” refers to those items related to the Group as a whole rather than directly attributable to the other three business segments, including the Group’s holdings of premises, investment properties, equity investments and interests in associates.

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. Inter-segment funding is charged according to the internal funds transfer pricing mechanism of the Group.

Nine months ended 30 September 2009

	Personal	Corporate	Treasury	Others	Subtotal	Eliminations	Consolidated
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Net interest income/(expenses)							
– external . . . . .	1,618	4,515	6,248	(2)	12,379	–	12,379
– inter-segment . . . . .	2,662	(556)	(2,058)	(48)	–	–	–
	<u>4,280</u>	<u>3,959</u>	<u>4,190</u>	<u>(50)</u>	<u>12,379</u>	<u>–</u>	<u>12,379</u>
Net fees and commission income . . .	3,164	1,849	10	64	5,087	(44)	5,043
Net trading income/(expenses). . . . .	363	116	835	(2)	1,312	1	1,313
Net gain on financial instruments designated at fair value through profit or loss . . . . .	–	–	255	–	255	–	255
Net gain on investment in securities .	–	–	73	–	73	–	73
Other operating income . . . . .	21	31	2	1,331	1,385	(1,046)	339
<b>Net operating income before impairment allowances</b>	<b>7,828</b>	<b>5,955</b>	<b>5,365</b>	<b>1,343</b>	<b>20,491</b>	<b>(1,089)</b>	<b>19,402</b>
Net (charge)/reversal of impairment allowances . . . . .	(110)	199	(107)	(3)	(21)	–	(21)
<b>Net operating income . . . . .</b>	<b>7,718</b>	<b>6,154</b>	<b>5,258</b>	<b>1,340</b>	<b>20,470</b>	<b>(1,089)</b>	<b>19,381</b>
Operating expenses . . . . .	(4,324)	(1,568)	(544)	(3,818)*	(10,254)	1,089	(9,165)
<b>Operating profit/(loss) . . . . .</b>	<b>3,394</b>	<b>4,586</b>	<b>4,714</b>	<b>(2,478)</b>	<b>10,216</b>	<b>–</b>	<b>10,216</b>
Net gain from disposal of/fair value adjustments on investment properties . . . . .	–	–	–	1,266	1,266	–	1,266
Net gain from disposal/revaluation of properties, plant and equipment . .	–	–	–	24	24	–	24
Share of profits less losses of associates . . . . .	–	–	–	4	4	–	4
<b>Profit/(loss) before taxation . . . . .</b>	<b>3,394</b>	<b>4,586</b>	<b>4,714</b>	<b>(1,184)</b>	<b>11,510</b>	<b>–</b>	<b>11,510</b>
<b>At 30 September 2009</b>							
<b>Assets</b>							
Segment assets . . . . .	175,170	362,165	632,181	34,140	1,203,656	(6,420)	1,197,236
Interests in associates. . . . .	–	–	–	89	89	–	89
	<u>175,170</u>	<u>362,165</u>	<u>632,181</u>	<u>34,229</u>	<u>1,203,745</u>	<u>(6,420)</u>	<u>1,197,325</u>
<b>Liabilities</b>							
Segment liabilities . . . . .	570,188	348,544	181,860	7,649	1,108,241	(6,420)	1,101,821
<b>Nine months ended 30 September 2009</b>							
<b>Other information</b>							
Additions of properties, plant and equipment . . . . .	6	1	–	250	257	–	257
Depreciation . . . . .	216	105	72	362	755	–	755
Amortisation of securities . . . . .	–	–	(59)	–	(59)	–	(59)

\* Mainly includes the expenses incurred on Lehman Brothers related products (Note 10)



**Nine months ended 30 September 2008**

	<b>Personal</b>	<b>Corporate</b>	<b>Treasury</b>	<b>Others</b>	<b>Subtotal</b>	<b>Eliminations</b>	<b>Consolidated</b>
	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>	<b>HK\$'m</b>
Net interest (expenses)/income							
– external . . . . .	(2,577)	4,785	11,700	2	13,910	–	13,910
– inter-segment . . . . .	7,802	(188)	(7,161)	(453)	–	–	–
	<u>5,225</u>	<u>4,597</u>	<u>4,539</u>	<u>(451)</u>	<u>13,910</u>	<u>–</u>	<u>13,910</u>
Net fees and commission							
income/(expenses) . . . . .	2,786	1,615	7	(96)	4,312	(57)	4,255
Net trading income/(expenses) . . . .	466	99	1,198	(102)	1,661	–	1,661
Net loss on financial instruments							
designated at fair value through							
profit or loss . . . . .	–	–	(117)	–	(117)	–	(117)
Net gain on investment in securities .	–	–	40	–	40	–	40
Other operating income . . . . .	<u>55</u>	<u>13</u>	<u>1</u>	<u>1,281</u>	<u>1,350</u>	<u>(1,033)</u>	<u>317</u>
<b>Net operating income before</b>							
<b>impairment allowances</b>	8,532	6,324	5,668	632	21,156	(1,090)	20,066
Net (charge)/reversal of impairment							
allowances . . . . .	<u>(24)</u>	<u>(499)</u>	<u>(5,348)</u>	<u>1</u>	<u>(5,870)</u>	<u>–</u>	<u>(5,870)</u>
<b>Net operating income</b> . . . . .	8,508	5,825	320	633	15,286	(1,090)	14,196
Operating expenses . . . . .	<u>(4,377)</u>	<u>(1,695)</u>	<u>(585)</u>	<u>(599)</u>	<u>(7,256)</u>	<u>1,090</u>	<u>(6,166)</u>
<b>Operating profit/(loss)</b> . . . . .	4,131	4,130	(265)	34	8,030	–	8,030
Net gain from disposal of/fair value							
adjustments on investment							
properties . . . . .	–	–	–	475	475	–	475
Net gain from disposal/revaluation of							
properties, plant and equipment . .	–	–	–	5	5	–	5
Share of profits less losses of							
associates . . . . .	<u>–</u>	<u>–</u>	<u>–</u>	<u>9</u>	<u>9</u>	<u>–</u>	<u>9</u>
<b>Profit/(loss) before taxation</b> . . . .	<u>4,131</u>	<u>4,130</u>	<u>(265)</u>	<u>523</u>	<u>8,519</u>	<u>–</u>	<u>8,519</u>
<b>At 31 December 2008</b>							
<b>Assets</b>							
Segment assets . . . . .	165,148	324,606	603,965	30,984	1,124,703	(6,795)	1,117,908
Interests in associates. . . . .	<u>–</u>	<u>–</u>	<u>–</u>	<u>88</u>	<u>88</u>	<u>–</u>	<u>88</u>
	<u>165,148</u>	<u>324,606</u>	<u>603,965</u>	<u>31,072</u>	<u>1,124,791</u>	<u>(6,795)</u>	<u>1,117,996</u>
<b>Liabilities</b>							
Segment liabilities . . . . .	<u>523,682</u>	<u>309,254</u>	<u>203,481</u>	<u>6,159</u>	<u>1,042,576</u>	<u>(6,795)</u>	<u>1,035,781</u>
<b>Nine months ended</b>							
<b>30 September 2008</b>							
<b>Other information</b>							
Additions of properties, plant and							
equipment . . . . .	8	2	–	361	371	–	371
Depreciation . . . . .	204	107	68	354	733	–	733
Amortisation of securities . . . . .	<u>–</u>	<u>–</u>	<u>104</u>	<u>–</u>	<u>104</u>	<u>–</u>	<u>104</u>

### **32. 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 is subject to the control of the State Council of the PRC Government through China Investment Corporation (“CIC”), its wholly-owned subsidiary Central Huijin Investment Ltd. (“Central Huijin”), and BOC in which Central Huijin has controlling equity interests.

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.

There was no material change in the nature and quantity of the transactions with related parties for the period ended 30 September 2009 compared to the information set out in the Group’s 2008 audited financial statements.

### **33. Compliance with HKAS 34**

The financial information for the period ended 30 September 2009 complies with HKAS 34 “Interim Financial Reporting” issued by the HKICPA.

### **34. Statutory accounts**

The financial information is unaudited and does not constitute statutory accounts. The statutory accounts for the year ended 31 December 2008 have been delivered to the Registrar of Companies and the HKMA. The auditors expressed an unqualified opinion on those statutory accounts in their report dated 24 March 2009.

# INDEPENDENT REVIEW REPORT

## REPORT ON REVIEW OF FINANCIAL INFORMATION

### TO THE BOARD OF DIRECTORS OF BANK OF CHINA (HONG KONG) LIMITED

*(incorporated in Hong Kong with limited liability)*

#### Introduction

We have reviewed the financial information set out on pages A-1 to A-59, which comprises the condensed consolidated balance sheet of Bank of China (Hong Kong) Limited (the “Bank”) and its subsidiaries (together, the “Group”) as at 30 September 2009 and the related condensed consolidated statements of income, comprehensive income, changes in equity and cash flows for the nine-month period then ended, and a summary of significant accounting policies and other explanatory notes. The directors of the Bank are responsible for the preparation and presentation of this financial information in accordance with Hong Kong Accounting Standard 34 “Interim Financial Reporting”. Our responsibility is to express a conclusion on this financial information based on our review and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

#### Scope of Review

We conducted our review in accordance with Hong Kong Standard on Review Engagements 2410, “Review of Interim Financial Information Performed by the Independent Auditor of the Entity” issued by the Hong Kong Institute of Certified Public Accountants. A review of the financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

#### Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the financial information is not prepared, in all material respects, in accordance with Hong Kong Accounting Standard 34 “Interim Financial Reporting”.

#### PricewaterhouseCoopers

*Certified Public Accountants*

Hong Kong, 29 January 2010

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#### Note:

1. The Independent Review Report set out herein is reproduced from the original Independent Review Report and page references contained therein refer to the original unaudited condensed consolidated financial information for the nine months ended September 30, 2009.

## ADDITIONAL INFORMATION

### SUBSIDIARIES OF THE BANK

The particulars of our subsidiaries are as follows:

<u>Name of company</u>	<u>Country/place and date of incorporation/operation</u>	<u>Issued and fully paid up share capital/registered capital</u>	<u>Percentage of attributable equity interest</u>	<u>Principal activities</u>
Nanyang Commercial Bank, Limited	Hong Kong 2 February 1948	Ordinary shares HK\$700,000,000	100.00%	Banking business
Chiyu Banking Corporation Limited	Hong Kong 24 April 1947	Ordinary shares HK\$300,000,000	70.49%	Banking business
BOC Credit Card (International) Limited	Hong Kong 9 September 1980	Ordinary shares HK\$480,000,000	100.00%	Credit card services
Arene Trading Limited	Hong Kong 22 August 1978	Ordinary shares HK\$500,000	100.00%	Property holding and investment
Bank of China (Hong Kong) Nominees Limited*	Hong Kong 1 October 1985	Ordinary shares HK\$2	100.00%	Nominee services
Bank of China (Hong Kong) Trustees Limited*	Hong Kong 6 November 1987	Ordinary shares HK\$3,000,000	100.00%	Trustee and agency services
BOC Group Trustee Company Limited*	Hong Kong 1 December 1997	Ordinary shares HK\$200,000,000	64.20%	Trustee services
BOC Travel Services Limited	Hong Kong 24 August 1982	Ordinary shares HK\$2,000,000	100.00%	Travel services
BOCHK Financial Products (Cayman) Limited	Cayman Islands 10 November 2006	Ordinary shares US\$50,000	100.00%	Note issuing
BOCHK Information Technology (Shenzhen) Co., Ltd.*	PRC 16 April 1990	Registered capital HK\$70,000,000	100.00%	Property holding and investment
BOCHK Information Technology Services (Shenzhen) Ltd*	PRC 26 May 1993	Registered capital HK\$40,000,000	100.00%	Information technology services
BOCI-Prudential Trustee Limited*	Hong Kong 11 October 1999	Ordinary shares HK\$300,000,000	41.10%	Trustee services

<b>Name of company</b>	<b>Country/place and date of incorporation/operation</b>	<b>Issued and fully paid up share capital/registered capital</b>	<b>Percentage of attributable equity interest</b>	<b>Principal activities</b>
Che Hsing (Nominees) Limited*	Hong Kong 23 April 1980	Ordinary shares HK\$10,000	100.00%	Nominee services
Chiyu Banking Corporation (Nominees) Limited*	Hong Kong 3 November 1981	Ordinary shares HK\$100,000	70.49%	Investment holding
Chung Chiat Company Limited	Hong Kong 9 April 1980	Ordinary shares HK\$200	100.00%	Property holding and investment
Dwell Bay Limited	Hong Kong 19 December 1980	Ordinary shares HK\$100,000	100.00%	Property holding and investment
Glister Company Limited*	Hong Kong 26 March 2001	Ordinary shares HK\$2	70.49%	Investment holding
Glory Cardinal Limited*	Hong Kong 4 May 2001	Ordinary shares HK\$2	70.49%	Investment holding
Grace Charter Limited*	Hong Kong 4 May 2001	Ordinary shares HK\$2	70.49%	Investment holding
G.Z.Y. Microfilm Technology (Shenzhen) Co., Ltd.*	PRC 24 September 1993	Registered capital HK\$40,000,000	100.00%	Property holding and investment
Hua Chiao Commercial (Nominees) Limited*	Hong Kong 28 October 1986	Ordinary shares HK\$10,000	100.00%	Nominee services
Kincheng Finance (H.K.) Limited	Hong Kong 30 March 1979	Ordinary shares HK\$100	100.00%	Loan financing
Kincheng Investments & Developments (H.K.) Limited	Hong Kong 15 May 1981	Ordinary shares HK\$6,000	100.00%	Property holding and investment
Kincheng (Nominees) Limited*	Hong Kong 12 December 1980	Ordinary shares HK\$100,000	100.00%	Nominee services
Kiu Nam Investment Corporation Limited	Hong Kong 9 November 1963	Ordinary shares HK\$2,000,000	100.00%	Property holding and investment
Kwong Li Nam Investment Agency Limited*	Hong Kong 25 May 1984	Ordinary shares HK\$3,050,000	100.00%	Investment agency
Nan Song Company, Limited*	Hong Kong 13 April 1965	Ordinary shares HK\$1,000,000	100.00%	Property investment and investment holding

<b>Name of company</b>	<b>Country/place and date of incorporation/operation</b>	<b>Issued and fully paid up share capital/registered capital</b>	<b>Percentage of attributable equity interest</b>	<b>Principal activities</b>
Nanyang Commercial Bank (China) Limited	PRC 14 December 2007	Registered capital RMB4,100,000,000	100.00%	Banking business
Nanyang Commercial Bank (Nominees) Limited*	Hong Kong 22 August 1980	Ordinary shares HK\$50,000	100.00%	Nominee services
Nanyang Commercial Bank Trustee Limited*	Hong Kong 22 October 1976	Ordinary shares HK\$3,000,000	100.00%	Trustee services
Nanyang Finance Company Limited	Hong Kong 16 March 1979	Ordinary shares HK\$50,000,000	100.00%	Financial services
Pacific Trend Profits Corporation*	British Virgin Islands 20 April 2001	Registered shares US\$1	70.49%	Investment holding
Patson (HK) Limited*	Hong Kong 18 August 1970	Ordinary shares HK\$1,000,000	100.00%	Property investment
Perento Limited	Hong Kong 27 September 1983	Ordinary shares HK\$10,000	100.00%	Property holding and investment
Po Hay Enterprises Limited	Hong Kong 2 October 1979	Ordinary shares HK\$100,000	100.00%	Property holding and investment
Po Sang Financial Investment Services Company Limited*	Hong Kong 23 September 1980	Ordinary shares HK\$25,000,000	100.00%	Gold trading and investment holding
Po Sang Futures Limited*	Hong Kong 19 October 1993	Ordinary shares HK\$25,000,000	100.00%	Commodities brokerage
Rams City (Nominees) Limited*	Hong Kong 2 May 1986	Ordinary shares HK\$2,000,000	100.00%	Nominee services
Sanicon Investment Limited	Hong Kong 24 January 2000	Ordinary shares HK\$2	100.00%	Property holding and investment
Seng Sun Development Company, Limited*	Hong Kong 11 December 1961	Ordinary shares HK\$2,800,000	70.49%	Investment holding
Shenstone Limited	Hong Kong 4 September 1979	Ordinary shares HK\$2	100.00%	Property holding and investment
Sin Chiao Enterprises Corporation, Limited*	Hong Kong 13 September 1961	Ordinary shares HK\$3,000,000	100.00%	Property holding and investment

<b>Name of company</b>	<b>Country/place and date of incorporation/operation</b>	<b>Issued and fully paid up share capital/registered capital</b>	<b>Percentage of attributable equity interest</b>	<b>Principal activities</b>
Sin Hua Trustee Limited*	Hong Kong 27 October 1978	Ordinary shares HK\$3,000,000	100.00%	Trustee services
Sin Mei (Nominee) Limited*	Hong Kong 27 April 1982	Ordinary shares HK\$100,000	100.00%	Nominee services
Sin Yeh Shing Company Limited	Hong Kong 28 November 1980	Ordinary shares HK\$100,000	100.00%	Property holding and investment
Sino Information Services Company Limited	Hong Kong 11 February 1993	Ordinary shares HK\$7,000,000	100.00%	Information services
The China-South Sea (Nominees) Services Limited*	Hong Kong 13 February 1981	Ordinary shares HK\$100,000	100.00%	Nominee services
The China State (Nominees) Limited*	Hong Kong 14 May 1982	Ordinary shares HK\$100,000	100.00%	Nominee services
The China State Trustee Limited*	Hong Kong 17 July 1981	Ordinary shares HK\$3,000,000	100.00%	Trustee services
Track Link Investment Limited	Hong Kong 8 February 1994	Ordinary shares HK\$2	100.00%	Property holding and investment
Yien Yieh (Nominee) Limited*	Hong Kong 26 June 2001	Ordinary shares HK\$2,000	100.00%	Nominee services

Arene Trading Limited, Rams City (Nominees) Limited, Yien Yieh (Nominee) Limited and The China State Trustee Limited will dissolve in 13 April 2010.

Sanicon Investment Limited commenced member's voluntary winding up on 11 September 2009.

**Remarks:**

Name of subsidiaries which are not included in the consolidation group for regulatory purposes in respect of capital adequacy is marked with \* in the above table. BOCHK and its subsidiaries specified by the HKMA form the basis of consolidation 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.

## DEFINITIONS

In this financial information, unless the context otherwise requires, the following terms shall have the meanings set out below:

Terms	Meanings
“ABS” . . . . .	Asset-backed securities
“Board of Directors” . . . . .	The Board of Directors of BOCHK
“BOC” . . . . .	Bank of China Limited, a joint stock commercial bank with limited liability established under the laws of the PRC, the H shares and A shares of which are listed on the Hong Kong Stock Exchange and the Shanghai Stock Exchange respectively
“BOCHK” or “the Bank” . . . . .	Bank of China (Hong Kong) Limited, a company incorporated under the laws of Hong Kong and a wholly owned subsidiary of BOC Hong Kong (Holdings) Limited
“CIC” . . . . .	China Investment Corporation
“Central Huijin” . . . . .	Central Huijin Investment Ltd. (formerly known as “Central SAFE Investments Limited”)
“EURIBOR” . . . . .	Euro Interbank Offered Rate
“the Group” . . . . .	The Bank and its subsidiaries collectively referred as the Group
“HKAS(s)” . . . . .	Hong Kong Accounting Standard(s)
“HKFRS(s)” . . . . .	Hong Kong Financial Reporting Standard(s)
“HKICPA” . . . . .	Hong Kong Institute of Certified Public Accountants
“HK(IFRIC)-Int” . . . . .	Hong Kong (IFRIC) Interpretation
“HKMA” . . . . .	Hong Kong Monetary Authority
“Hong Kong” or “Hong Kong SAR” . .	Hong Kong Special Administrative Region
“LIBOR” . . . . .	London Interbank Offered Rate
“MBS” . . . . .	Mortgage-backed securities
“Mainland China” . . . . .	The mainland of the PRC
“Moody’s” . . . . .	Moody’s Investors Service
“PRC” . . . . .	The People’s Republic of China
“RMB” or “Renminbi” . . . . .	Renminbi, the lawful currency of the PRC
“VAR” . . . . .	Value at Risk



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